2020 ANNUAL REPORT

AUBURN NATIONAL
BANCORPORATION, INC.

2020 ANNUAL REPORT

AN UNPRECEDENTED TEAM

AUBURN NATIONAL

BANCORPORATION, INC.

"I am so proud of everyone on the AuburnBank team for meeting the challenges of 2020 and providing the quality service you have come to expect."

— Bob Dumas, Chairman, President, and CEO

To Our Shareholders and Friends,

We've always known that we have the right people in place to serve our community no matter what comes our way. 2020 gave us a unique opportunity to prove that our team is unprecedented.

For the full year of 2020, the Company reported net earnings of $7.5 million, or $2.09 per share. The decrease in 2020 net earnings compared to 2019 was primarily driven by the impact of the Coronavirus (COVID-19) pandemic, which resulted in an increased provision for loan losses and a lower interest rate environment.

I am extremely proud of our organization's response to COVID-19. From maintaining a safe work environment, to providing accessibility for our customers and our communities, our team quickly adapted to the challenges during the year and produced meaningful financial results. Mortgage lending income increased by $1.4 million, or 168%, compared to 2019. Our lending team provided 423 loans for $36.5 million under the Paycheck Protection Program, supporting over 5,500 jobs, and Auburn National Bancorporation, Inc. was named a "Banking Performance Powerhouse" by *Bank Director* as a high-performing bank based on total shareholder return generated over a 20-year period ended June 30, 2020.

Customers always come first. That's been true for 114 years. Whether you walk through our doors, use our drive-thrus, or log in to the AuburnBank app from your kitchen table, we are committed to serving your financial needs however we can. That's why we broke ground on a redevelopment project at our main campus. Phase I of our project, consisting of our new bank/office facility and new parking deck, continues on schedule for completion by year end. This building will be bigger and better. But most importantly, it will help us better serve our community.

Our capital and asset quality continues to be strong. As we enter the next decade, we will keep our focus on providing high-quality financial products and services combined with the latest technology while maintaining emphasis on protection of your confidential information.

Since 1907, our mission has been to serve our customers, our businesses and our communities with quality service, financial products that meet your financial needs, and being a strong corporate contributor.

Thank you for your support and encouragement as we continue our original mission – to serve you!

Robert W. Dumas

Robert W. Dumas
Chairman, President and CEO
AuburnBank and ANBC

A Truly Unforgettable Year

Like the rest of the world, 2020 was not a normal year for AuburnBank. Our employees had to balance serving our community with suddenly having to teach their children from home, care for their own families, and keep themselves safe. Their professionalism and passion for serving our community shined brighter than ever this year. This effort is not only recognized locally, but on a national level.

"Seeing the hard work of our team being recognized on a national scale is a tremendous honor."

— Bob Dumas, Chairman, President, and CEO

Bank Director's 2021 RankingBanking study identified banks that have built enviable value for their shareholders to uncover the building blocks of long-term performance. Banks were selected based on total shareholder return generated over a 20-year period ending June 30, 2020. AuburnBank was selected #1 overall for best credit risk strategy and finished #20 overall in the powerhouse rankings.

Just in time for historically low interest rates, 2020 was also the year we launched online applications for mortgage lending. Our mortgage team was busier than ever. We saw a 168% increase in mortgage lending income compared to 2019 and earned the 2020 Best Bank & Mortgage Lender in the *Opelika-Auburn News* reader survey.

Our Team Brought the Hardware Home

2021
Best Credit Risk Strategy
Bank Director: RankingBanking 2021

2020
Best Bank & Mortgage Lender
OA News Reader's Choice Awards

#20
Top 20 Performance Powerhouses
Bank Director: RankingBanking 2021

Grab Your Hard Hat

If you've been around town within the last 6 months, you may have noticed the building that's been at 100 N. Gay Street since 1964 is no longer there. That's because the needs of our community are changing. One hundred fourteen years ago, when this bank was founded, no one could have imagined a town like Auburn becoming the economic powerhouse of East Alabama. They couldn't have envisioned that a little bank founded with just $10,000 would today be Auburn's first and only remaining bank chartered in Auburn, boasting assets of approximately $957 million and currently the 12th-largest financial institution in Alabama.

Team meetings are about to get a major upgrade. In November of 2020, we broke ground on a four-story, 91,000-square-foot-plus building. Scheduled to be completed by year-end 2021, this will be an invaluable tool to ensure we can keep serving our community for 114 more years. Our retail and support teams will be under one roof,

and it will feature additional Class-A office space as well as retail space fronting Gay Street. The construction of a 500+ space parking deck on the site is almost complete.

> **"Even though we're building something new, our commitment remains the same — helping a community, a university, and its people to grow and make their dreams come true."**
> — Bob Dumas, Chairman, President, and CEO

But a taller building and more square footage won't change who we are at our core. From downtown Auburn to the surrounding areas, we will always put our community and your financial needs first.

Helping Businesses When They Need It Most

2020 put us in a unique position to help our local businesses stay in business and keep their employees paid. Utilizing the federal Paycheck Protection Program, we provided 423 loans worth over $36.5 Million. This helped support over 5,500 jobs in our community. Here are 2 examples of local business owners who we supported.

1.5	1	8	400
years in business	year with AuburnBank	employees	weekly customers

4 Seasons Cleaners, John King, Owner

"My loan officer, Robert Smith, helped me learn the ropes of the PPP program. It was so early on during the pandemic, we met in a secure parking lot outside to safely sign my paperwork. My PPP loan amount was immediately deposited into my account."

Four Seasons Cleaners

Owned by KJ King Enterprises LLC

47	7	294	40
years in business	years with AuburnBank	employees	weekly customers

2A USA Inc, David G. DeBaets, Owner

2a USA

"Robert Smith and his team did a fabulous job helping us navigate the PPP application and approval process. They guided us every step of the way and went beyond the call of duty to assist us on the application drivers!"

Auburn National Bancorporation, Inc. and AuburnBank Board of Directors

Robert W. Dumas
Chairman, President & CEO,
AuburnBank

Terry W. Andrus
Retired, CEO,
East Alabama Medical Center

Anne M. May
Retired Partner,
Machen McChesney, CPAs

William F. Ham Jr.
Owner,
Varsity Enterprises

E. L. Spencer III
Investor

C. Wayne Alderman
Secretary to ANBC
Dean and Professor Emeritus,
College of Business,
Auburn University

J. Tutt Barrett
Attorney,
Dean and Barrett

Laura Cooper
Executive Director, Lee County
Youth Development

David E. Housel
Director of Athletics Emeritus,
Auburn University

Opelika Branch Advisory Board

William H. Brown
President, Brown Agency, Inc.

William G. Dyas
Realtor, First Realty

Doug M. Horn
Owner, Doug Horn Roofing &
Contracting Co.

William P. Johnston
President, J&M Bookstore

C. Eddie Smith
Senior Vice President,
City President, Opelika Branch

R. Kraig Smith, M.D.
Lee OBGYN

Sherrie Murphy Stanyard
Senior Account Manager,
Craftmaster Printers, Inc.

Robert G. Young
Vice President, Sales
Young's Plant Farm, Inc.

Seated left to right: William H. Brown, C. Eddie Smith, and William G. Dyas
Standing: William P. Johnston and R. Kraig Smith, M.D.
Not pictured: Doug M. Horn and Sherrie M. Stanyard

Valley Branch Advisory Board

Terrell E. Bishop
Senior Vice President
City President, Valley Branch

H. David Ennis Sr.
President, Novelli-Ennis
& Company, CPAs

John H. Hood II
Pharmacist, Hood's
Pharmacy

Roy W. McClendon Jr.
Retired Pharmacist

Claud E. (Skip) McCoy Jr.
Attorney, Johnson, Caldwell
& McCoy Law Firm

Frank P. Norman
Owner, Johnny's New York
Style Pizza and Wingstop

Seated left to right: H. David Ennis Sr., Terrell E. Bishop, and Roy W. McClendon Jr.
Standing: Claud E. (Skip) McCoy Jr., Frank P. Norman, and John H. Hood II.

Photos taken Pre-COVID

AuburnBank Officers

Robert W. Dumas
Chairman, President
& Chief Executive Officer

David Hedges
Executive Vice President,
Chief Financial Officer

Terrell E. Bishop
Senior Vice President,
City President, Valley
Branch

S. Mark Bridges
Senior Vice President,
Commercial/Consumer
Loans

James E. Dulaney
Senior Vice President,
Business Development/
Marketing

Pam Fuller
Senior Vice President,
Operations

W. Thomas Johnson
Senior Vice President,
Senior Lender

Marla Kickliter
Senior Vice President,
Compliance & Internal
Auditor

Shannon O'Donnell
Senior Vice President,
Credit Administration,
Chief Risk Officer

Jerry Siegel
Senior Vice President, IT/IS
Chief Technology Officer

C. Eddie Smith
Senior Vice President,
City President, Opelika
Branch

Robert Smith
Senior Vice President,
Chief Lending Officer

James Walker
Senior Vice President,
Chief Accounting Officer

David Warren
Senior Vice President,
Commercial/Consumer
Loans

Bob R. Adkins
Vice President,
Commercial/Consumer
Loans

Patty Allen
Vice President,
Commercial/Consumer
Loans

Scottie Arnold
Vice President,
Administration Deposit
Products/Services

Kris Blackmon
Vice President,
Asset/Liability Manager
Chief Investment Officer

Laura Carrington
Vice President,
Human Resource Officer

Bruce Emfinger
Vice President,
Commercial/Consumer
Loans

Christy Fogle
Vice President,
Credit Administration

April Herring
Vice President,
Mortgage Division Manager

Ginnie Y. Lunsford
Vice President,
Loan Operations

Wanda McCaghren
Vice President,
Commercial/Consumer
Loans

Marcia Otwell
Vice President, Admin/
Shareholder Relations

James R. Pack
Vice President,
Financial Reporting

Greg Pettey
Vice President,
Commercial/Consumer
Loans

Jeff Stanfield
Vice President,
Commercial/Consumer
Loans

Karen Bence
Assistant Vice President,
Security, BSA/OFAC
Officer

Suzanne Gibson
Assistant Vice President,
Portfolio Management
Officer

Woody Odom
Assistant Vice President
IT/IS

Cindy Royster
Assistant Vice President,
Branch Administration & IRA
Specialist

Joanna Watts
Assistant Vice President,
IT/IS

Rhonda Sanders
Deposit Operations,
Customer Identification
Program Officer

Leigh Ann Thompson
Data Analytics Officer

Latoya Watts
Branch Administrator,
Training Officer

Hope Woods
Assistant BSA Officer,
Assistant Security Officer

Auburn National Bancorporation, Inc.

Financial Highlights

(Dollars in thousands, except per share data)

	For the Years Ended December 31,				
	2020	2019	2018	2017	2016
Earnings					
Net Interest Income	$24,338	$26,064	$25,570	$24,526	$22,732
Provision for Loan Losses	1,100	<250>	——	<300>	<485>
Net Earnings	7,454	9,741	8,834	7,846	8,150
Per Share:					
Net Earnings	2.09	2.72	2.42	2.15	2.24
Cash Dividends	1.02	1.00	0.96	0.92	0.90
Book Value	30.20	27.57	24.44	23.85	22.55
Shares Issued	3,957,135	3,957,135	3,957,135	3,957,135	3,957,135
Weighted Average Shares Outstanding	3,566,207	3,581,476	3,643,780	3,643,616	3,643,504
Financial Condition					
Total Assets	956,597	828,570	818,077	853,381	831,943
Loans, net of unearned income	461,700	460,901	476,908	453,651	430,946
Investment Securities	335,177	235,902	239,801	257,697	243,572
Total Deposits	839,792	724,152	724,193	757,659	739,143
Long-Term Debt	——	——	——	3,217	3,217
Stockholders' Equity	107,689	98,328	89,055	86,906	82,177
Selected Ratios					
Return on Average Total Assets	0.83%	1.18%	1.08%	0.94%	0.98%
Return on Average Total Equity	7.12%	10.35%	10.14%	9.17%	9.65%
Average Stockholders' Equity to Average Assets	11.63%	11.39%	10.63%	10.35%	10.14%
Allowance for Loan Losses as a % of Loans	1.22%	0.95%	1.00%	1.05%	1.08%
Loans to Total Deposits	54.98%	63.65%	65.85%	59.88%	58.30%

Financial Section

Auburn National Bancorporation, Inc. 2020 Annual Report

SPECIAL CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Various of the statements made herein under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Quantitative and Qualitative Disclosures about Market Risk", "Risk Factors" and elsewhere, are "forward-looking statements" within the meaning and protections of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause the actual results, performance, achievements or financial condition of the Company to be materially different from future results, performance, achievements or financial condition expressed or implied by such forward-looking statements. You should not expect us to update any forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as "may," "will," "anticipate," "assume," "should," "indicate," "would," "believe," "contemplate," "expect," "estimate," "continue," "plan," "point to," "project," "could," "intend," "target" and other similar words and expressions of the future. These forward-looking statements may not be realized due to a variety of factors, including, without limitation: (i) the effects of future economic, business and market conditions and changes, foreign, domestic and locally, including seasonality, including as a result of natural disasters or climate change, such as rising sea and water levels, hurricanes and tornados, coronavirus or other epidemics or pandemics; (ii) the effects of war or other conflicts, acts of terrorism, or other events that may affect general economic conditions; (iii) governmental monetary and fiscal policies; (iv) legislative and regulatory changes, including changes in banking, securities and tax laws, regulations and rules and their application by our regulators, including capital and liquidity requirements, and changes in the scope and cost of FDIC insurance; (v) the failure of assumptions and estimates, as well as differences in, and changes to, economic, market and credit conditions, including changes in borrowers' credit risks and payment behaviors from those used in our loan portfolio reviews; (vi) the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities, and interest-sensitive assets and liabilities, and the risks and uncertainty of the amounts realizable; (vii) changes in borrower credit risks and payment behaviors; (viii) changes in the availability and cost of credit and capital in the financial markets, and the types of instruments that may be included as capital for regulatory purposes; (ix) changes in the prices, values and sales volumes of residential and commercial real estate; (x) the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, including the disruption effects of financial technology and other competitors who are not subject to the same regulations as the Company and the Bank; (xi) the failure of assumptions and estimates underlying the establishment of allowances for possible loan losses and other asset impairments, losses valuations of assets and liabilities and other estimates; (xii) the costs of redeveloping our headquarters and the timing and amount of rental income upon completion of the project; (xiii) the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions; (xiv) changes in technology or products that may be more difficult, costly, or less effective than anticipated; (xv) cyber-attacks and data breaches that may compromise our systems, our vendor systems or customers' information; (xvi) the risks that our deferred tax assets ("DTAs"), if any, could be reduced if estimates of future taxable income from our operations and tax planning strategies are less than currently estimated, and sales of our capital stock could trigger a reduction in the amount of net operating loss carry-forwards that we may be able to utilize for income tax purposes; and (xvii) other factors and risks described under "Risk Factors" herein and in any of our subsequent reports that we make with the Securities and Exchange Commission (the "Commission" or "SEC") under the Exchange Act.

All written or oral forward-looking statements that are made by us or are attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

BUSINESS INFORMATION

Auburn National Bancorporation, Inc. (the "Company") is a bank holding company registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve") under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). The Company was incorporated in Delaware in 1990, and in 1994 it succeeded its Alabama predecessor as the bank holding company controlling AuburnBank, an Alabama state member bank with its principal office in Auburn, Alabama (the "Bank"). The Company and its predecessor have controlled the Bank since 1984. As a bank holding company, the Company may diversify into a broader range of financial services and other business activities than currently are permitted to the Bank under applicable laws and regulations. The holding company structure also provides greater financial and operating flexibility than is presently permitted to the Bank.

The Bank has operated continuously since 1907 and currently conducts its business primarily in East Alabama, including Lee County and surrounding areas. The Bank has been a member of the Federal Reserve System since April 1995. The Bank's primary regulators are the Federal Reserve and the Alabama Superintendent of Banks (the "Alabama Superintendent"). The Bank has been a member of the Federal Home Loan Bank of Atlanta (the "FHLB") since 1991.

Services

The Bank offers checking, savings, transaction deposit accounts and certificates of deposit, and is an active residential mortgage lender in its primary service area. The Bank's primary service area includes the cities of Auburn and Opelika, Alabama and nearby surrounding areas in East Alabama, primarily in Lee County. The Bank also offers commercial, financial, agricultural, real estate construction and consumer loan products and other financial services. The Bank is one of the largest providers of automated teller services in East Alabama and operates ATM machines in 13 locations in its primary service area. The Bank offers Visa® Checkcards, which are debit cards with the Visa logo that work like checks but can be used anywhere Visa is accepted, including ATMs. The Bank's Visa Checkcards can be used internationally through the Plus® network. The Bank offers online banking, bill payment and other electronic services through its Internet website, *www.auburnbank.com*. Our online banking services, bill payment and electronic services are subject to certain cybersecurity risks.

Loans and Loan Concentrations

The Bank makes loans for commercial, financial and agricultural purposes, as well as for real estate mortgages, real estate acquisition, construction and development and consumer purposes. While there are certain risks unique to each type of lending, management believes that there is more risk associated with commercial, real estate acquisition, construction and development, agricultural and consumer lending than with residential real estate mortgage loans. To help manage these risks, the Bank has established underwriting standards used in evaluating each extension of credit on an individual basis, which are substantially similar for each type of loan. These standards include a review of the economic conditions affecting the borrower, the borrower's financial strength and capacity to repay the debt, the underlying collateral and the borrower's past credit performance. We apply these standards at the time a loan is made and monitor them periodically throughout the life of the loan. See "Lending Practices" for a discussion of regulatory guidance on commercial real estate lending.

The Bank has loans outstanding to borrowers in all industries within our primary service area. Any adverse economic or other conditions affecting these industries would also likely have an adverse effect on the local workforce, other local businesses, and individuals in the community that have entered into loans with the Bank. For example, the auto manufacturing business and its suppliers have positively affected our local economy, but automobile manufacturing is cyclical and adversely affected by increases in interest rates. Decreases in automobile sales, including adverse changes due to interest rate increases, and the economic effects of the impact of COVID-19, including continuing supply chain disruptions, could adversely affect nearby Kia and Hyundai automotive plants and their suppliers' local spending and employment, and could adversely affect economic conditions in the markets we serve. However, management believes that due to the diversified mix of industries located within the Bank's primary service area, adverse changes in one industry may not necessarily affect other area industries to the same degree or within the same time frame. The Bank's primary service area also is subject to both local and national economic conditions and fluctuations. While most loans are made within our primary service area, some residential mortgage loans are originated outside the primary service area, and the Bank from time to time has purchased loan participations from outside its primary service area.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at December 31, 2020 and 2019 and our results of operations for the years ended December 31, 2020 and 2019. The purpose of this discussion is to provide information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein. In addition, this discussion and analysis contains forward-looking statements, so you should refer to Item 1A, "Risk Factors" and "Special Cautionary Notice Regarding Forward-Looking Statements".

OVERVIEW

The Company was incorporated in 1990 under the laws of the State of Delaware and became a bank holding company after it acquired its Alabama predecessor, which was a bank holding company established in 1984. The Bank, the Company's principal subsidiary, is an Alabama state-chartered bank that is a member of the Federal Reserve System and has operated continuously since 1907. Both the Company and the Bank are headquartered in Auburn, Alabama. The Bank conducts its business primarily in East Alabama, including Lee County and surrounding areas. The Bank operates full-service branches in Auburn, Opelika, Notasulga and Valley, Alabama. The Bank also operates loan production offices in Auburn and Phenix City, Alabama.

Summary of Results of Operations

	Year ended December 31	
(Dollars in thousands, except per share data)	**2020**	**2019**
Net interest income (a)	$ 24,830	$ 26,621
Less: tax-equivalent adjustment	492	557
Net interest income (GAAP)	24,338	26,064
Noninterest income	5,375	5,494
Total revenue	29,713	31,558
Provision for loan losses	1,100	(250)
Noninterest expense	19,554	19,697
Income tax expense	1,605	2,370
Net earnings	$ 7,454	$ 9,741
Basic and diluted net earnings per share	$ 2.09	$ 2.72

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

Financial Summary

The Company's net earnings were $7.5 million for the full year 2020, compared to $9.7 million for the full year 2019. Basic and diluted net earnings per share were $2.09 per share for the full year 2020, compared to $2.72 per share for the full year 2019. The decrease in full year 2020 net earnings was primarily driven by the negative impact of the COVID-19 pandemic, which resulted in elevated provision for loan losses, compared to 2019, in addition to a lower interest rate environment.

Net interest income (tax-equivalent) was $24.8 million in 2020, a 7% decrease compared to $26.6 million in 2019. This decrease was primarily due to net interest margin compression resulting from the Federal Reserve's interest rate reductions in response to COVID-19. Net interest margin (tax-equivalent) decreased to 2.92% in 2020, compared to 3.43% in 2019, primarily due to the lower interest rate environment and changes in our asset mix resulting from the significant increase in customer deposits.

At December 31, 2020, the Company's allowance for loan losses was $5.6 million, or 1.22% of total loans, compared to $4.4 million, or 0.95% of total loans, at December 31, 2019. Excluding Paycheck Protection Program ("PPP") loans, the Company's allowance for loan losses was 1.27% of total loans at December 31, 2020. The Company recorded a provision for loan losses of $1.1 million in 2020 compared to a negative provision for loan losses of $0.3 million during 2019. The increase in the provision for loan losses was related to changes in economic conditions and portfolio trends driven by the impact of COVID-19 and resulting adverse economic conditions, including higher unemployment in our primary market area. The provision for loan losses is based upon various estimates and judgements, including the absolute level of loans, loan growth, credit quality and the amount of net charge-offs. Net recoveries as a percent of average loans were 0.03% in 2020 compared to net charge-offs as a percent of average loans of 0.03% in 2019.

Noninterest income was $5.4 million in 2020 compared to $5.5 million in 2019. Although total noninterest income was largely unchanged in 2020, 2019 included a $1.7 million gain that resulted from the termination of a loan guarantee program operated by the State of Alabama. This decrease was partially offset by an increase in mortgage lending income of $1.5 million during 2020 compared to 2019, as lower interest rates for mortgage loans increased refinancing activity and pricing margins improved.

Noninterest expense was $19.6 million in 2020 compared to $19.7 million in 2019. The decrease was primarily due to a reduction of $0.6 million in salaries and benefits expense which was offset by an increase of $0.6 million in various expenses related to the planned redevelopment of the Company's headquarters in downtown Auburn.

Income tax expense was $1.6 million in 2020 and $2.4 million in 2019 reflecting an effective tax rate of 17.72% and 19.57%, respectively. This change was primarily due to a decrease in the level of earnings before taxes relative to tax-exempt sources of income. The Company's effective income tax rate is principally impacted by tax-exempt earnings from the Company's investments in municipal securities and bank-owned life insurance.

The Company paid cash dividends of $1.02 per share in 2020, an increase of 2% from 2019. At December 31, 2020, the Bank's regulatory capital ratios were well above the minimum amounts required to be "well capitalized" under current regulatory standards with a total risk-based capital ratio of 18.31%, a tier 1 leverage ratio of 10.32% and common equity tier 1 ("CET1") of 17.27% at December 31, 2020.

COVID-19 Impact Assessment

In December 2019, COVID-19 was first reported in China and has since spread to a number of other countries, including the United States. In March 2020, the World Health Organization declared COVID-19 a global pandemic and the United States declared a National Public Health Emergency. The COVID-19 pandemic has severely restricted the level of economic activity in our markets. In response to the COVID-19 pandemic, the State of Alabama, and most other states, have taken preventative or protective actions to prevent the spread of the virus, including imposing restrictions on travel and business operations and a statewide mask mandate, advising or requiring individuals to limit or forego their time outside of their homes, limitations on gathering of people and social distancing, and causing temporary closures of businesses that have been deemed to be non-essential. Though certain of these measures have been relaxed or eliminated, increases in reported cases could cause these measures to be reestablished. Auburn University, a major source of economic activity in Lee County, went to remote instruction on March 16, 2020. Auburn University announced its guidelines for the remainder of the 2020/2021 school year, which involves both remote and in person instruction as well as other social distancing measures. The economic effects of these measures are not presently known.

COVID-19 has significantly affected local state, national and global health and economic activity and its future effects are uncertain and will depend on various factors, including, among others, the duration and scope of the pandemic, the development and distribution of COVID-19 testing and contact tracing, effective drug treatments and vaccines, together with governmental, regulatory and private sector responses. COVID-19 has had continuing significant effects on the economy, financial markets and our employees, customers and vendors. Our business, financial condition and results of operations generally rely upon the ability of our borrowers to make deposits and repay their loans, the value of collateral underlying our secured loans, market value, stability and liquidity and demand for loans and other products and services we offer, all of which are affected by the pandemic. See "Balance Sheet Analysis – Loans" for supplemental COVID-19 disclosures.

We have implemented a number of procedures in response to the pandemic to support the safety and well-being of our employees, customers and shareholders.

- We believe our business continuity plan has worked to provide essential banking services to our communities and customers, while protecting our employees' health. As part of our efforts to exercise social distancing in accordance with the guidelines of the Centers for Disease Control and the Governor of the State of Alabama, starting March 23, 2020, we limited branch lobby service to appointment only while continuing to operate our branch drive-thru facilities and ATMs. On June 1, 2020, we re-opened some of our branch lobbies as permitted by state public health guidelines. We continue to provide services through our online and other electronic channels. In addition, we established remote work access to help employees stay at home where job duties permit.

- We are focused on servicing the financial needs of our commercial and consumer clients with extensions and deferrals to loan customers effected by COVID-19, provided such customers were not more than 30 days past due at the time of the request; and

- We are a participating lender in the PPP. PPP loans are forgivable, in whole or in part, if the proceeds are used for payroll and other permitted purposes in accordance with the requirements of the PPP. These loans carry a fixed rate of 1.00% and a term of two years (loans made before June 5, 2020) or five years (loans made on or after June 5, 2020), if not forgiven, in whole or in part. Payments are deferred until either the date on which the Small Business Administration ("SBA") remits the amount of forgiveness proceeds to the lender or the date that is 10 months after the last day of the covered period if the borrower does not apply for forgiveness within that 10-month period. We believe these loans and our participation in the program is good for our customers and the communities we serve.

A summary of PPP loans extended during 2020 follows:

(Dollars in thousands)	**# of SBA Approved**	**Mix**		**$ of SBA Approved**	**Mix**
SBA Tier:					
$2 million to $10 million	—	— %	$	—	— %
$350,000 to less than $2 million	23	5		14,691	40
Up to $350,000	400	95		21,784	60
Total	423	100 %	$	36,475	100 %

The Company extended $36.5 million in loans to 423 small businesses under the PPP during 2020. We collected approximately $1.5 million in fees related to our PPP loans, which are being recognized net of related costs, as a yield adjustment over the life of the underlying PPP loans. During 2020, we received payments and forgiveness on 158 loans totaling $17.5 million. The outstanding balance for the remaining 265 loans as December 31, 2020 was approximately $19.0 million.

On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (the "Economic Aid Act") was signed into law. The Economic Aid Act provides a second $900 billion stimulus package, including $325 billion in additional PPP loans. As of February 28, 2021, the Company has extended $17.4 million in loans to 169 small businesses under the PPP provided by the Economic Aid Act.

We continue to closely monitor this pandemic, and are working to continue our services during the pandemic and to address developments as those occur. Our results of operations for the year ended December 31, 2020, and our financial condition at that date reflect only the initial effects of the pandemic, and may not be indicative of future results or financial conditions, including possible additional monetary or fiscal stimulus, and the possible effects of the expiration or extension of temporary accounting and bank regulatory relief measures in response to the COVID-19 pandemic.

As of December 31, 2020, all of our capital ratios were in excess of all regulatory requirements to be well capitalized. The effects of the COVID-19 pandemic on our borrowers could result in adverse changes to credit quality and our regulatory capital ratios. We continue to closely monitor this pandemic, and are working to continue our services during the pandemic and to address developments as those occur.

CRITICAL ACCOUNTING POLICIES

The accounting and financial reporting policies of the Company conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, our assessment of other-than-temporary impairment, recurring and non-recurring fair value measurements, the valuation of other real estate owned, and the valuation of deferred tax assets, were critical to the determination of our financial position and results of operations. Other policies also require subjective judgment and assumptions and may accordingly impact our financial position and results of operations.

Allowance for Loan Losses

The Company assesses the adequacy of its allowance for loan losses prior to the end of each calendar quarter. The level of the allowance is based upon management's evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan loss rates and other pertinent factors, including regulatory recommendations. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loans are charged off, in whole or in part, when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a "confirming event" has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

The Company deems loans impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan. The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs.

The level of allowance maintained is believed by management to be adequate to absorb probable losses inherent in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

In assessing the adequacy of the allowance, the Company also considers the results of its ongoing internal, independent loan review process. The Company's loan review process assists in determining whether there are loans in the portfolio whose credit quality has weakened over time and evaluating the risk characteristics of the entire loan portfolio. The Company's loan review process includes the judgment of management, the input from our independent loan reviewers, and reviews that may have been conducted by bank regulatory agencies as part of their examination process. The Company incorporates loan review results in the determination of whether or not it is probable that it will be able to collect all amounts due according to the contractual terms of a loan.

As part of the Company's quarterly assessment of the allowance, management divides the loan portfolio into five segments: commercial and industrial, construction and land development, commercial real estate, residential real estate, and consumer installment loans. The Company analyzes each segment and estimates an allowance allocation for each loan segment.

The allocation of the allowance for loan losses begins with a process of estimating the probable losses inherent for these types of loans. The estimates for these loans are established by category and based on the Company's internal system of credit risk ratings and historical loss data. The estimated loan loss allocation rate for the Company's internal system of credit risk grades is based on its experience with similarly graded loans. For loan segments where the Company believes it does not have sufficient historical loss data, the Company may make adjustments based, in part, on loss rates of peer bank groups. At December 31, 2020 and 2019, and for the years then ended, the Company adjusted its historical loss rates for the commercial real estate portfolio segment based, in part, on loss rates of peer bank groups.

The estimated loan loss allocation for all five loan portfolio segments is then adjusted for management's estimate of probable losses for several "qualitative and environmental" factors. The allocation for qualitative and environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and are based upon quarterly trend assessments in delinquent and nonaccrual loans, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These qualitative and environmental factors are considered for each of the five loan segments and the allowance allocation, as determined by the processes noted above, is increased or decreased based on the incremental assessment of these factors.

The Company regularly re-evaluates its practices in determining the allowance for loan losses. Since the fourth quarter of 2016, the Company has increased its look-back period each quarter to incorporate the effects of at least one economic downturn in its loss history. The Company believes the extension of its look-back period is appropriate due to the risks inherent in the loan portfolio. Absent this extension, the early cycle periods in which the Company experienced significant losses would be excluded from the determination of the allowance for loan losses and its balance would decrease. For the year ended December 31, 2020, the Company increased its look-back period to 47 quarters to continue to include losses incurred by the Company beginning with the first quarter of 2009. The Company will likely continue to increase its look-back period to incorporate the effects of at least one economic downturn in its loss history. During 2020, the Company adjusted certain qualitative and economic factors related to changes in economic conditions driven by the impact of the COVID-19 pandemic and resulting adverse economic conditions, including higher unemployment in our primary market area. Further adjustments may be made in the future as a result of the ongoing COVID-19 pandemic.

Assessment for Other-Than-Temporary Impairment of Securities

On a quarterly basis, management makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired.

For debt securities with an unrealized loss, an other-than-temporary impairment write-down is triggered when (1) the Company has the intent to sell a debt security, (2) it is more likely than not that the Company will be required to sell the debt security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the debt security. If the Company has the intent to sell a debt security or if it is more likely than not that it will be required to sell the debt security before recovery, the other-than-temporary write-down is equal to the entire difference between the debt security's amortized cost and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income, net of applicable taxes.

The Company is required to own certain stock as a condition of membership, such as Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB"). These non-marketable equity securities are accounted for at cost which equals par or redemption value. These securities do not have a readily determinable fair value as their ownership is restricted and there is no market for these securities. The Company records these non-marketable equity securities as a component of other assets, which are periodically evaluated for impairment. Management considers these non-marketable equity securities to be long-term investments. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

Fair Value Determination

U.S. GAAP requires management to value and disclose certain of the Company's assets and liabilities at fair value, including investments classified as available-for-sale and derivatives. ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. For more information regarding fair value measurements and disclosures, please refer to Note 15, Fair Value, of the consolidated financial statements that accompany this report.

Fair values are based on active market prices of identical assets or liabilities when available. Comparable assets or liabilities or a composite of comparable assets in active markets are used when identical assets or liabilities do not have readily available active market pricing. However, some of the Company's assets or liabilities lack an available or comparable trading market characterized by frequent transactions between willing buyers and sellers. In these cases, fair value is estimated using pricing models that use discounted cash flows and other pricing techniques. Pricing models and their underlying assumptions are based upon management's best estimates for appropriate discount rates, default rates, prepayments, market volatility and other factors, taking into account current observable market data and experience.

These assumptions may have a significant effect on the reported fair values of assets and liabilities and the related income and expense. As such, the use of different models and assumptions, as well as changes in market conditions, could result in materially different net earnings and retained earnings results.

Other Real Estate Owned

Other real estate owned ("OREO"), consists of properties obtained through foreclosure or in satisfaction of loans and is reported at the lower of cost or fair value, less estimated costs to sell at the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation adjustments are determined on a specific property basis and are included as a component of other noninterest expense along with holding costs. Any gains or losses on disposal of OREO are also reflected in noninterest expense. Significant judgments and complex estimates are required in estimating the fair value of OREO, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility. As a result, the net proceeds realized from sales transactions could differ significantly from appraisals, comparable sales, and other estimates used to determine the fair value of other OREO.

Deferred Tax Asset Valuation

A valuation allowance is recognized for a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of taxable income over the last three years and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that we will realize the benefits of these deductible differences at December 31, 2020. The amount of the deferred tax assets considered realizable, however, could be reduced if estimates of future taxable income are reduced.

Average Balance Sheet and Interest Rates

	Year ended December 31			
	2020		2019	
(Dollars in thousands)	Average Balance	Yield/ Rate	Average Balance	Yield/ Rate
Loans and loans held for sale	$ 465,378	4.74%	$ 474,259	4.83%
Securities - taxable	234,420	1.68%	178,410	2.24%
Securities - tax-exempt (a)	63,029	3.72%	66,628	3.99%
Total securities	297,449	2.11%	245,038	2.72%
Federal funds sold	30,977	0.41%	20,223	2.09%
Interest bearing bank deposits	56,104	0.41%	36,869	2.16%
Total interest-earning assets	849,908	3.38%	776,389	3.97%
Deposits:				
NOW	154,431	0.34%	134,430	0.53%
Savings and money market	242,485	0.44%	218,630	0.44%
Certificates of deposits	165,120	1.36%	170,835	1.46%
Total interest-bearing deposits	562,036	0.68%	523,895	0.80%
Short-term borrowings	1,864	0.48%	1,443	0.49%
Total interest-bearing liabilities	563,900	0.68%	525,338	0.80%
Net interest income and margin (a)	$ 24,830	2.92%	$ 26,621	3.43%

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".

RESULTS OF OPERATIONS

Net Interest Income and Margin

Net interest income (tax-equivalent) was $24.8 million in 2020, compared to $26.6 million in 2019. This decrease was due to a decline in the Company's net interest margin (tax-equivalent).

The tax-equivalent yield on total interest-earning assets decreased by 59 basis points in 2020 from 2019 to 3.38%. This decrease was primarily due to the lower rate environment, including a 150 basis point reduction in the federal funds rate that occurred in March 2020 and changes in our asset mix from the significant short-term liquidity increase in customer deposits.

The cost of total interest-bearing liabilities decreased 12 basis points in 2020 from 2019 to 0.68%. Such costs declined less than the declines in rates earned on our interest earning assets.

The Company continues to deploy various asset liability management strategies to manage its risk to interest rate fluctuations. The Company's net interest margin could experience pressure due to reduced earning asset yields and increased competition for quality loan opportunities.

Provision for Loan Losses

The provision for loan losses represents a charge to earnings necessary to provide an allowance for loan losses that management believes, based on its processes and estimates, should be adequate to provide for the probable losses on outstanding loans. The provision for loan losses was $1.1 million in 2020, compared to a negative provision for loan losses of $0.3 million in 2019. The increase in the provision for loan losses was related to adverse changes in economic conditions and portfolio trends driven by the impact of COVID-19 pandemic, including higher unemployment in our primary market area. The provision for loan losses is based upon various factors, including the absolute level of loans, loan growth, the credit quality, and the amount of net charge-offs or recoveries.

Based upon its assessment of the loan portfolio, management adjusts the allowance for loan losses to an amount it believes should be appropriate to adequately cover its estimate of probable losses in the loan portfolio. The Company's allowance for loan losses as a percentage of total loans was 1.22% at December 31, 2020, compared to 0.95% at December 31, 2019. At December 31, 2020, the Company's allowance for loan losses was 1.27% of total loans, excluding PPP loans. While the policies and procedures used to estimate the allowance for loan losses, as well as the resulting provision for loan losses charged to operations, are considered adequate by management and are reviewed from time to time by our regulators, they are based on estimates and judgments and are therefore approximate and imprecise. Factors beyond our control (such as conditions in the local and national economy, local real estate markets, or industries) may have a material adverse effect on our asset quality and the adequacy of our allowance for loan losses resulting in significant increases in the provision for loan losses.

Noninterest Income

	Year ended December 31	
(Dollars in thousands)	**2020**	**2019**
Service charges on deposit accounts	$ 585	$ 717
Mortgage lending	2,319	866
Bank-owned life insurance	724	437
Gain from loan guarantee program	—	1,717
Securities gains (losses), net	103	(123)
Other	1,644	1,880
Total noninterest income	$ 5,375	$ 5,494

The decrease in service charges on deposit accounts was driven by a decline in consumer spending activity as a result of the COVID-19 pandemic.

The Company's income from mortgage lending is primarily attributable to the (1) origination and sale of new mortgage loans and (2) servicing of mortgage loans. Origination income, net, is comprised of gains or losses from the sale of the mortgage loans originated, origination fees, underwriting fees and other fees associated with the origination of loans, which are netted against the commission expense associated with these originations. The Company's normal practice is to originate mortgage loans for sale in the secondary market and to either sell or retain the MSRs when the loan is sold.

MSRs are recognized based on the fair value of the servicing right on the date the corresponding mortgage loan is sold. Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Servicing fee income is reported net of any related amortization expense.

The Company evaluates MSRs for impairment on a quarterly basis. Impairment is determined by grouping MSRs by common predominant characteristics, such as interest rate and loan type. If the aggregate carrying amount of a particular group of MSRs exceeds the group's aggregate fair value, a valuation allowance for that group is established. The valuation allowance is adjusted as the fair value changes. An increase in mortgage interest rates typically results in an increase in the fair value of the MSRs while a decrease in mortgage interest rates typically results in a decrease in the fair value of MSRs.

The following table presents a breakdown of the Company's mortgage lending income for 2020 and 2019.

	Year ended December 31	
(Dollars in thousands)	**2020**	**2019**
Origination income	$ 2,300	$ 545
Servicing fees, net	19	321
Total mortgage lending income	$ 2,319	$ 866

The increase in mortgage lending income was primarily due to an increase in mortgage refinance activity. The Company's income from mortgage lending typically fluctuates as mortgage interest rates change and is primarily attributable to the origination and sale of new mortgage loans. The increase in mortgage lending income was partially offset by a decrease in servicing fees, net of related amortization expense as prepayment speeds increased during 2020, resulting in increased amortization expense.

Income from bank-owned life insurance increased primarily due to $0.3 million in non-taxable death benefits received in 2020. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e., increases or decreases in the cash surrender value of the policies and death benefits received) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support these policies. Earnings on these policies are generally not taxable.

In 2019, the Company recognized a gain of $1.7 million resulting from the termination of a Loan Guarantee Program (the "Program") operated by the State of Alabama. For more information regarding the Program, please refer to Note 5, Loans and Allowance for Loan Losses, of the consolidated financial statements that accompany this report.

The decrease in other noninterest income was primarily due to a $0.3 million pre-tax gain from an insurance recovery received in the first quarter of 2019.

Noninterest Expense

	Year ended December 31	
(Dollars in thousands)	**2020**	**2019**
Salaries and benefits	$ 11,316	$ 11,931
Net occupancy and equipment	2,511	1,907
Professional fees	1,052	1,014
FDIC and other regulatory assessments	256	181
Other	4,419	4,664
Total noninterest expense	$ 19,554	$ 19,697

The decrease in salaries and benefits expense was primarily due to lower full-time equivalent employees, incentive accruals and an increase in deferred costs related to the PPP loan program.

The increase in net occupancy and equipment expense was primarily due to various expenses related to the redevelopment of the Company's headquarters in downtown Auburn. This amount includes revised depreciation estimates and other temporary relocation costs. For more information regarding changes in accounting estimates, please refer to Note 1, Summary of Significant Accounting Policies, of the consolidated financial statements that accompany this report.

Income Tax Expense

Income tax expense was $1.6 million in 2020 compared to $2.4 million in 2019. The Company's effective income tax rate was 17.72% in 2020, compared to 19.57% in 2019. This change was primarily due to a decrease in the level of earnings before taxes relative to tax-exempt sources of income. The Company's effective income tax rate is principally impacted by tax-exempt earnings from the Company's investments in municipal securities and bank-owned life insurance.

BALANCE SHEET ANALYSIS

Securities

Securities available-for-sale were $335.2 million at December 31, 2020, compared to $235.9 million at December 31, 2019. This increase reflects an increase in the amortized cost basis of securities available-for-sale of $91.9 million, and an increase of $7.4 million in the fair value of securities available-for-sale. The increase in the amortized cost basis of securities available-for-sale was primarily attributable to management allocating more funding to the investment portfolio following the significant increases in customer deposits. The increase in the fair value of securities was primarily due to a decrease in long-term interest rates. The average annualized tax-equivalent yields earned on total securities were 2.11% in 2020 and 2.72% in 2019.

The following table shows the carrying value and weighted average yield of securities available-for-sale as of December 31, 2020 according to contractual maturity. Actual maturities may differ from contractual maturities of mortgage-backed securities ("MBS") because the mortgages underlying the securities may be called or prepaid with or without penalty.

(Dollars in thousands)		1 year or less	1 to 5 years	5 to 10 years	After 10 years	December 31, 2020 Total Fair Value
Agency obligations	$	5,048	24,834	55,367	12,199	97,448
Agency MBS		—	1,154	20,502	141,814	163,470
State and political subdivisions		477	632	8,405	64,745	74,259
Total available-for-sale	$	5,525	26,620	84,274	218,758	335,177
Weighted average yield:						
Agency obligations		1.59%	1.84%	1.51%	1.22%	1.56%
Agency MBS		—	3.31%	1.67%	1.42%	1.46%
State and political subdivisions		4.01%	4.13%	2.32%	2.81%	2.77%
Total available-for-sale		1.80%	1.95%	1.63%	1.82%	1.78%

Loans

(In thousands)		2020	2019	2018	2017	December 31 2016
Commercial and industrial	$	82,585	56,782	63,467	59,086	49,850
Construction and land development		33,514	32,841	40,222	39,607	41,650
Commercial real estate		255,136	270,318	261,896	239,033	220,439
Residential real estate		84,154	92,575	102,597	106,863	110,855
Consumer installment		7,099	8,866	9,295	9,588	8,712
Total loans		462,488	461,382	477,477	454,177	431,506
Less: unearned income		(788)	(481)	(569)	(526)	(560)
Loans, net of unearned income	$	461,700	460,901	476,908	453,651	430,946

Total loans, net of unearned income, were $461.7 million at December 31, 2020, and $460.9 million at December 31, 2019. Excluding PPP loans, total loans, net of unearned income, were $442.7 million, a decrease of $18.2 million, or 4% from December 31, 2019. This decrease was primarily due to a decrease in commercial real estate loans and residential real estate loans of $15.2 million and $8.4 million, respectively, as lower rates increased refinance activity and payoffs for multi-family residential and consumer mortgage loans. Four loan categories represented the majority of the loan portfolio at December 31, 2020: commercial real estate (55%), residential real estate (18%), commercial and industrial (18%) and construction and land development (7%). Approximately 21% of the Company's commercial real estate loans were classified as owner-occupied at December 31, 2020.

Within the residential real estate portfolio segment, the Company had junior lien mortgages of approximately $8.7 million, or 2%, and $10.8 million, or 2%, of total loans, net of unearned income at December 31, 2020 and 2019, respectively. For residential real estate mortgage loans with a consumer purpose, the Company had no loans that required interest only payments at December 31, 2020, compared to approximately $0.8 million at December 31, 2019. The Company's residential real estate mortgage portfolio does not include any option ARM loans, subprime loans, or any material amount of other high-risk consumer mortgage products.

The average yield earned on loans and loans held for sale was 4.74% in 2020 and 4.83% in 2019.

The specific economic and credit risks associated with our loan portfolio include, but are not limited to, the effects of current economic conditions, including the COVID-19 pandemic's effects, on our borrowers' cash flows, real estate market sales volumes, valuations, availability and cost of financing properties, real estate industry concentrations, competitive pressures from a wide range of other lenders, deterioration in certain credits, interest rate fluctuations, reduced collateral values or non-existent collateral, title defects, inaccurate appraisals, financial deterioration of borrowers, fraud, and any violation of applicable laws and regulations.

The Company attempts to reduce these economic and credit risks through its loan-to-value guidelines for collateralized loans, investigating the creditworthiness of borrowers and monitoring borrowers' financial position. Also, we have established and periodically review, lending policies and procedures. Banking regulations limit a bank's credit exposure by prohibiting unsecured loan relationships that exceed 10% of its capital; or 20% of capital, if loans in excess of 10% of capital are fully secured. Under these regulations, we are prohibited from having secured loan relationships in excess of approximately $20.4 million. Furthermore, we have an internal limit for aggregate credit exposure (loans outstanding plus unfunded commitments) to a single borrower of $18.3 million. Our loan policy requires that the Loan Committee of the Board of Directors approve any loan relationships that exceed this internal limit. At December 31, 2020, the Bank had no relationships exceeding these limits.

We periodically analyze our commercial loan portfolio to determine if a concentration of credit risk exists in any one or more industries. We use classification systems broadly accepted by the financial services industry in order to categorize our commercial borrowers. Loan concentrations to borrowers in the following classes exceeded 25% of the Bank's total risk-based capital at December 31, 2020 (and related balances at December 31, 2019).

	December 31	
(In thousands)	**2020**	**2019**
Lessors of 1-4 family residential properties	$ 49,127	$ 43,652
Hotel/motel	42,900	43,719
Multi-family residential properties	40,203	44,839
Shopping centers	30,000	30,407

Supplemental COVID-19 Industry Exposure

We have identified certain commercial sectors with enhanced risk resulting from the impact of COVID-19. Loans within these sectors represent 86% of the Company's total COVID-19 related modifications at December 31, 2020. The table below summarizes the loans outstanding for these sectors at December 31, 2020.

	Portfolio Segment				
(Dollars in thousands)	**Commercial and industrial**	**Construction and land development**	**Commercial real estate**	**Total**	**% of Total Loans**
December 31, 2020:					
Hotel/motel	$ 866	10,549	42,900	$ 54,315	12 %
Shopping centers	8	—	30,000	30,008	6
Retail, excluding shopping centers	327	—	18,053	18,380	4
Restaurants	1,407	—	12,865	14,272	3
Total	$ 2,608	10,549	103,818	$ 116,975	25 %

In light of disruptions in economic conditions caused by COVID-19, the financial regulators have issued guidance encouraging banks to work constructively with borrowers affected by the virus in our community. This guidance, including the Interagency Statement on COVID-19 Loan Modifications and the Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions, provides that the agencies will not criticize financial institutions that mitigate credit risk through prudent actions consistent with safe and sound practices. Specifically, examiners will not criticize institutions for working with borrowers as part of a risk mitigation strategy intended to improve existing loans, even if the restructured loans have or develop weaknesses that ultimately result in adverse credit classification. Upon demonstrating the need for payment relief, the bank will work with qualified borrowers that were otherwise current before the pandemic to determine the most appropriate deferral option. For residential mortgage and consumer loans the borrower may elect to defer payments for up to three months. Interest continues to accrue and the amount due at maturity increases. Commercial real estate, commercial, and small business borrowers may elect to defer payments for up to three months or pay scheduled interest payments for a nine-month period. The bank recognizes that a combination of the payment relief options may be prudent dependent on a borrower's business type. As of December 31, 2020 we have granted loan payment deferrals or payments of interest-only primarily on commercial and industrial and commercial real estate loans totaling $32.3 million, or 7% of total loans. This was a decline from $87.1 million, or 18% of total loans at September 30, 2020 and $112.7 million, or 24% of total loans at June 30, 2020. The tables below provide information concerning the composition of these COVID-19 modifications as of December 31, 2020, all of which represent second deferral requests.

COVID-19 Modifications

(Dollars in thousands)	# of Loans Modified	Balance	% of Portfolio Modified	Modification Types: Interest Only Payment	Modification Types: P&I Payments Deferred
Commercial and industrial	2	$ 741	— %	100 %	— %
Commercial real estate	12	31,399	7	100	—
Residential real estate	2	133	—	—	100
Total	16	$ 32,273	7 %	99 %	1 %

COVID-19 Modifications within Commercial Real Estate Segments

(Dollars in thousands)	# of Loans Modified	Balance of Loans Modified	% of Total Segment Loans
Hotel/motel	10	$ 26,427	49 %
Restaurants	1	1,442	10

Section 4013 of the CARES Act provides that a qualified loan modification is exempt by law from classification as a TDR pursuant to GAAP. In addition, the Interagency Statement on COVID-19 Loan Modifications provides circumstances in which a loan modification is not subject to classification as a TDR if such loan is not eligible for modification under Section 4013.

Allowance for Loan Losses

The Company maintains the allowance for loan losses at a level that management believes appropriate to adequately cover the Company's estimate of probable losses inherent in the loan portfolio. The allowance for loan losses was $5.6 million at December 31, 2020 compared to $4.4 million at December 31, 2019, which management believed to be adequate at each of the respective dates. The judgments and estimates associated with the determination of the allowance for loan losses are described under "Critical Accounting Policies."

A summary of the changes in the allowance for loan losses and certain asset quality ratios for each of the five years in the five year period ended December 31, 2020 is presented below.

		Year ended December 31				
(Dollars in thousands)		**2020**	**2019**	**2018**	**2017**	**2016**
Allowance for loan losses:						
Balance at beginning of period	$	4,386	4,790	4,757	4,643	4,289
Charge-offs:						
Commercial and industrial		(7)	(364)	(52)	(449)	(97)
Commercial real estate		—	—	(38)	—	(194)
Residential real estate		—	(6)	(26)	(107)	(182)
Consumer installment		(38)	(38)	(52)	(40)	(67)
Total charge-offs		(45)	(408)	(168)	(596)	(540)
Recoveries:						
Commercial and industrial		94	117	70	461	29
Construction and land development		—	—	—	347	1,212
Commercial real estate		—	1	19	—	—
Residential real estate		63	109	79	115	127
Consumer installment		20	27	33	87	11
Total recoveries		177	254	201	1,010	1,379
Net recoveries (charge-offs)		132	(154)	33	414	839
Provision for loan losses		1,100	(250)	—	(300)	(485)
Ending balance	$	5,618	4,386	4,790	4,757	4,643
as a % of loans		1.22 %	0.95	1.00	1.05	1.08
as a % of nonperforming loans		1,052 %	2,345	2,691	160	196
Net (recoveries) charge-offs as a % of average loans		(0.03) %	0.03	(0.01)	(0.09)	(0.19)

As described under "Critical Accounting Policies", management assesses the adequacy of the allowance prior to the end of each calendar quarter. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan loss rates, and other pertinent factors. This evaluation is inherently subjective as it requires various material estimates and judgments including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The ratio of our allowance for loan losses to total loans outstanding was 1.22% at December 31, 2020, compared to 0.95% at December 31, 2019. At December 31, 2020, the Company's allowance for loan losses was 1.27% of total loans, excluding PPP loans. In the future, the allowance to total loans outstanding ratio will increase or decrease to the extent the factors that influence our quarterly allowance assessment, including the duration and magnitude of COVID-19 effects, in their entirety either improve or weaken. In addition our regulators, as an integral part of their examination process, will periodically review the Company's allowance for loan losses, and may require the Company to make additional provisions to the allowance for loan losses based on their judgment about information available to them at the time of their examinations.

Nonperforming Assets

At December 31, 2020 the Company had $0.5 million in nonperforming assets compared to $0.2 million at December 31, 2019.

The table below provides information concerning total nonperforming assets and certain asset quality ratios.

(Dollars in thousands)		December 31 2020	2019	2018	2017	2016
Nonperforming assets:						
Nonperforming (nonaccrual) loans	$	534	187	178	2,972	2,370
Other real estate owned		—	—	172	—	152
Total nonperforming assets	$	534	187	350	2,972	2,522
as a % of loans and other real estate owned		0.12 %	0.04	0.07	0.66	0.59
as a % of total assets		0.06 %	0.02	0.04	0.35	0.30
Nonperforming loans as a % of total loans		0.12 %	0.04	0.04	0.66	0.55
Accruing loans 90 days or more past due	$	141	—	—	—	—

The table below provides information concerning the composition of nonaccrual loans at December 31, 2020 and 2019, respectively.

(In thousands)		December 31 2020	2019
Nonaccrual loans:			
Commercial real estate	$	212	—
Residential real estate		322	187
Total nonaccrual loans / nonperforming loans	$	534	187

The Company discontinues the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At December 31, 2020 and 2019, respectively, the Company had $0.5 million and $0.2 million in loans on nonaccrual.

At December 31, 2020 there were $0.1 million in loans 90 days past due and still accruing interest, compared to none at December 31, 2019.

Other Real Estate Owned

At December 31, 2020 and 2019, respectively, the Company held no OREO properties acquired from borrowers.

Potential Problem Loans

Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the Federal Reserve, the Company's primary regulator, for loans classified as substandard, excluding nonaccrual loans. Potential problem loans, which are not included in nonperforming assets, amounted to $2.9 million, or 1.0% of total loans at December 31, 2020, compared to $4.4 million, or 1.0% of total loans at December 31, 2019.

The table below provides information concerning the composition of potential problem loans at December 31, 2020 and 2019, respectively.

		December 31	
(In thousands)		2020	2019
Potential problem loans:			
Commercial and industrial	$	218	266
Construction and land development		254	1,043
Commercial real estate		188	99
Residential real estate		2,229	2,899
Consumer installment		23	64
Total potential problem loans	$	2,912	4,371

At December 31, 2020, approximately $0.9 million or 30.3% of total potential problem loans were past due at least 30 but less than 90 days.

The following table is a summary of the Company's performing loans that were past due at least 30 days but less than 90 days as of December 31, 2020 and 2019, respectively.

		December 31	
(In thousands)		2020	2019
Performing loans past due 30 to 89 days:			
Commercial and industrial	$	230	24
Construction and land development		61	456
Commercial real estate		29	—
Residential real estate		1,509	1,608
Consumer installment		29	64
Total performing loans past due 30 to 89 days	$	1,858	2,152

Deposits

		December 31	
(In thousands)		2020	2019
Noninterest bearing demand	$	245,398	196,218
NOW		155,870	138,315
Money market		199,937	160,934
Savings		78,187	61,486
Certificates of deposit under $100,000		54,920	59,516
Certificates of deposit and other time deposits of $100,000 or more		105,481	107,683
Total deposits	$	839,793	724,152

Total deposits increased $115.6 million, or 16%, to $839.8 million at December 31, 2020, compared to $724.2 million at December 31, 2019. Noninterest-bearing deposits were $245.4 million, or 29% of total deposits, at December 31, 2020, compared to $196.2 million, or 27% of total deposits at December 31, 2019. These increases reflect deposits from customers who received PPP loans, the impact of government stimulus checks, delayed tax payments and reduced customer spending during the COVID-19 pandemic.

The average rates paid on total interest-bearing deposits were 0.68% in 2020 and 0.80% in 2019.

Other Borrowings

Other borrowings generally consist of short-term borrowings and long-term debt. Short-term borrowings generally consist of federal funds purchased and securities sold under agreements to repurchase with an original maturity of one year or less. The Bank had available federal fund lines totaling $41.0 million with none outstanding at December 31, 2020 and 2019, respectively. Securities sold under agreements to repurchase totaled $2.4 million and $1.1 million at December 31, 2020 and 2019, respectively.

The average rates paid on short-term borrowings was 0.48% and 0.49% in 2020 and 2019, respectively. Information concerning the average balances, weighted average rates, and maximum amounts outstanding for short-term borrowings during the two-year period ended December 31, 2020 is included in Note 9 to the accompanying consolidated financial statements included in this annual report.

The Company had no long-term debt outstanding at December 31, 2020 and 2019, respectively.

CAPITAL ADEQUACY

The Company's consolidated stockholders' equity was $107.7 million and $98.3 million as of December 31, 2020 and 2019, respectively. The increase from December 31, 2019 was primarily driven by net earnings of $7.5 million and other comprehensive income due to the change in unrealized gains on securities available-for-sale, net of tax, of $5.5 million, which was partially offset by cash dividends paid of $3.6 million.

On January 1, 2015, the Company and Bank became subject to the rules of the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules included the implementation of a capital conservation buffer that is added to the minimum requirements for capital adequacy purposes. The capital conservation buffer was subject to a three year phase-in period that began on January 1, 2016 and was fully phased-in on January 1, 2019 at 2.5%. A banking organization with a conservation buffer of less than the required amount will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At December 31, 2020, the Bank’s ratio was sufficient to meet the fully phased-in conservation buffer.

Effective March 20, 2020, the Federal Reserve and the other federal banking regulators adopted an interim final rule that amended the capital conservation buffer. The interim final rule was adopted as a final rule on August 26, 2020. The new rule revises the definition of “eligible retained income” for purposes of the maximum payout ratio to allow banking organizations to more freely use their capital buffers to promote lending and other financial intermediation activities, by making the limitations on capital distributions more gradual. The eligible retained income is now the greater of (i) net income for the four preceding quarters, net of distributions and associated tax effects not reflected in net income; and (ii) the average of all net income over the preceding four quarters. The interim final rule only affects the capital buffers, and banking organizations were encouraged to make prudent capital distribution decisions.

The Federal Reserve has treated us as a “small bank holding company’ under the Federal Reserve’s policy. Accordingly, our capital adequacy is evaluated at the Bank level, and not for the Company and its consolidated subsidiaries. The Bank’s tier 1 leverage ratio was 10.32%, CET1 risk-based capital ratio was 17.27%, tier 1 risk-based capital ratio was 17.27%, and total risk-based capital ratio was 18.31% at December 31, 2020. These ratios exceed the minimum regulatory capital percentages of 5.0% for tier 1 leverage ratio, 6.5% for CET1 risk-based capital ratio, 8.0% for tier 1 risk-based capital ratio, and 10.0% for total risk-based capital ratio to be considered “well capitalized.” The Bank’s capital conservation buffer was 10.31% at December 31, 2020.

MARKET AND LIQUIDITY RISK MANAGEMENT

Management's objective is to manage assets and liabilities to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. The Bank's Asset Liability Management Committee ("ALCO") is charged with the responsibility of monitoring these policies, which are designed to ensure an acceptable asset/liability composition. Two critical areas of focus for ALCO are interest rate risk and liquidity risk management.

Interest Rate Risk Management

In the normal course of business, the Company is exposed to market risk arising from fluctuations in interest rates because assets and liabilities may mature or reprice at different times. For example, if liabilities reprice faster than assets, and interest rates are generally rising, earnings will initially decline. In addition, assets and liabilities may reprice at the same time but by different amounts. For example, when the general level of interest rates is rising, the Company may increase rates paid on interest bearing demand deposit accounts and savings deposit accounts by an amount that is less than the general increase in market interest rates. Also, short-term and long-term market interest rates may change by different amounts. For example, a flattening yield curve may reduce the interest spread between new loan yields and funding costs. Further, the remaining maturity of various assets and liabilities may shorten or lengthen as interest rates change. For example, if long-term mortgage interest rates decline sharply, mortgage-backed securities in the securities portfolio may prepay earlier than anticipated, which could reduce earnings. Interest rates may also have a direct or indirect effect on loan demand, loan losses, mortgage origination volume, the fair value of MSRs and other items affecting earnings.

ALCO measures and evaluates the interest rate risk so that we can meet customer demands for various types of loans and deposits. ALCO determines the most appropriate amounts of on-balance sheet and off-balance sheet items. Measurements used to help manage interest rate sensitivity include an earnings simulation and an economic value of equity model.

Earnings simulation. Management believes that interest rate risk is best estimated by our earnings simulation modeling. On at least a quarterly basis, the following 12 month time period is simulated to determine a baseline net interest income forecast and the sensitivity of this forecast to changes in interest rates. The baseline forecast assumes an unchanged or flat interest rate environment. Forecasted levels of earning assets, interest-bearing liabilities, and off-balance sheet financial instruments are combined with ALCO forecasts of market interest rates for the next 12 months and other factors in order to produce various earnings simulations and estimates.

To help limit interest rate risk, we have guidelines for earnings at risk which seek to limit the variance of net interest income from gradual changes in interest rates. For changes up or down in rates from management's flat interest rate forecast over the next 12 months, policy limits for net interest income variances are as follows:

+/- 20% for a gradual change of 400 basis points

+/- 15% for a gradual change of 300 basis points

+/- 10% for a gradual change of 200 basis points

+/- 5% for a gradual change of 100 basis points

The following table reports the variance of net interest income over the next 12 months assuming a gradual change in interest rates up or down when compared to the baseline net interest income forecast at December 31, 2020.

Changes in Interest Rates	Net Interest Income % Variance
400 basis points	(2.42)%
300 basis points	(2.27)
200 basis points	(1.67)
100 basis points	(0.86)
(100) basis points	2.34
(200) basis points	NM
(300) basis points	NM
(400) basis points	NM

NM=not meaningful

At December 31, 2020, our earnings simulation model indicated that we were in compliance with the policy guidelines noted above.

Economic Value of Equity

Economic value of equity ("EVE") measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are estimated by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case EVE. In contrast with our earnings simulation model which evaluates interest rate risk over a 12 month timeframe, EVE uses a terminal horizon which allows for the re-pricing of all assets, liabilities, and off-balance sheet items. Further, EVE is measured using values as of a point in time and does not reflect any actions that ALCO might take in responding to or anticipating changes in interest rates, or market and competitive conditions.

To help limit interest rate risk, we have stated policy guidelines for an instantaneous basis point change in interest rates, such that our EVE should not decrease from our base case by more than the following:

45% for an instantaneous change of +/- 400 basis points

35% for an instantaneous change of +/- 300 basis points

25% for an instantaneous change of +/- 200 basis points

15% for an instantaneous change of +/- 100 basis points

The following table reports the variance of EVE assuming an immediate change in interest rates up or down when compared to the baseline EVE at December 31, 2020.

Changes in Interest Rates	EVE % Variance
400 basis points	(22.20) %
300 basis points	(15.00)
200 basis points	(8.25)
100 basis points	(2.63)
(100) basis points	1.17
(200) basis points	NM
(300) basis points	NM
(400) basis points	NM

NM=not meaningful

At December 31, 2020, our EVE model indicated that we were in compliance with the policy guidelines noted above.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates, and other economic and market factors, including market perceptions. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types of assets and liabilities may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as “interest rate caps and floors”) which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates or economic stress, which may differ across industries and economic sectors. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios in seeking satisfactory, consistent levels of profitability within the framework of the Company’s established liquidity, loan, investment, borrowing, and capital policies.

The Company may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. From time to time, the Company may enter into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. At December 31, 2020 and 2019, the Company had no derivative contracts to assist in managing interest rate sensitivity.

Liquidity Risk Management

Liquidity is the Company’s ability to convert assets into cash equivalents in order to meet daily cash flow requirements, primarily for deposit withdrawals, loan demand and maturing obligations. Without proper management of its liquidity, the Company could experience higher costs of obtaining funds due to insufficient liquidity, while excessive liquidity can lead to a decline in earnings due to the cost of foregoing alternative higher-yielding investment opportunities.

Liquidity is managed at two levels. The first is the liquidity of the Company. The second is the liquidity of the Bank. The management of liquidity at both levels is essential, because the Company and the Bank are separate and distinct legal entities with different funding needs and sources, and each are subject to regulatory guidelines and requirements. The Company depends upon dividends from the Bank for liquidity to pay its operating expenses, debt obligations and dividends. The Bank’s payment of dividends depends on its earnings, liquidity, capital and the absence of any regulatory restrictions.

The primary source of funding and liquidity for the Company has been dividends received from the Bank. If needed, the Company could also issue common stock or other securities. Primary uses of funds by the Company include dividends paid to stockholders and stock repurchases.

Primary sources of funding for the Bank include customer deposits, other borrowings, repayment and maturity of securities, and sale and repayment of loans. The Bank has access to federal funds lines from various banks and borrowings from the Federal Reserve discount window. In addition to these sources, the Bank has participated in the FHLB's advance program to obtain funding for its growth. Advances include both fixed and variable terms and are taken out with varying maturities. As of December 31, 2020, the Bank had a remaining available line of credit with the FHLB totaling $281.4 million. As of December 31, 2020, the Bank also had $41.0 million of federal funds lines, with none outstanding. Primary uses of funds include repayment of maturing obligations and growing the loan portfolio.

The following table presents additional information about our contractual obligations as of December 31, 2020, which by their terms had contractual maturity and termination dates subsequent to December 31, 2020:

	Payments due by period					
(Dollars in thousands)		Total	1 year or less	1 to 3 years	3 to 5 years	More than 5 years
Contractual obligations:						
Deposit maturities (1)	$	839,792	767,683	62,904	9,205	—
Operating lease obligations		811	103	201	206	301
Total	$	840,603	767,786	63,105	9,411	301

(1) Deposits with no stated maturity (demand, NOW, money market, and savings deposits) are presented in the "1 year or less" column

Management believes that the Company and the Bank have adequate sources of liquidity to meet all known contractual obligations and unfunded commitments, including loan commitments and reasonable borrower, depositor, and creditor requirements over the next 12 months.

Off-Balance Sheet Arrangements

At December 31, 2020, the Bank had outstanding standby letters of credit of $1.2 million and unfunded loan commitments outstanding of $75.0 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, the Bank has the ability to liquidate federal funds sold or securities available-for-sale, or on a short-term basis to borrow and purchase federal funds from other financial institutions.

Residential mortgage lending and servicing activities

Since 2009, we have primarily sold residential mortgage loans in the secondary market to Fannie Mae while retaining the servicing of these loans. The sale agreements for these residential mortgage loans with Fannie Mae and other investors include various representations and warranties regarding the origination and characteristics of the residential mortgage loans. Although the representations and warranties vary among investors, they typically cover ownership of the loan, validity of the lien securing the loan, the absence of delinquent taxes or liens against the property securing the loan, compliance with loan criteria set forth in the applicable agreement, compliance with applicable federal, state, and local laws, among other matters.

As of December 31, 2020, the unpaid principal balance of residential mortgage loans, which we have originated and sold, but retained the servicing rights was $267.2 million. Although these loans are generally sold on a non-recourse basis, except for breaches of customary seller representations and warranties, we may have to repurchase residential mortgage loans in cases where we breach such representations or warranties or the other terms of the sale, such as where we fail to deliver required documents or the documents we deliver are defective. Investors also may require the repurchase of a mortgage loan when an early payment default underwriting review reveals significant underwriting deficiencies, even if the mortgage loan has subsequently been brought current. Repurchase demands are typically reviewed on an individual loan by loan basis to validate the claims made by the investor and to determine if a contractually required repurchase event has occurred. We seek to reduce and manage the risks of potential repurchases or other claims by mortgage loan investors through our underwriting, quality assurance and servicing practices, including good communications with our residential mortgage investors.

The Company was not required to repurchase any loans during 2020 and 2019 as a result of representation and warranty provisions contained in the Company's sale agreements with Fannie Mae, and had no pending repurchase or make-whole requests at December 31, 2020.

We service all residential mortgage loans originated and sold by us to Fannie Mae. As servicer, our primary duties are to: (1) collect payments due from borrowers; (2) advance certain delinquent payments of principal and interest; (3) maintain and administer any hazard, title, or primary mortgage insurance policies relating to the mortgage loans; (4) maintain any required escrow accounts for payment of taxes and insurance and administer escrow payments; and (5) foreclose on defaulted mortgage loans or take other actions to mitigate the potential losses to investors consistent with the agreements governing our rights and duties as servicer.

The agreement under which we act as servicer generally specifies a standard of responsibility for actions taken by us in such capacity and provides protection against expenses and liabilities incurred by us when acting in compliance with the respective servicing agreements. However, if we commit a material breach of our obligations as servicer, we may be subject to termination if the breach is not cured within a specified period following notice. The standards governing servicing and the possible remedies for violations of such standards are determined by servicing guides issued by Fannie Mae as well as the contract provisions established between Fannie Mae and the Bank. Remedies could include repurchase of an affected loan.

Although to date repurchase requests related to representation and warranty provisions, and servicing activities have been limited, it is possible that requests to repurchase mortgage loans may increase in frequency if investors more aggressively pursue all means of recovering losses on their purchased loans. As of December 31, 2020, we believe that this exposure is not material due to the historical level of repurchase requests and loss trends, the results of our quality control reviews, and the fact that 99% of our residential mortgage loans serviced for Fannie Mae were current as of such date. We maintain ongoing communications with our investors and will continue to evaluate this exposure by monitoring the level and number of repurchase requests as well as the delinquency rates in our investor portfolios.

Section 4021 of the CARES Act allows borrowers under 1-to-4 family residential mortgage loans sold to Fannie Mae to request forbearance to the servicer after affirming that such borrower is experiencing financial hardships during the COVID-19 emergency. Except for vacant or abandoned properties, Fannie Mae servicers may not initiate foreclosures on similar procedures or related evictions or sales until December 31, 2020. The forbearance period has been extended, generally, to March 31, 2021. The Bank sells mortgage loans to Fannie Mae and services these on an actual/actual basis. As a result, the Bank is not obligated to make any advances to Fannie Mae on principal and interest on such mortgage loans where the borrower is entitled to forbearance.

Effects of Inflation and Changing Prices

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with GAAP and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

CURRENT ACCOUNTING DEVELOPMENTS

The following ASU has been issued by the FASB but is not yet effective.

- ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments;*

Information about this pronouncement is described in more detail below.

ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): - Measurement of Credit Losses on Financial Instruments*, amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, the new standard eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses using a broader range of information regarding past events, current conditions and forecasts assessing the collectability of cash flows. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however the new standard will require that credit losses be presented as an allowance rather than as a write-down. The new guidance affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. For public business entities, the new guidance was originally effective for annual and interim periods in fiscal years beginning after December 15, 2019. The Company has developed an implementation team that is following a general timeline. The team has been working with an advisory consultant, with whom a third-party software license has been purchased. The Company's preliminary evaluation indicates the provisions of ASU No. 2016-13 are expected to impact the Company's consolidated financial statements, in particular the level of the reserve for credit losses. The Company is continuing to evaluate the extent of the potential impact and expects that portfolio composition and economic conditions at the time of adoption will be a factor. On October 16, 2019, the FASB approved a previously issued proposal granting smaller reporting companies a postponement of the required implementation date for ASU 2016-13. The Company will now be required to implement the new standard in January 2023, with early adoption permitted in any period prior to that date.

Table 1 – Explanation of Non-GAAP Financial Measures

In addition to results presented in accordance with GAAP, this annual report on Form 10-K includes certain designated net interest income amounts presented on a tax-equivalent basis, a non-GAAP financial measure, including the presentation of total revenue and the calculation of the efficiency ratio.

The Company believes the presentation of net interest income on a tax-equivalent basis provides comparability of net interest income from both taxable and tax-exempt sources and facilitates comparability within the industry. Although the Company believes these non-GAAP financial measures enhance investors' understanding of its business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP. The reconciliation of these non-GAAP financial measures from GAAP to non-GAAP is presented below.

					Year ended December 31
(In thousands)	**2020**	**2019**	**2018**	**2017**	**2016**
Net interest income (GAAP)	$ 24,338	26,064	25,570	24,526	22,732
Tax-equivalent adjustment	492	557	613	1,205	1,276
Net interest income (Tax-equivalent)	$ 24,830	26,621	26,183	25,731	24,008

Table 2 - Selected Financial Data

(Dollars in thousands, except per share amounts)		Year ended December 31 2020	2019	2018	2017	2016
Income statement						
Tax-equivalent interest income (a)	$	28,686	30,804	29,859	29,325	28,092
Total interest expense		3,856	4,183	3,676	3,594	4,084
Tax equivalent net interest income (a)		24,830	26,621	26,183	25,731	24,008
Provision for loan losses		1,100	(250)	—	(300)	(485)
Total noninterest income		5,375	5,494	3,325	3,441	3,383
Total noninterest expense		19,554	19,697	17,874	16,784	15,348
Net earnings before income taxes and tax-equivalent adjustment		9,551	12,668	11,634	12,688	12,528
Tax-equivalent adjustment		492	557	613	1,205	1,276
Income tax expense		1,605	2,370	2,187	3,637	3,102
Net earnings	$	7,454	9,741	8,834	7,846	8,150
Per share data:						
Basic and diluted net earnings	$	2.09	2.72	2.42	2.15	2.24
Cash dividends declared	$	1.02	1.00	0.96	0.92	0.90
Weighted average shares outstanding						
Basic and diluted		3,566,207	3,581,476	3,643,780	3,643,616	3,643,504
Shares outstanding		3,566,276	3,566,146	3,643,868	3,643,668	3,643,523
Book value	$	30.20	27.57	24.44	23.85	22.55
Common stock price						
High	$	63.40	53.90	53.50	40.25	31.31
Low		24.11	30.61	28.88	30.75	24.56
Period-end	$	42.29	53.00	31.66	38.90	31.31
To earnings ratio		20.23x	19.49	13.08	18.09	13.98
To book value		140 %	192	130	163	139
Performance ratios:						
Return on average equity		7.12 %	10.35	10.14	9.17	9.65
Return on average assets		0.83 %	1.18	1.08	0.94	0.98
Dividend payout ratio		48.80 %	36.76	39.67	42.79	40.18
Average equity to average assets		11.63 %	11.39	10.63	10.30	10.14
Asset Quality:						
Allowance for loan losses as a % of:						
Loans		1.22 %	0.95	1.00	1.05	1.08
Nonperforming loans		1,052 %	2,345	2,691	160	196
Nonperforming assets as a % of:						
Loans and other real estate owned		0.12 %	0.04	0.07	0.66	0.59
Total assets		0.06 %	0.02	0.04	0.35	0.30
Nonperforming loans as % of loans		0.12 %	0.04	0.04	0.66	0.55
Net (recoveries) charge-offs as a % of average loans		(0.03) %	0.03	(0.01)	(0.09)	(0.19)
Capital Adequacy (c):						
CET 1 risk-based capital ratio		17.27 %	17.28	16.49	16.42	16.44
Tier 1 risk-based capital ratio		17.27 %	17.28	16.49	16.98	17.00
Total risk-based capital ratio		18.31 %	18.12	17.38	17.91	17.95
Tier 1 leverage ratio		10.32 %	11.23	11.33	10.95	10.27
Other financial data:						
Net interest margin (a)		2.92 %	3.43	3.40	3.29	3.05
Effective income tax rate		17.72 %	19.57	19.84	31.67	27.57
Efficiency ratio (b)		64.74 %	61.33	60.57	57.53	56.03
Selected period end balances:						
Securities	$	335,177	235,902	239,801	257,697	243,572
Loans, net of unearned income		461,700	460,901	476,908	453,651	430,946
Allowance for loan losses		5,618	4,386	4,790	4,757	4,643
Total assets		956,597	828,570	818,077	853,381	831,943
Total deposits		839,792	724,152	724,193	757,659	739,143
Long-term debt		—	—	—	3,217	3,217
Total stockholders' equity		107,689	98,328	89,055	86,906	82,177

(a) Tax-equivalent. See "Table 1 - Explanation of Non-GAAP Financial Measures".
(b) Efficiency ratio is the result of noninterest expense divided by the sum of noninterest income and tax-equivalent net interest income.
(c) Regulatory capital ratios presented are for the Company's wholly-owned subsidiary, AuburnBank.

Table 3 - Average Balance and Net Interest Income Analysis

	Year ended December 31					
	2020			2019		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Interest-earning assets:						
Loans and loans held for sale (1)	$ 465,378	$ 22,055	4.74%	$ 474,259	$ 22,930	4.83%
Securities - taxable	234,420	3,932	1.68%	178,410	4,000	2.24%
Securities - tax-exempt (2)	63,029	2,343	3.72%	66,628	2,656	3.99%
Total securities	297,449	6,275	2.11%	245,038	6,656	2.72%
Federal funds sold	30,977	125	0.41%	20,223	423	2.09%
Interest bearing bank deposits	56,104	231	0.41%	36,869	795	2.16%
Total interest-earning assets	849,908	28,686	3.38%	776,389	30,804	3.97%
Cash and due from banks	13,727			14,037		
Other assets	37,010			36,119		
Total assets	$ 900,645			$ 826,545		
Interest-bearing liabilities:						
Deposits:						
NOW	$ 154,431	523	0.34%	$ 134,430	710	0.53%
Savings and money market	242,485	1,071	0.44%	218,630	969	0.44%
Certificates of deposits	165,120	2,253	1.36%	170,835	2,497	1.46%
Total interest-bearing deposits	562,036	3,847	0.68%	523,895	4,176	0.80%
Short-term borrowings	1,864	9	0.48%	1,443	7	0.49%
Total interest-bearing liabilities	563,900	3,856	0.68%	525,338	4,183	0.80%
Noninterest-bearing deposits	227,127			203,828		
Other liabilities	4,884			3,228		
Stockholders' equity	104,734			94,151		
Total liabilities and and stockholders' equity	$ 900,645			$ 826,545		
Net interest income and margin		$ 24,830	2.92%		$ 26,621	3.43%

(1) Average loan balances are shown net of unearned income and loans on nonaccrual status have been included in the computation of average balances.

(2) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 21%.

Table 4 - Volume and Rate Variance Analysis

(Dollars in thousands)	Years ended December 31, 2020 vs. 2019			Years ended December 31, 2019 vs. 2018		
	Net	Due to change in		Net	Due to change in	
	Change	Rate (2)	Volume (2)	Change	Rate (2)	Volume (2)
Interest income:						
Loans and loans held for sale	$ (875)	(455)	(420)	$ 1,164	358	806
Securities - taxable	(68)	(1,010)	942	(51)	18	(69)
Securities - tax-exempt (1)	(313)	(180)	(133)	(265)	(88)	(177)
Total securities	(381)	(1,190)	809	(316)	(70)	(246)
Federal funds sold	(298)	(342)	44	(131)	46	(177)
Interest bearing bank deposits	(564)	(645)	81	228	109	119
Total interest income	$ (2,118)	(2,632)	514	$ 945	443	502
Interest expense:						
Deposits:						
NOW	$ (187)	(255)	68	$ 282	235	47
Savings and money market	102	(3)	105	114	124	(10)
Certificates of deposits	(244)	(166)	(78)	168	361	(193)
Total interest-bearing deposits	(329)	(424)	95	564	720	(156)
Short-term borrowings	2	—	2	(11)	(5)	(6)
Long-term debt	—	—	—	(46)	—	(46)
Total interest expense	(327)	(424)	97	507	715	(208)
Net interest income	$ (1,791)	(2,208)	417	$ 438	(272)	710

(1) Yields on tax-exempt securities have been computed on a tax-equivalent basis using an income tax rate of 21%.

(2) Changes that are not solely a result of volume or rate have been allocated to volume.

Table 5 - Loan Portfolio Composition

					December 31
(In thousands)	2020	2019	2018	2017	2016
Commercial and industrial	$ 82,585	56,782	63,467	59,086	49,850
Construction and land development	33,514	32,841	40,222	39,607	41,650
Commercial real estate	255,136	270,318	261,896	239,033	220,439
Residential real estate	84,154	92,575	102,597	106,863	110,855
Consumer installment	7,099	8,866	9,295	9,588	8,712
Total loans	462,488	461,382	477,477	454,177	431,506
Less: unearned income	(788)	(481)	(569)	(526)	(560)
Loans, net of unearned income	461,700	460,901	476,908	453,651	430,946
Less: allowance for loan losses	(5,618)	(4,386)	(4,790)	(4,757)	(4,643)
Loans, net	$ 456,082	456,515	472,118	448,894	426,303

Table 6 - Loan Maturities and Sensitivities to Changes in Interest Rates

	December 31, 2020							
(Dollars in thousands)		1 year or less	1 to 5 years	After 5 years	Total	Adjustable Rate	Fixed Rate	Total
Commercial and industrial	$	20,829	26,025	35,731	82,585	15,159	67,426	82,585
Construction and land development		25,461	6,160	1,893	33,514	19,915	13,599	33,514
Commercial real estate		19,534	109,706	125,896	255,136	4,798	250,338	255,136
Residential real estate		6,853	23,549	53,752	84,154	30,272	53,882	84,154
Consumer installment		1,981	4,595	523	7,099	62	7,037	7,099
Total loans	$	74,658	170,035	217,795	462,488	70,206	392,282	462,488

Table 7 - Allowance for Loan Losses and Nonperforming Assets

			Year ended December 31			
(Dollars in thousands)		2020	2019	2018	2017	2016
Allowance for loan losses:						
Balance at beginning of period	$	4,386	4,790	4,757	4,643	4,289
Charge-offs:						
Commercial and industrial		(7)	(364)	(52)	(449)	(97)
Commercial real estate		—	—	(38)	—	(194)
Residential real estate		—	(6)	(26)	(107)	(182)
Consumer installment		(38)	(38)	(52)	(40)	(67)
Total charge-offs		(45)	(408)	(168)	(596)	(540)
Recoveries:						
Commercial and industrial		94	117	70	461	29
Construction and land development		—	—	—	347	1,212
Commercial real estate		—	1	19	—	—
Residential real estate		63	109	79	115	127
Consumer installment		20	27	33	87	11
Total recoveries		177	254	201	1,010	1,379
Net recoveries (charge-offs)		132	(154)	33	414	839
Provision for loan losses		1,100	(250)	—	(300)	(485)
Ending balance	$	5,618	4,386	4,790	4,757	4,643
as a % of loans		1.22 %	0.95	1.00	1.05	1.08
as a % of nonperforming loans		1,052 %	2,345	2,691	160	196
Net (recoveries) charge-offs as % of average loans		(0.03) %	0.03	(0.01)	(0.09)	(0.19)
Nonperforming assets:						
Nonaccrual/nonperforming loans	$	534	187	178	2,972	2,370
Other real estate owned		—	—	172	—	152
Total nonperforming assets	$	534	187	350	2,972	2,522
as a % of loans and other real estate owned		0.12 %	0.04	0.07	0.66	0.59
as a % total assets		0.06 %	0.02	0.04	0.35	0.30
Nonperforming loans as a % of total loans		0.12 %	0.04	0.04	0.66	0.55
Accruing loans 90 days or more past due	$	141	—	—	—	—

Table 8 - Allocation of Allowance for Loan Losses

	December 31									
	2020		2019		2018		2017		2016	
(Dollars in thousands)	Amount	%*	Amount	%*	Amount	%*	Amount	%*	Amount	%*
Commercial and industrial	$ 807	17.9	$ 577	12.3	$ 778	13.3	$ 653	13.0	$ 540	11.6
Construction and land development	594	7.2	569	7.1	700	8.4	734	8.7	812	9.7
Commercial real estate	3,169	55.2	2,289	58.6	2,218	54.9	2,126	52.7	2,071	51.0
Residential real estate	944	18.2	813	20.1	946	21.5	1,071	23.5	1,107	25.7
Consumer installment	104	1.5	138	1.9	148	1.9	173	2.1	113	2.0
Total allowance for loan losses	$ 5,618		$ 4,386		$ 4,790		$ 4,757		$ 4,643	

* Loan balance in each category expressed as a percentage of total loans.

Table 9 - CDs and Other Time Deposits of $100,000 or More

(Dollars in thousands)		December 31, 2020
Maturity of:		
3 months or less	$	6,417
Over 3 months through 6 months		7,965
Over 6 months through 12 months		42,978
Over 12 months		48,121
Total CDs and other time deposits of $100,000 or more	$	105,481

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the direction of the Company's Chief Executive Officer and Chief Financial Officer, management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2020 in accordance with the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control – Integrated Framework (2013). Based on this assessment, management has concluded that such internal control over financial reporting was effective as of December 31, 2020.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to the final rules of the Securities and Exchange Commission that permit the Company to provide only a management's report in this annual report.

Changes in Internal Control Over Financial Reporting

During the period covered by this report, there has not been any change in the Company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Auburn National Bancorporation, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Auburn National Bancorporation, Inc. and its subsidiaries (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements and schedules (collectively, the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Allowance for Loan Losses

As described in Note 5 to the Company's consolidated financial statements, the Company has a gross loan portfolio of $462.5 million and related allowance for loan losses of $5.6 million as of December 31, 2020. As described by the Company in Note 1, the evaluation of the allowance for loan losses is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a regular basis and is based upon the Company's review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions.

We identified the Company’s estimate of the allowance for loan losses as a critical audit matter. The principal considerations for our determination of the allowance for loan losses as a critical audit matter related to the high degree of subjectivity in the Company’s judgments in determining the qualitative factors. Auditing these complex judgments and assumptions by the Company involves especially challenging auditor judgment due to the nature and extent of audit evidence and effort required to address these matters, including the extent of specialized skill or knowledge needed.

The primary procedures we performed to address this critical audit matter included:

- We evaluated the relevance and the reasonableness of assumptions related to evaluation of the loan portfolio, current economic conditions, and other risk factors used in development of the qualitative factors for collectively evaluated loans.
- We evaluated the reasonableness of assumptions and data used by the Company in developing the qualitative factors by comparing these data points to internally developed and third-party sources, and other audit evidence gathered.

Elliott Davis, LLC

We have served as the Company's auditor since 2015.

Greenville, South Carolina
March 9, 2021

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31	
(Dollars in thousands, except share data)	**2020**	**2019**
Assets:		
Cash and due from banks	$ 14,868	$ 15,172
Federal funds sold	28,557	25,944
Interest bearing bank deposits	69,150	51,327
Cash and cash equivalents	112,575	92,443
Securities available-for-sale	335,177	235,902
Loans held for sale	3,418	2,202
Loans, net of unearned income	461,700	460,901
Allowance for loan losses	(5,618)	(4,386)
Loans, net	456,082	456,515
Premises and equipment, net	22,193	14,743
Bank-owned life insurance	19,232	19,202
Other assets	7,920	6,872
Total assets	$ 956,597	$ 827,879
Liabilities:		
Deposits:		
Noninterest-bearing	$ 245,398	$ 196,218
Interest-bearing	594,394	527,934
Total deposits	839,792	724,152
Federal funds purchased and securities sold under agreements to repurchase	2,392	1,069
Accrued expenses and other liabilities	6,723	4,330
Total liabilities	848,907	729,551
Stockholders' equity:		
Preferred stock of $0.01 par value; authorized 200,000 shares; issued shares - none	—	—
Common stock of $0.01 par value; authorized 8,500,000 shares; issued 3,957,135 shares	39	39
Additional paid-in capital	3,789	3,784
Retained earnings	105,617	101,801
Accumulated other comprehensive income, net	7,599	2,059
Less treasury stock, at cost - 390,859 shares and 390,989 shares at December 31, 2020 and 2019, respectively	(9,354)	(9,355)
Total stockholders' equity	107,690	98,328
Total liabilities and stockholders' equity	$ 956,597	$ 827,879

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Earnings

(Dollars in thousands, except share and per share data)	Year ended December 31 2020		2019	
Interest income:				
Loans, including fees	$	22,055	$	22,930
Securities:				
Taxable		3,932		4,000
Tax-exempt		1,851		2,099
Federal funds sold and interest bearing bank deposits		356		1,218
Total interest income		28,194		30,247
Interest expense:				
Deposits		3,847		4,176
Short-term borrowings		9		7
Total interest expense		3,856		4,183
Net interest income		24,338		26,064
Provision for loan losses		1,100		(250)
Net interest income after provision for loan losses		23,238		26,314
Noninterest income:				
Service charges on deposit accounts		585		717
Mortgage lending		2,319		866
Bank-owned life insurance		724		437
Gain from loan guarantee program		—		1,717
Other		1,644		1,880
Securities gains (losses), net		103		(123)
Total noninterest income		5,375		5,494
Noninterest expense:				
Salaries and benefits		11,316		11,931
Net occupancy and equipment		2,511		1,907
Professional fees		1,052		1,014
FDIC and other regulatory assessments		256		181
Other		4,419		4,664
Total noninterest expense		19,554		19,697
Earnings before income taxes		9,059		12,111
Income tax expense		1,605		2,370
Net earnings	$	7,454	$	9,741
Net earnings per share:				
Basic and diluted	$	2.09	$	2.72
Weighted average shares outstanding:				
Basic and diluted		3,566,207		3,581,476

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

	Year ended December 31	
(Dollars in thousands)	**2020**	**2019**
Net earnings	$ 7,454	$ 9,741
Other comprehensive income, net of tax:		
Unrealized net holding gain on securities	5,617	5,730
Reclassification adjustment for net (gain) loss on securities recognized in net earnings	(77)	92
Other comprehensive income	5,540	5,822
Comprehensive income	$ 12,994	$ 15,563

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity

(Dollars in thousands, except share data)	Common Shares Outstanding	Common Stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Total
Balance, December 31, 2018	3,643,868	$ 39	3,779	95,635	(3,763)	(6,635)	$ 89,055
Net earnings	—	—	—	9,741	—	—	9,741
Other comprehensive income	—	—	—	—	5,822	—	5,822
Cash dividends paid ($1.00 per share)	—	—	—	(3,575)	—	—	(3,575)
Stock repurchases	(77,907)	—	—	—	—	(2,721)	(2,721)
Sale of treasury stock	185	—	5	—	—	1	6
Balance, December 31, 2019	3,566,146	$ 39	$ 3,784	$ 101,801	$ 2,059	$ (9,355)	$ 98,328
Net earnings	—	—	—	7,454	—	—	7,454
Other comprehensive income	—	—	—	—	5,540	—	5,540
Cash dividends paid ($0.96 per share)	—	—	—	(3,638)	—	—	(3,638)
Sale of treasury stock	130	—	5	—	—	1	6
Balance, December 31, 2020	3,566,276	$ 39	$ 3,789	$ 105,617	$ 7,599	$ (9,354)	$ 107,690

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Year ended December 31	
(In thousands)	**2020**	**2019**
Cash flows from operating activities:		
Net earnings	$ 7,454	$ 9,741
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	1,100	(250)
Depreciation and amortization	1,666	1,157
Premium amortization and discount accretion, net	2,862	1,853
Deferred tax benefit	(330)	(153)
Net (gain) loss on securities available for sale	(103)	123
Net gain on sale of loans held for sale	(2,300)	(545)
Net gain on other real estate owned	(52)	(59)
Loans originated for sale	(82,726)	(30,407)
Proceeds from sale of loans	83,138	28,892
Increase in cash surrender value of bank owned life insurance	(442)	(437)
Income recognized from death benefit on bank-owned life insurance	(282)	—
Net increase in other assets	(2,656)	(872)
Net increase in accrued expenses and other liabilities	2,399	1,807
Net cash provided by operating activities	$ 9,728	$ 10,850
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	21,029	36,462
Proceeds from maturities of securities available-for-sale	62,021	55,078
Purchase of securities available-for-sale	(177,686)	(81,843)
(Increase) decrease in loans, net	(766)	15,771
Net purchases of premises and equipment	(8,355)	(1,809)
(Increase) decrease in FHLB stock	(9)	32
Proceeds from bank-owned life insurance death benefit	694	—
Proceeds from sale of other real estate owned	151	394
Net cash (used in) provided by investing activities	$ (102,921)	$ 24,085
Cash flows from financing activities:		
Net increase (decrease) in noninterest-bearing deposits	49,180	(5,430)
Net increase in interest-bearing deposits	66,460	5,389
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	1,323	(1,231)
Stock repurchases	—	(2,721)
Dividends paid	(3,638)	(3,575)
Net cash provided by (used in) financing activities	$ 113,325	$ (7,568)
Net change in cash and cash equivalents	$ 20,132	$ 27,367
Cash and cash equivalents at beginning of period	92,443	65,076
Cash and cash equivalents at end of period	$ 112,575	$ 92,443
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	$ 4,055	$ 4,092
Income taxes	678	2,295
Gain from loan guarantee program	—	(1,717)
Supplemental disclosure of non-cash transactions:		
Initial recognition of operating lease right of use assets	$ —	$ 891
Initial recognition of operating lease liabilities	—	889
Real estate acquired through foreclosure	99	82

See accompanying notes to consolidated financial statements

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Auburn National Bancorporation, Inc. (the "Company") is a bank holding company whose primary business is conducted by its wholly-owned subsidiary, AuburnBank (the "Bank"). AuburnBank is a commercial bank located in Auburn, Alabama. The Bank provides a full range of banking services in its primary market area, Lee County, which includes the Auburn-Opelika Metropolitan Statistical Area.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Significant intercompany transactions and accounts are eliminated in consolidation.

COVID-19 Uncertainty

COVID-19 has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. Following the COVID-19 outbreak in December 2019 and January 2020, market interest rates declined significantly. The federal banking agencies encouraged financial institutions to prudently work with borrowers and passed legislation to provide relief from reporting loan classifications due to modifications related to the COVID-19 outbreak. The spread of COVID-19 has caused us to modify our business practices, including employee travel, employee work locations, and cancellation of physical participation in meetings, events and conferences. The rapid development and fluidity of this situation precludes any predication as to the ultimate impact of the COVID-19 outbreak. Nevertheless, the outbreak presents uncertainty and risk with respect to the Company, its performance, and its financial results.

Revenue Recognition

On January 1, 2018, the Company implemented ASU 2014-09, *Revenue from Contracts with Customers*, codified at *ASC* 606. The Company adopted ASC 606 using the modified retrospective transition method. The majority of the Company's revenue stream is generated from interest income on loans and deposits which are outside the scope of ASC 606.

The Company's sources of income that fall within the scope of ASC 606 include service charges on deposits, investment services, interchange fees and gains and losses on sales of other real estate, all of which are presented as components of noninterest income. The following is a summary of the revenue streams that fall within the scope of ASC 606:
Service charges on deposits, investment services, ATM and interchange fees – Fees from these services are either transaction-based, for which the performance obligations are satisfied when the individual transaction is processed, or set periodic service charges, for which the performance obligations are satisfied over the period the service is provided. Transaction-based fees are recognized at the time the transaction is processed, and periodic service charges are recognized over the service period.

Gains on sales of other real estate – A gain on sale should be recognized when a contract for sale exists and control of the asset has been transferred to the buyer. ASC 606 lists several criteria required to conclude that a contract for sale exists, including a determination that the institution will collect substantially all of the consideration to which it is entitled. In addition to the loan-to-value, the analysis is based on various other factors, including the credit quality of the borrower, the structure of the loan, and any other factors that may affect collectability.

Use of Estimates

The preparation of 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 the disclosure of contingent assets and liabilities as of the balance sheet date and the reported amounts of income and expense during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses, fair value measurements, valuation of other real estate owned, and valuation of deferred tax assets.

Change in Accounting Estimate

During the fourth quarter of 2019, the Company reassessed its estimate of the useful lives of certain fixed assets. The Company revised its original useful life estimate for certain land improvements, buildings and improvements and furniture, fixtures and equipment, with a carrying value of $0.5 million at December 31, 2019, to correspond with estimated demolition dates planned as part of the redevelopment project for our main campus. This is considered a change in accounting estimate, per ASC 250-10, where adjustments should be made prospectively. The effects of this change in accounting estimate on the 2020 and 2019 consolidated financial statements, respectively, was a decrease in net earnings of $342 thousand, or $0.10 per share and $161 thousand, or $0.04 per share.

Reclassifications

Certain amounts reported in the prior period have been reclassified to conform to the current-period presentation. These reclassifications had no impact on the Company's previously reported net earnings or total stockholders' equity.

Subsequent Events

The Company has evaluated the effects of events or transactions through the date of this filing that have occurred subsequent to December 31, 2020. The Company does not believe there are any material subsequent events that would require further recognition or disclosure.

Accounting Standards Adopted in 2020

In 2020, the Company adopted new guidance related to the following Accounting Standards Update ("Update" or "ASU"):

- ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*; and

- ASU 2018-15, *Intangibles – Goodwill and Other – Internal Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract.*

Information about these pronouncements is described in more detail below.

ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement,* improves the disclosure requirements on fair value measurements by eliminating the requirements to disclose (i) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; (ii) the policy for timing of transfers between levels; and (iii) the valuation processes for Level 3 fair value measurements. This ASU also added specific disclosure requirements for fair value measurements for public entities including the requirement to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements.

The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2019, and all interim periods within those fiscal years. Early adoption was permitted upon issuance of the ASU. Entities are permitted to early adopt amendments that remove or modify disclosures and delay the adoption of the additional disclosures until their effective date. The Company adopted this ASU on January 1, 2020. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

ASU 2018-15, *Intangibles – Goodwill and Other – Internal Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract* aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include internal-use software license). This ASU requires entities to use the guidance in FASB ASC 350-40, Intangibles - Goodwill and Other - Internal Use Software, to determine whether to capitalize or expense implementation costs related to the service contract. This ASU also requires entities to (i) expense capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement; (ii) present the expense related to the capitalized implementation costs in the same line item on the income statement as fees associated with the hosting element of the arrangement; (iii) classify payments for capitalized implementation costs in the statement of cash flows in the same manner as payments made for fees associated with the hosting element; and (iv) present the capitalized implementation costs in the same balance sheet line item that a prepayment for the fees associated with the hosting arrangement would be presented.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption was permitted. The Company adopted this ASU on January 1, 2020. Adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Cash Equivalents

Cash equivalents include cash on hand, cash items in process of collection, amounts due from banks, including interest bearing deposits with other banks, and federal funds sold.

Securities

Securities are classified based on management's intention at the date of purchase. At December 31, 2020, all of the Company's securities were classified as available-for-sale. Securities available-for-sale are used as part of the Company's interest rate risk management strategy, and they may be sold in response to changes in interest rates, changes in prepayment risks or other factors. All securities classified as available-for-sale are recorded at fair value with any unrealized gains and losses reported in accumulated other comprehensive income (loss), net of the deferred income tax effects. Interest and dividends on securities, including the amortization of premiums and accretion of discounts are recognized in interest income using the effective interest method. Premiums are amortized to the earliest call date while discounts are accreted over the estimated life of the security. Realized gains and losses from the sale of securities are determined using the specific identification method.

On a quarterly basis, management makes an assessment to determine whether there have been events or economic circumstances to indicate that a security on which there is an unrealized loss is other-than-temporarily impaired.

For debt securities with an unrealized loss, an other-than-temporary impairment write-down is triggered when (1) the Company has the intent to sell a debt security, (2) it is more likely than not that the Company will be required to sell the debt security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the debt security. If the Company has the intent to sell a debt security or if it is more likely than not that it will be required to sell the debt security before recovery, the other-than-temporary write-down is equal to the entire difference between the debt security's amortized cost and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings, as a realized loss in securities gains (losses), and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income, net of applicable taxes.

Loans held for sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Loan sales are recognized when the transaction closes, the proceeds are collected, and ownership is transferred. Continuing involvement, through the sales agreement, consists of the right to service the loan for a fee for the life of the loan, if applicable. Gains on the sale of loans held for sale are recorded net of related costs, such as commissions, and reflected as a component of mortgage lending income in the consolidated statements of earnings.

In the course of conducting the Bank's mortgage lending activities of originating mortgage loans and selling those loans in the secondary market, the Bank makes various representations and warranties to the purchaser of the mortgage loans. Every loan closed by the Bank's mortgage center is run through a government agency automated underwriting system. Any exceptions noted during this process are remedied prior to sale. These representations and warranties also apply to underwriting the real estate appraisal opinion of value for the collateral securing these loans. Failure by the Company to comply with the underwriting and/or appraisal standards could result in the Company being required to repurchase the mortgage loan or to reimburse the investor for losses incurred (make whole requests) if such failure cannot be cured by the Company within the specified period following discovery.

Loans

Loans are reported at their outstanding principal balances, net of any unearned income, charge-offs, and any deferred fees or costs on originated loans. Interest income is accrued based on the principal balance outstanding. Loan origination fees, net of certain loan origination costs, are deferred and recognized in interest income over the contractual life of the loan using the effective interest method. Loan commitment fees are generally deferred and amortized on a straight-line basis over the commitment period, which results in a recorded amount that approximates fair value.

The accrual of interest on loans is discontinued when there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or the principal or interest is more than 90 days past due, unless the loan is both well-collateralized and in the process of collection. Generally, all interest accrued but not collected for loans that are placed on nonaccrual status is reversed against current interest income. Interest collections on nonaccrual loans are generally applied as principal reductions. The Company determines past due or delinquency status of a loan based on contractual payment terms.

A loan is considered impaired when it is probable the Company will be unable to collect all principal and interest payments due according to the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as part of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the provision for loan losses.

Impaired loans also include troubled debt restructurings ("TDRs"). In the normal course of business, management may grant concessions to borrowers who are experiencing financial difficulty. The concessions granted most frequently for TDRs involve reductions or delays in required payments of principal and interest for a specified time, the rescheduling of payments in accordance with a bankruptcy plan or the charge-off of a portion of the loan. In most cases, the conditions of the credit also warrant nonaccrual status, even after the restructuring occurs. As part of the credit approval process, the restructured loans are evaluated for adequate collateral protection in determining the appropriate accrual status at the time of restructuring. TDR loans may be returned to accrual status if there has been at least a six-month sustained period of repayment performance by the borrower.

The Company began offering short-term loan modifications to assist borrowers during the COVID-19 pandemic. If the modification meets certain conditions, the modification does not need to be accounted for as a TDR. For more information, please refer to Note 5, Loans and Allowance for Loan Losses.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management believes is adequate to absorb probable losses inherent in the loan portfolio. Loan losses are charged against the allowance when they are known. Subsequent recoveries are credited to the allowance. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, growth, composition of the loan portfolio, homogeneous pools of loans, risk ratings of specific loans, historical loan loss factors, identified impaired loans and other factors related to the portfolio. This evaluation is performed quarterly and is inherently subjective, as it requires various material estimates that are susceptible to significant change, including the amounts and timing of future cash flows expected to be received on any impaired loans. In addition, regulatory agencies, as an integral part of their examination process, will periodically review the Company's allowance for loan losses, and may require the Company to record additions to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Land is carried at cost. Land improvements, buildings and improvements, and furniture, fixtures, and equipment are carried at cost, less accumulated depreciation computed on a straight-line method over the useful lives of the assets or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured.

Nonmarketable equity investments

Nonmarketable equity investments include equity securities that are not publicly traded and securities acquired for various purposes. The Bank is required to maintain certain minimum levels of equity investments with certain regulatory and other entities in which the Bank has an ongoing business relationship based on the Bank's common stock and surplus (with regard to the relationship with the Federal Reserve Bank) or outstanding borrowings (with regard to the relationship with the Federal Home Loan Bank of Atlanta). These nonmarketable equity securities are accounted for at cost which equals par or redemption value. These securities do not have a readily determinable fair value as their ownership is restricted and there is no market for these securities. These securities can only be redeemed or sold at their par value and only to the respective issuing government supported institution or to another member institution. The Company records these nonmarketable equity securities as a component of other assets, which are periodically evaluated for impairment. Management considers these nonmarketable equity securities to be long-term investments. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

Transfers of Financial Assets

Transfers of an entire financial asset (i.e. loan sales), a group of entire financial assets, or a participating interest in an entire financial asset (i.e. loan participations sold) are accounted for as sales when control over the assets have been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking 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.

Mortgage Servicing Rights

The Company recognizes as assets the rights to service mortgage loans for others, known as MSRs. The Company determines the fair value of MSRs at the date the loan is transferred. An estimate of the Company's MSRs is determined using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees.

Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Under the amortization method, MSRs are amortized in proportion to, and over the period of, estimated net servicing income. The amortization of MSRs is analyzed monthly and is adjusted to reflect changes in prepayment speeds, as well as other factors. MSRs are evaluated for impairment based on the fair value of those assets. Impairment is determined by stratifying MSRs into groupings based on predominant risk characteristics, such as interest rate and loan type. If, by individual stratum, the carrying amount of the MSRs exceeds fair value, a valuation allowance is established through a charge to earnings. The valuation allowance is adjusted as the fair value changes. MSRs are included in the other assets category in the accompanying consolidated balance sheets.

Securities sold under agreements to repurchase

Securities sold under agreements to repurchase generally mature less than one year from the transaction date. Securities sold under agreements to repurchase are reflected as a secured borrowing in the accompanying consolidated balance sheets at the amount of cash received in connection with each transaction.

Income Taxes

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. The net deferred tax asset is reflected as a component of other assets in the accompanying consolidated balance sheets.

Income tax expense or benefit for the year is allocated among continuing operations and other comprehensive income (loss), as applicable. The amount allocated to continuing operations is the income tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of (1) changes in certain circumstances that cause a change in judgment about the realization of deferred tax assets in future years, (2) changes in income tax laws or rates, and (3) changes in income tax status, subject to certain exceptions. The amount allocated to other comprehensive income (loss) is related solely to changes in the valuation allowance on items that are normally accounted for in other comprehensive income (loss) such as unrealized gains or losses on available-for-sale securities.

In accordance with ASC 740, *Income Taxes*, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. It is the Company's policy to recognize interest and penalties related to income tax matters in income tax expense. The Company and its wholly-owned subsidiaries file a consolidated income tax return.

Fair Value Measurements

ASC 820, *Fair Value Measurements,* which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. ASC 820 applies only to fair-value measurements that are already required or permitted by other accounting standards. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. For more information related to fair value measurements, please refer to Note 15, Fair Value.

NOTE 2: BASIC AND DILUTED NET EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the year. Diluted net earnings per share reflect the potential dilution that could occur upon exercise of securities or other rights for, or convertible into, shares of the Company's common stock. As of December 31, 2020 and 2019, respectively, the Company had no such securities or other rights issued or outstanding, and therefore, no dilutive effect to consider for the diluted net earnings per share calculation.

The basic and diluted net earnings per share computations for the respective years are presented below.

	Year ended December 31	
(Dollars in thousands, except share and per share data)	**2020**	**2019**
Basic and diluted:		
Net earnings	$ 7,454	$ 9,741
Weighted average common shares outstanding	3,566,207	3,581,476
Net earnings per share	$ 2.09	$ 2.72

NOTE 3: RESTRICTED CASH BALANCES

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank ("FRB") based principally on the type and amount of their deposits. Effective March 26, 2020, the FRB no longer requires banks to maintain reserve balances on deposit with the FRB. The Bank did not have a required reserve balance at the FRB at December 31, 2019.

NOTE 4: SECURITIES

At December 31, 2020 and 2019, respectively, all securities within the scope of ASC 320, *Investments – Debt and Equity Securities* were classified as available-for-sale. The fair value and amortized cost for securities available-for-sale by contractual maturity at December 31, 2020 and 2019, respectively, are presented below.

(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost
December 31, 2020								
Agency obligations (a)	$ 5,048	24,834	55,367	12,199	97,448	3,156	98	$ 94,390
Agency MBS (a)	—	1,154	20,502	141,814	163,470	3,245	133	160,358
State and political subdivisions	477	632	8,405	64,745	74,259	3,988	11	70,282
Total available-for-sale	$ 5,525	26,620	84,274	218,758	335,177	10,389	242	$ 325,030
December 31, 2019								
Agency obligations (a)	$ 4,993	27,245	18,470	—	50,708	215	98	$ 50,591
Agency MBS (a)	—	560	4,510	118,207	123,277	798	261	$ 122,740
State and political subdivisions	—	1,355	6,166	54,396	61,917	2,104	9	$ 59,822
Total available-for-sale	$ 4,993	29,160	29,146	172,603	235,902	3,117	368	$ 233,153

(a) Includes securities issued by U.S. government agencies or government sponsored entities. Expected maturities of these securities may differ from contractual maturities because issues may have the right to call or repay obligations with or without prepayment penalties.

Securities with aggregate fair values of $166.9 million and $147.8 million at December 31, 2020 and 2019, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, Federal Home Loan Bank ("FHLB") advances, and for other purposes required or permitted by law.

Included in other assets on the accompanying consolidated balance sheets are nonmarketable equity investments. The carrying amounts of nonmarketable equity investments were $1.4 million at December 31, 2020 and 2019, respectively. Nonmarketable equity investments include FHLB of Atlanta stock, Federal Reserve Bank ("FRB") stock, and stock in a privately held financial institution.

Gross Unrealized Losses and Fair Value

The fair values and gross unrealized losses on securities at December 31, 2020 and 2019, respectively, segregated by those securities that have been in an unrealized loss position for less than 12 months and 12 months or more are presented below.

	Less than 12 Months		12 Months or Longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2020:						
Agency obligations	$ 15,416	98	—	—	15,416	$ 98
Agency MBS	41,488	133	—	—	41,488	133
State and political subdivisions	2,945	11	—	—	2,945	11
Total	$ 59,849	242	—	—	59,849	$ 242
December 31, 2019:						
Agency obligations	$ 24,734	97	4,993	1	29,727	$ 98
Agency MBS	40,126	98	21,477	163	61,603	261
State and political subdivisions	2,741	9	—	—	2,741	9
Total	$ 67,601	204	26,470	164	94,071	$ 368

For the securities in the previous table, the Company does not have the intent to sell and has determined it is not more likely than not that the Company will be required to sell the security before recovery of the amortized cost basis, which may be maturity. On a quarterly basis, the Company assesses each security for credit impairment. For debt securities, the Company evaluates, where necessary, whether credit impairment exists by comparing the present value of the expected cash flows to the securities' amortized cost basis.

In determining whether a loss is temporary, the Company considers all relevant information including:

- the length of time and the extent to which the fair value has been less than the amortized cost basis;
- adverse conditions specifically related to the security, an industry, or a geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement);
- the historical and implied volatility of the fair value of the security;
- the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future;
- failure of the issuer of the security to make scheduled interest or principal payments;
- any changes to the rating of the security by a rating agency; and
- recoveries or additional declines in fair value subsequent to the balance sheet date.

Agency obligations

The unrealized losses associated with agency obligations were primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities were issued by U.S. government agencies or government-sponsored entities and did not have any credit losses given the explicit government guarantee or other government support.

Agency mortgage-backed securities ("MBS")

The unrealized losses associated with agency MBS were primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities were issued by U.S. government agencies or government-sponsored entities and did not have any credit losses given the explicit government guarantee or other government support.

Securities of U.S. states and political subdivisions

The unrealized losses associated with securities of U.S. states and political subdivisions were primarily driven by changes in interest rates and were not due to the credit quality of the securities. Some of these securities are guaranteed by a bond insurer, but management did not rely on the guarantee in making its investment decision. These securities will continue to be monitored as part of the Company's quarterly impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond insurers. As a result, the Company expects to recover the entire amortized cost basis of these securities.

The carrying values of the Company's investment securities could decline in the future if the financial condition of an issuer deteriorates and the Company determines it is probable that it will not recover the entire amortized cost basis for the security. As a result, there is a risk that other-than-temporary impairment charges may occur in the future.

Other-Than-Temporarily Impaired Securities

Credit-impaired debt securities are debt securities where the Company has written down the amortized cost basis of a security for other-than-temporary impairment and the credit component of the loss is recognized in earnings. At December 31, 2020 and 2019, respectively, the Company had no credit-impaired debt securities and there were no additions or reductions in the credit loss component of credit-impaired debt securities during the years ended December 31, 2020 and 2019, respectively.

Realized Gains and Losses

The following table presents the gross realized gains and losses on sales related to securities.

		Year ended December 31	
(Dollars in thousands)		**2020**	**2019**
Gross realized gains	$	184	120
Gross realized losses		(81)	(243)
Realized gains (losses), net	$	103	(123)

NOTE 5: LOANS AND ALLOWANCE FOR LOAN LOSSES

		December 31		
(In thousands)		**2020**		**2019**
Commercial and industrial	$	82,585	$	56,782
Construction and land development		33,514		32,841
Commercial real estate:				
Owner occupied		54,033		48,860
Hotel/motel		42,900		43,719
Multifamily		40,203		44,839
Other		118,000		132,900
Total commercial real estate		255,136		270,318
Residential real estate:				
Consumer mortgage		35,027		48,923
Investment property		49,127		43,652
Total residential real estate		84,154		92,575
Consumer installment		7,099		8,866
Total loans		462,488		461,382
Less: unearned income		(788)		(481)
Loans, net of unearned income	$	461,700	$	460,901

Loans secured by real estate were approximately 80.6% of the total loan portfolio at December 31, 2020. At December 31, 2020, the Company's geographic loan distribution was concentrated primarily in Lee County, Alabama and surrounding areas.

In accordance with ASC 310, *Receivables*, a portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. As part of the Company's quarterly assessment of the allowance, the loan portfolio is disaggregated into the following portfolio segments: commercial and industrial, construction and land development, commercial real estate, residential real estate and consumer installment. Where appropriate, the Company's loan portfolio segments are further disaggregated into classes. A class is generally determined based on the initial measurement attribute, risk characteristics of the loan, and an entity's method for monitoring and determining credit risk.

The following describe the risk characteristics relevant to each of the portfolio segments and classes.

Commercial and industrial ("C&I") — includes loans to finance business operations, equipment purchases, or other needs for small and medium-sized commercial customers. Also included in this category are loans to finance agricultural production. Generally, the primary source of repayment is the cash flow from business operations and activities of the borrower. We are a participating lender in the PPP. PPP loans are forgivable in whole or in part, if the proceeds are used for payroll and other permitted purposes in accordance with the requirements of the PPP. As of December 31, 2020, the Company has 265 PPP loans with an aggregate outstanding principal balance of $19.0 million included in this category.

Construction and land development ("C&D") — includes both loans and credit lines for the purpose of purchasing, carrying and developing land into commercial developments or residential subdivisions. Also included are loans and lines for construction of residential, multi-family and commercial buildings. Generally the primary source of repayment is dependent upon the sale or refinance of the real estate collateral.

Commercial real estate ("CRE") — includes loans disaggregated into three classes: (1) owner occupied (2) multi-family and (3) other.

Owner occupied – includes loans secured by business facilities to finance business operations, equipment and owner-occupied facilities primarily for small and medium-sized commercial customers. Generally the primary source of repayment is the cash flow from business operations and activities of the borrower, who owns the property.

Hotel/motel – includes loans for hotels and motels. Generally, the primary source of repayment is dependent upon income generated from the real estate collateral. The underwriting of these loans takes into consideration the occupancy and rental rates, as well as the financial health of the borrower.

Multifamily – primarily includes loans to finance income-producing multi-family properties. Loans in this class include loans for 5 or more unit residential property and apartments leased to residents. Generally, the primary source of repayment is dependent upon income generated from the real estate collateral. The underwriting of these loans takes into consideration the occupancy and rental rates, as well as the financial health of the borrower.

Other – primarily includes loans to finance income-producing commercial properties. Loans in this class include loans for neighborhood retail centers, hotels, medical and professional offices, single retail stores, industrial buildings, and warehouses leased generally to local businesses and residents. Generally the primary source of repayment is dependent upon income generated from the real estate collateral. The underwriting of these loans takes into consideration the occupancy and rental rates as well as the financial health of the borrower.

Residential real estate ("RRE") — includes loans disaggregated into two classes: (1) consumer mortgage and (2) investment property.

Consumer mortgage – primarily includes first or second lien mortgages and home equity lines to consumers that are secured by a primary residence or second home. These loans are underwritten in accordance with the Bank's general loan policies and procedures which require, among other things, proper documentation of each borrower's financial condition, satisfactory credit history and property value.

Investment property – primarily includes loans to finance income-producing 1-4 family residential properties. Generally, the primary source of repayment is dependent upon income generated from leasing the property securing the loan. The underwriting of these loans takes into consideration the rental rates as well as the financial health of the borrower.

Consumer installment — includes loans to individuals both secured by personal property and unsecured. Loans include personal lines of credit, automobile loans, and other retail loans. These loans are underwritten in accordance with the Bank's general loan policies and procedures which require, among other things, proper documentation of each borrower's financial condition, satisfactory credit history, and if applicable, property value.

The following is a summary of current, accruing past due and nonaccrual loans by portfolio class as of December 31, 2020 and 2019.

(In thousands)	Current	Accruing 30-89 Days Past Due	Accruing Greater than 90 days	Total Accruing Loans	Non-Accrual	Total Loans
December 31, 2020:						
Commercial and industrial	$ 82,355	230	—	82,585	—	$ 82,585
Construction and land development	33,453	61	—	33,514	—	33,514
Commercial real estate:						
Owner occupied	54,033	—	—	54,033	—	54,033
Hotel/motel	42,900	—	—	42,900	—	42,900
Multifamily	40,203	—	—	40,203	—	40,203
Other	117,759	29	—	117,788	212	118,000
Total commercial real estate	254,895	29	—	254,924	212	255,136
Residential real estate:						
Consumer mortgage	33,169	1,503	140	34,812	215	35,027
Investment property	49,014	6	—	49,020	107	49,127
Total residential real estate	82,183	1,509	140	83,832	322	84,154
Consumer installment	7,069	29	1	7,099	—	7,099
Total	$ 459,955	1,858	141	461,954	534	$ 462,488
December 31, 2019:						
Commercial and industrial	$ 56,758	24	—	56,782	—	$ 56,782
Construction and land development	32,385	456	—	32,841	—	32,841
Commercial real estate:						
Owner occupied	48,860	—	—	48,860	—	48,860
Hotel/motel	43,719	—	—	43,719	—	43,719
Multifamily	44,839	—	—	44,839	—	44,839
Other	132,900	—	—	132,900	—	132,900
Total commercial real estate	270,318	—	—	270,318	—	270,318
Residential real estate:						
Consumer mortgage	47,151	1,585	—	48,736	187	48,923
Investment property	43,629	23	—	43,652	—	43,652
Total residential real estate	90,780	1,608	—	92,388	187	92,575
Consumer installment	8,802	64	—	8,866	—	8,866
Total	$ 459,043	2,152	—	461,195	187	$ 461,382

The gross interest income which would have been recorded under the original terms of those nonaccrual loans had they been accruing interest, amounted to approximately $20 thousand and $9 thousand for the years ended December 31, 2020 and 2019, respectively.

Allowance for Loan Losses

The allowance for loan losses as of and for the years ended December 31, 2020 and 2019, is presented below.

	Year ended December 31	
(In thousands)	**2020**	**2019**
Beginning balance	$ 4,386	$ 4,790
Charged-off loans	(45)	(408)
Recovery of previously charged-off loans	177	254
Net recoveries (charge-offs)	132	(154)
Provision for loan losses	1,100	(250)
Ending balance	$ 5,618	$ 4,386

The Company assesses the adequacy of its allowance for loan losses prior to the end of each calendar quarter. The level of the allowance is based upon management's evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan loss rates and other pertinent factors, including regulatory recommendations. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loans are charged off, in whole or in part, when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a "confirming event" has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

The Company deems loans impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan. The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs.

The level of allowance maintained is believed by management to be adequate to absorb probable losses inherent in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

In assessing the adequacy of the allowance, the Company also considers the results of its ongoing internal, independent loan review process. The Company's loan review process assists in determining whether there are loans in the portfolio whose credit quality has weakened over time and evaluating the risk characteristics of the entire loan portfolio. The Company's loan review process includes the judgment of management, the input from our independent loan reviewers, and reviews that may have been conducted by bank regulatory agencies as part of their examination process. The Company incorporates loan review results in the determination of whether or not it is probable that it will be able to collect all amounts due according to the contractual terms of a loan.

As part of the Company's quarterly assessment of the allowance, management divides the loan portfolio into five segments: commercial and industrial, construction and land development, commercial real estate, residential real estate, and consumer installment loans. The Company analyzes each segment and estimates an allowance allocation for each loan segment.

The allocation of the allowance for loan losses begins with a process of estimating the probable losses inherent for these types of loans. The estimates for these loans are established by category and based on the Company's internal system of credit risk ratings and historical loss data. The estimated loan loss allocation rate for the Company's internal system of credit risk grades is based on its experience with similarly graded loans. For loan segments where the Company believes it does not have sufficient historical loss data, the Company may make adjustments based, in part, on loss rates of peer bank groups. At December 31, 2020 and 2019, and for the years then ended, the Company adjusted its historical loss rates for the commercial real estate portfolio segment based, in part, on loss rates of peer bank groups.

The estimated loan loss allocation for all five loan portfolio segments is then adjusted for management's estimate of probable losses for several "qualitative and environmental" factors. The allocation for qualitative and environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and are based upon quarterly trend assessments in delinquent and nonaccrual loans, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These qualitative and environmental factors are considered for each of the five loan segments and the allowance allocation, as determined by the processes noted above, is increased or decreased based on the incremental assessment of these factors.

The Company regularly re-evaluates its practices in determining the allowance for loan losses. Since the fourth quarter of 2016, the Company has increased its look-back period each quarter to incorporate the effects of at least one economic downturn in its loss history. The Company believes the extension of its look-back period is appropriate due to the risks inherent in the loan portfolio. Absent this extension, the early cycle periods in which the Company experienced significant losses would be excluded from the determination of the allowance for loan losses and its balance would decrease. For the year ended December 31, 2020, the Company increased its look-back period to 47 quarters to continue to include losses incurred by the Company beginning with the first quarter of 2009. The Company will likely continue to increase its look-back period to incorporate the effects of at least one economic downturn in its loss history. During 2020, the Company adjusted certain qualitative and economic factors related to changes in economic conditions driven by the impact of the COVID-19 pandemic and resulting adverse economic conditions, including higher unemployment in our primary market area. Further adjustments may be made in the future as a result of the ongoing COVID-19 pandemic.

The following table details the changes in the allowance for loan losses by portfolio segment for the years ended December 31, 2020 and 2019.

(in thousands)		Commercial and industrial	Construction and land Development	Commercial Real Estate	Residential Real Estate	Consumer Installment		Total
Balance, December 31, 2018	$	778	700	2,218	946	148	$	4,790
Charge-offs		(364)	—	—	(6)	(38)		(408)
Recoveries		117	—	1	109	27		254
Net (charge-offs) recoveries		(247)	—	1	103	(11)		(154)
Provision		46	(131)	70	(236)	1		(250)
Balance, December 31, 2019	$	577	569	2,289	813	138	$	4,386
Charge-offs		(7)	—	—	—	(38)		(45)
Recoveries		94	—	—	63	20		177
Net recoveries (charge-offs)		87	—	—	63	(18)		132
Provision		143	25	880	68	(16)		1,100
Balance, December 31, 2020	$	807	594	3,169	944	104	$	5,618

The following table presents an analysis of the allowance for loan losses and recorded investment in loans by portfolio segment and impairment methodology as of December 31, 2020 and 2019.

		Collectively evaluated (1)		Individually evaluated (2)		Total	
(In thousands)		Allowance for loan losses	Recorded investment in loans	Allowance for loan losses	Recorded investment in loans	Allowance for loan losses	Recorded investment in loans
December 31, 2020:							
Commercial and industrial	$	807	82,585	—	—	807	82,585
Construction and land development		594	33,514	—	—	594	33,514
Commercial real estate		3,169	254,920	—	216	3,169	255,136
Residential real estate		944	84,047	—	107	944	84,154
Consumer installment		104	7,099	—	—	104	7,099
Total	$	5,618	462,165	—	323	5,618	462,488
December 31, 2019:							
Commercial and industrial	$	577	56,683	—	99	577	56,782
Construction and land development		569	32,841	—	—	569	32,841
Commercial real estate		2,289	270,318	—	—	2,289	270,318
Residential real estate		813	92,575	—	—	813	92,575
Consumer installment		138	8,866	—	—	138	8,866
Total	$	4,386	461,283	—	99	4,386	461,382

(1) Represents loans collectively evaluated for impairment in accordance with ASC 450-20, *Loss Contingencies* (formerly FAS 5), and pursuant to amendments by ASU 2010-20 regarding allowance for unimpaired loans.
(2) Represents loans individually evaluated for impairment in accordance with ASC 310-30, *Receivables* (formerly FAS 114), and pursuant to amendments by ASU 2010-20 regarding allowance for impaired loans.

Credit Quality Indicators

The credit quality of the loan portfolio is summarized no less frequently than quarterly using categories similar to the standard asset classification system used by the federal banking agencies. The following table presents credit quality indicators for the loan portfolio segments and classes. These categories are utilized to develop the associated allowance for loan losses using historical losses adjusted for qualitative and environmental factors and are defined as follows:

- Pass – loans which are well protected by the current net worth and paying capacity of the obligor (or guarantors, if any) or by the fair value, less cost to acquire and sell, of any underlying collateral.
- Special Mention – loans with potential weakness that may, if not reversed or corrected, weaken the credit or inadequately protect the Company's position at some future date. These loans are not adversely classified and do not expose an institution to sufficient risk to warrant an adverse classification.
- Substandard Accruing – loans that exhibit a well-defined weakness which presently jeopardizes debt repayment, even though they are currently performing. These loans are characterized by the distinct possibility that the Company may incur a loss in the future if these weaknesses are not corrected.
- Nonaccrual – includes loans where management has determined that full payment of principal and interest is in doubt.

(In thousands)		Pass	Special Mention	Substandard Accruing	Nonaccrual		Total loans
December 31, 2020							
Commercial and industrial	$	79,984	2,383	218	—	$	82,585
Construction and land development		33,260	—	254	—		33,514
Commercial real estate:							
Owner occupied		51,265	2,627	141	—		54,033
Hotel/motel		35,084	7,816	—	—		42,900
Multifamily		36,673	3,530	—	—		40,203
Other		116,498	1,243	47	212		118,000
Total commercial real estate		239,520	15,216	188	212		255,136
Residential real estate:							
Consumer mortgage		32,518	397	1,897	215		35,027
Investment property		48,501	187	332	107		49,127
Total residential real estate		81,019	584	2,229	322		84,154
Consumer installment		7,069	7	23	—		7,099
Total	$	440,852	18,190	2,912	534	$	462,488
December 31, 2019							
Commercial and industrial	$	54,340	2,176	266	—	$	56,782
Construction and land development		31,798	—	1,043	—		32,841
Commercial real estate:							
Owner occupied		47,865	917	78	—		48,860
Hotel/motel		43,719	—	—	—		43,719
Multifamily		44,839	—	—	—		44,839
Other		132,030	849	21	—		132,900
Total commercial real estate		268,453	1,766	99	—		270,318
Residential real estate:							
Consumer mortgage		45,247	962	2,527	187		48,923
Investment property		42,331	949	372	—		43,652
Total residential real estate		87,578	1,911	2,899	187		92,575
Consumer installment		8,742	60	64	—		8,866
Total	$	450,911	5,913	4,371	187	$	461,382

During the fourth quarter of 2019, the Company recognized a gain of $1.7 million resulting from the termination of a Loan Guarantee Program (the "Program") operated by the State of Alabama. The payment of $1.7 million received by the Company in October 2019 was recorded as a gain and included in noninterest income on the accompanying consolidated statements of earnings. The Program required a 1% fee on the commitment balance at origination and in return the Company received a guarantee of up to 50% of losses in the event of the borrower's default. The Company had 5 loans outstanding totaling $10.3 million that were enrolled in the Program prior to its termination by the State of Alabama. Despite being enrolled in the Program, these loans would have met the Company's normal loan underwriting criteria at origination. All of these loans were categorized as Pass within the Company's credit quality asset classification at the date of the Program's termination.

Impaired loans

The following table presents details related to the Company's impaired loans. Loans which have been fully charged-off do not appear in the following table. The related allowance generally represents the following components which correspond to impaired loans:

- Individually evaluated impaired loans equal to or greater than $500 thousand secured by real estate (nonaccrual construction and land development, commercial real estate, and residential real estate).

- Individually evaluated impaired loans equal to or greater than $250 thousand not secured by real estate (nonaccrual commercial and industrial and consumer loans).

The following table sets forth certain information regarding the Company's impaired loans that were individually evaluated for impairment at December 31, 2020 and 2019.

(In thousands)	December 31, 2020 Unpaid principal balance (1)	Charge-offs and payments applied (2)	Recorded investment (3)	Related allowance
With no allowance recorded:				
Commercial real estate:				
Other	$ 216	(4)	212	$ —
Total commercial real estate	216	(4)	212	—
Residential real estate:				
Investment property	109	(2)	107	—
Total residential real estate	109	(2)	107	—
Total impaired loans	$ 325	(6)	319	$ —

(1) Unpaid principal balance represents the contractual obligation due from the customer.
(2) Charge-offs and payments applied represents cumulative charge-offs taken, as well as interest payments that have been applied against the outstanding principal balance.
(3) Recorded investment represents the unpaid principal balance less charge-offs and payments applied; it is shown before any related allowance for loan losses.

(In thousands)	December 31, 2019 Unpaid principal balance (1)	Charge-offs and payments applied (2)	Recorded investment (3)	Related allowance
With no allowance recorded:				
Commercial and industrial	$ 335	(236)	99	$ —
Total impaired loans	$ 335	(236)	99	$ —

(1) Unpaid principal balance represents the contractual obligation due from the customer.
(2) Charge-offs and payments applied represents cumulative charge-offs taken, as well as interest payments that have been applied against the outstanding principal balance.
(3) Recorded investment represents the unpaid principal balance less charge-offs and payments applied; it is shown before any related allowance for loan losses.

The following table provides the average recorded investment in impaired loans and the amount of interest income recognized on impaired loans after impairment by portfolio segment and class.

(In thousands)	Year ended December 31, 2020 Average recorded investment	Total interest income recognized	Year ended December 31, 2019 Average recorded investment	Total interest income recognized
Impaired loans:				
Commercial and industrial	$ —	—	$ 8	—
Commercial real estate:				
Owner occupied	—	—	24	9
Other	116	—	—	—
Total commercial real estate	116	—	24	9
Residential real estate:				
Investment property	59	—	—	—
Total residential real estate	59	—	—	—
Total	$ 175	—	$ 32	9

Troubled Debt Restructurings

Impaired loans also include troubled debt restructurings ("TDRs"). Section 4013 of the CARES Act, "Temporary Relief From Troubled Debt Restructurings," provides banks the option to temporarily suspend certain requirements under ASC 340-10 TDR classifications for a limited period of time to account for the effects of COVID-19. In addition, the Interagency Statement on COVID-19 Loan Modifications, encourages banks to work prudently with borrowers and describes the agencies' interpretation of how accounting rules under ASC 310-40, "Troubled Debt Restructurings by Creditors," apply to certain COVID-19-related modifications. The Interagency Statement on COVID-19 Loan Modifications was supplemented on June 23, 2020 by the Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions. If a loan modification is eligible, a bank may elect to account for the loan under section 4013 of the CARES Act. If a loan modification is not eligible under section 4013, or if the bank elects not to account for the loan modification under section 4013, the Revised Statement includes criteria when a bank may presume a loan modification is not a TDR in accordance with ASC 310-40.

The Company evaluates loan extensions or modifications not qualified under Section 4013 of the CARES Act or under the Interagency Statement on COVID-19 Loan Modifications in accordance with FASB ASC 340-10 with respect to the classification of the loan as a TDR. In the normal course of business, management may grant concessions to borrowers that are experiencing financial difficulty. A concession may include, but is not limited to, delays in required payments of principal and interest for a specified period, reduction of the stated interest rate of the loan, reduction of accrued interest, extension of the maturity date, or reduction of the face amount or maturity amount of the debt. A concession has been granted when, as a result of the restructuring, the Bank does not expect to collect, when due, all amounts owed, including interest at the original stated rate. A concession may have also been granted if the debtor is not able to access funds elsewhere at a market rate for debt with similar risk characteristics as the restructured debt. In making the determination of whether a loan modification is a TDR, the Company considers the individual facts and circumstances surrounding each modification. As part of the credit approval process, the restructured loans are evaluated for adequate collateral protection in determining the appropriate accrual status at the time of restructure.

Similar to other impaired loans, TDRs are measured for impairment based on the present value of expected payments using the loan's original effective interest rate as the discount rate, or the fair value of the collateral, less selling costs if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, impairment is recognized by establishing a valuation allowance as part of the allowance for loan losses or a charge-off to the allowance for loan losses. In periods subsequent to the modification, all TDRs are evaluated individually, including those that have payment defaults, for possible impairment.

At December 31, 2019 the Company had no TDRs. The following is a summary of accruing and nonaccrual TDRs and the related loan losses, by portfolio segment and class at December 31, 2020.

	TDRs			
(In thousands)	Accruing	Nonaccrual	Total	Related Allowance
December 31, 2020				
Commercial real estate:				
Other	$ —	212	212	—
Total commercial real estate	—	212	212	—
Investment property	—	107	107	—
Total residential real estate	—	107	107	—
Total	$ —	319	319	$ —

At December 31, 2020, there were no significant outstanding commitments to advance additional funds to customers whose loans had been restructured.

There were no loans modified in a TDR during the year ended December 31, 2019. The following table summarizes loans modified in a TDR during the year ended December 31, 2020 both before and after modification.

($ in thousands)	Number of contracts		Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
December 31, 2020				
Commercial real estate:				
Other	1	$	216	216
Total commercial real estate	1		216	216
Investment property	3		111	111
Total residential real estate	3		111	111
Total	4	$	327	327

Four loans were modified in a TDR during the year ended December 31, 2020. The only concession granted by the Company was related to a delay in the required payment of principal and/or interest.

During the years ended December 31, 2020 and 2019, respectively, the Company had no loans modified in a TDR within the previous 12 months for which there was a payment default (defined as 90 days or more past due).

NOTE 6: PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2020 and 2019 is presented below

.

		December 31	
(Dollars in thousands)		2020	2019
Land and improvements	$	9,829	9,874
Buildings and improvements		7,436	9,987
Furniture, fixtures, and equipment		2,715	3,109
Construction in progress		8,171	107
Total premises and equipment		28,151	23,077
Less: accumulated depreciation		(5,958)	(8,334)
Premises and equipment, net	$	22,193	14,743

Depreciation expense was approximately $905 thousand and $662 thousand for the years ended December 31, 2020 and 2019, respectively, and is a component of net occupancy and equipment expense in the consolidated statements of earnings.

NOTE 7: MORTGAGE SERVICING RIGHTS, NET

MSRs are recognized based on the fair value of the servicing rights on the date the corresponding mortgage loans are sold. An estimate of the Company's MSRs is determined using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Under the amortization method, MSRs are amortized in proportion to, and over the period of, estimated net servicing income. Servicing fee income is recorded net of related amortization expense and recognized in earnings as part of mortgage lending income.

The Company has recorded MSRs related to loans sold without recourse to Fannie Mae. The Company generally sells conforming, fixed-rate, closed-end, residential mortgages to Fannie Mae. MSRs are included in other assets on the accompanying consolidated balance sheets.

The Company evaluates MSRs for impairment on a quarterly basis. Impairment is determined by stratifying MSRs into groupings based on predominant risk characteristics, such as interest rate and loan type. If, by individual stratum, the carrying amount of the MSRs exceeds fair value, a valuation allowance is established. The valuation allowance is adjusted as the fair value changes. Changes in the valuation allowance are recognized in earnings as a component of mortgage lending income.

The following table details the changes in amortized MSRs and the related valuation allowance for the years ended December 31, 2020 and 2019.

		Year ended December 31	
(Dollars in thousands)		**2020**	**2019**
Beginning balance	$	1,299	1,441
Additions, net		671	241
Amortization expense		(640)	(383)
Ending balance	$	1,330	1,299
Valuation allowance included in MSRs, net:			
Beginning of period	$	—	—
End of period		—	—
Fair value of amortized MSRs:			
Beginning of period	$	2,111	2,697
End of period		1,489	2,111

Data and assumptions used in the fair value calculation related to MSRs at December 31, 2020 and 2019, respectively, are presented below.

		December 31	
(Dollars in thousands)		**2020**	**2019**
Unpaid principal balance	$	265,964	274,227
Weighted average prepayment speed (CPR)		20.7 %	11.6
Discount rate (annual percentage)		10.0 %	10.0
Weighted average coupon interest rate		3.6 %	3.9
Weighted average remaining maturity (months)		253	255
Weighted average servicing fee (basis points)		25.0	25.0

At December 31, 2020, the weighted average amortization period for MSRs was 3.7 years. Estimated amortization expense for each of the next five years is presented below.

(Dollars in thousands)		**December 31, 2020**
2021	$	308
2022		227
2023		170
2024		129
2025		101

NOTE 8: DEPOSITS

At December 31, 2020, the scheduled maturities of certificates of deposit and other time deposits are presented below.

(Dollars in thousands)	December 31, 2020
2021	$ 88,292
2022	50,332
2023	12,572
2024	5,842
2025	3,363
Thereafter	—
Total certificates of deposit and other time deposits	$ 160,401

Additionally, at December 31, 2020 and 2019, approximately $55.0 million and $57.4 million, respectively, of certificates of deposit and other time deposits were issued in denominations greater than $250 thousand.

At December 31, 2020 and 2019, the amount of deposit accounts in overdraft status that were reclassified to loans on the accompanying consolidated balance sheets was not material.

NOTE 9: SHORT-TERM BORROWINGS

At December 31, 2020 and 2019, the composition of short-term borrowings is presented below.

	2020		2019	
(Dollars in thousands)	Amount	Weighted Avg. Rate	Amount	Weighted Avg. Rate
Federal funds purchased:				
As of December 31	$ —	—	$ —	—
Average during the year	1	0.78 %	1	2.58 %
Maximum outstanding at any month-end	—		—	
Securities sold under agreements to repurchase:				
As of December 31	$ 2,392	0.50 %	$ 1,069	0.50 %
Average during the year	1,822	0.50 %	1,442	0.50 %
Maximum outstanding at any month-end	2,496		2,261	

Federal funds purchased represent unsecured overnight borrowings from other financial institutions by the Bank. The Bank had available federal fund lines totaling $41.0 million with none outstanding at December 31, 2020.

Securities sold under agreements to repurchase represent short-term borrowings with maturities less than one year collateralized by a portion of the Company's securities portfolio. Securities with an aggregate carrying value of $5.7 million and $2.6 million at December 31, 2020 and 2019, respectively, were pledged to secure securities sold under agreements to repurchase.

NOTE 10: LEASE COMMITMENTS

We lease certain office facilities and equipment under operating leases. Rent expense for all operating leases totaled $0.2 million for both the years ended December 31, 2020 and 2019. On January 1, 2019, we adopted a new accounting standard which required the recognition of certain operating leases on our balance sheet as lease right of use assets (reported as component of other assets) and related lease liabilities (reported as a component of accrued expenses and other liabilities). Aggregate lease right of use assets were $788 thousand and $785 thousand at December 31, 2020 and 2019, respectively. Aggregate lease liabilities were $811 thousand and $788 thousand at December 31, 2020 and 2019, respectively. Rent expense includes amounts related to items that are not included in the determination of lease right of use assets including expenses related to short-term leases totaling $0.1 million for the year ended December 31, 2020.

Lease payments under operating leases that were applied to our operating lease liability totaled $112 thousand during the year ended December 31, 2020. The following table reconciles future undiscounted lease payments due under non-cancelable operating leases (those amounts subject to recognition) to the aggregate operating lease liability as of December 31, 2020.

(Dollars in thousands)		**Future lease payments**
2021	$	127
2022		120
2023		120
2024		120
2025		111
Thereafter		300
Total undiscounted operating lease liabilities	$	898
Imputed interest		87
Total operating lease liabilities included in the accompanying consolidated balance sheets	$	811
Weighted-average lease terms in years		7.68
Weighted-average discount rate		3.02 %

NOTE 11: OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income is defined as the change in equity from all transactions other than those with stockholders, and it includes net earnings and other comprehensive income (loss). Other comprehensive income (loss) for the years ended December 31, 2020 and 2019, is presented below.

(Dollars in thousands)		**Pre-tax amount**	**Tax benefit (expense)**	**Net of tax amount**
2020:				
Unrealized net holding gain on securities	$	7,501	(1,884)	5,617
Reclassification adjustment for net gain on securities recognized in net earnings		(103)	26	(77)
Other comprehensive income	$	7,398	(1,858)	5,540
2019:				
Unrealized net holding gain on securities	$	7,651	(1,921)	5,730
Reclassification adjustment for net loss on securities recognized in net earnings		123	(31)	92
Other comprehensive loss	$	7,774	(1,952)	5,822

NOTE 12: INCOME TAXES

For the years ended December 31, 2020 and 2019 the components of income tax expense from continuing operations are presented below.

(Dollars in thousands)		Year ended December 31 2020	2019
Current income tax expense:			
Federal	$	1,459	1,939
State		476	584
Total current income tax expense		1,935	2,523
Deferred income tax benefit:			
Federal		(262)	(136)
State		(68)	(17)
Total deferred income tax benefit		(330)	(153)
Total income tax expense	$	1,605	2,370

Total income tax expense differs from the amounts computed by applying the statutory federal income tax rate of 21% to earnings before income taxes. A reconciliation of the differences for the years ended December 31, 2020 and 2019, is presented below.

		2020		2019	
(Dollars in thousands)		Amount	Percent of pre-tax earnings	Amount	Percent of pre-tax earnings
Earnings before income taxes	$	9,059		12,111	
Income taxes at statutory rate		1,902	21.0 %	2,543	21.0 %
Tax-exempt interest		(489)	(5.4)	(508)	(4.1)
State income taxes, net of federal tax effect		345	3.8	440	3.6
Bank-owned life insurance		(152)	(1.7)	(92)	(0.8)
Other		(1)	—	(13)	(0.1)
Total income tax expense	$	1,605	17.7 %	2,370	19.6 %

The Company had a net deferred tax liability of $1.5 million and $9 thousand included in other liabilities ts on the consolidated balance sheets at December 31, 2020 and 2019, respectively. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2020 and 2019 are presented below.

		December 31	
(Dollars in thousands)		**2020**	**2019**
Deferred tax assets:			
Allowance for loan losses	$	1,411	1,102
Accrued bonus		183	296
Right of use liability		204	198
Other		91	88
Total deferred tax assets		1,889	1,684
Deferred tax liabilities:			
Premises and equipment		199	315
Unrealized gain on securities		2,548	690
Originated mortgage servicing rights		334	326
Right of use asset		198	197
Other		147	165
Total deferred tax liabilities		3,426	1,693
Net deferred tax liability	$	(1,537)	(9)

A valuation allowance is recognized for a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not that some portion of the entire deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projection for future taxable income over the periods which the temporary differences resulting in the remaining deferred tax assets are deductible, management believes it is more-likely-than-not that the Company will realize the benefits of these deductible differences at December 31, 2020. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

The change in the net deferred tax asset for the years ended December 31, 2020 and 2019, is presented below.

		Year ended December 31	
(Dollars in thousands)		**2020**	**2019**
Net deferred tax (liability) asset:			
Balance, beginning of year	$	(9)	1,790
Deferred tax benefit (expense) related to continuing operations		330	153
Stockholders' equity, for accumulated other comprehensive (income) loss		(1,858)	(1,952)
Balance, end of year	$	(1,537)	(9)

ASC 740, *Income Taxes,* defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. This section also provides guidance on the de-recognition, measurement, and classification of income tax uncertainties in interim periods. As of December 31, 2020, the Company had no unrecognized tax benefits related to federal or state income tax matters. The Company does not anticipate any material increase or decrease in unrecognized tax benefits during 2021 relative to any tax positions taken prior to December 31, 2020. As of December 31, 2020, the Company has accrued no interest and no penalties related to uncertain tax positions. It is the Company’s policy to recognize interest and penalties related to income tax matters in income tax expense.

The Company and its subsidiaries file consolidated U.S. federal and State of Alabama income tax returns. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service and the State of Alabama for the years ended December 31, 2017 through 2020.

NOTE 13: EMPLOYEE BENEFIT PLAN

The Company sponsors a qualified defined contribution retirement plan, the Auburn National Bancorporation, Inc. 401(k) Plan (the "Plan"). Eligible employees may contribute up to 100% of eligible compensation, subject to statutory limits upon completion of 2 months of service. Furthermore, the Company allows employer Safe Harbor contributions. Participants are immediately vested in employer Safe Harbor contributions. The Company's matching contributions on behalf of participants were equal to $1.00 for each $1.00 contributed by participants, up to 3% of the participants' eligible compensation, and $0.50 for every $1.00 contributed by participants, up to 5% of the participants' eligible compensation, for a maximum matching contribution of 4% of the participants' eligible compensation. Company matching contributions to the Plan were $304 thousand and $264 thousand for the years ended December 31, 2020 and 2019, respectively, and are included in salaries and benefits expense.

NOTE 14: COMMITMENTS AND CONTINGENT LIABILITIES

Credit-Related Financial Instruments

The Company is 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.

At December 31, 2020 and 2019, the following financial instruments were outstanding whose contract amount represents credit risk.

	December 31	
(Dollars in thousands)	**2020**	**2019**
Commitments to extend credit	$ 74,970	$ 60,564
Standby letters of credit	1,237	1,921

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various assets as collateral, including accounts receivable, inventory, equipment, marketable securities, and property to support those commitments for which collateral is deemed necessary. The Company has recorded a liability for the estimated fair value of these standby letters of credit in the amount of $25 thousand and $39 thousand at December 31, 2020 and 2019, respectively.

Other Commitments

At December 31, 2020, the Company has a contract with a construction company for $25.3 million to construct a new bank headquarters in Auburn, Alabama.

Contingent Liabilities

The Company and the Bank are involved in various legal proceedings, arising in connection with their business. In the opinion of management, based upon consultation with legal counsel, the ultimate resolution of these proceeding will not have a material adverse effect upon the consolidated financial condition or results of operations of the Company and the Bank.

NOTE 15: FAIR VALUE

Fair Value Hierarchy

"Fair value" is defined by ASC 820, *Fair Value Measurements and Disclosures*, as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for an asset or liability at the measurement date. GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1—inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets.

Level 2—inputs to the valuation methodology include 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.

Level 3—inputs to the valuation methodology are unobservable and reflect the Company's own assumptions about the inputs market participants would use in pricing the asset or liability.

Level changes in fair value measurements

Transfers between levels of the fair value hierarchy are generally recognized at the end of the reporting period. The Company monitors the valuation techniques utilized for each category of financial assets and liabilities to ascertain when transfers between levels have been affected. The nature of the Company's financial assets and liabilities generally is such that transfers in and out of any level are expected to be infrequent. For the years ended December 31, 2020 and 2019, there were no transfers between levels and no changes in valuation techniques for the Company's financial assets and liabilities.

Assets and liabilities measured at fair value on a recurring basis

Securities available-for-sale

Fair values of securities available for sale were primarily measured using Level 2 inputs. For these securities, the Company obtains pricing from third party pricing services. These third party pricing services consider observable data that may include broker/dealer quotes, market spreads, cash flows, market consensus prepayment speeds, benchmark yields, reported trades for similar securities, credit information and the securities' terms and conditions. On a quarterly basis, management reviews the pricing received from the third party pricing services for reasonableness given current market conditions. As part of its review, management may obtain non-binding third party broker quotes to validate the fair value measurements. In addition, management will periodically submit pricing provided by the third party pricing services to another independent valuation firm on a sample basis. This independent valuation firm will compare the price provided by the third-party pricing service with its own price and will review the significant assumptions and valuation methodologies used with management.

The following table presents the balances of the assets and liabilities measured at fair value on a recurring as of December 31, 2020 and 2019, respectively, by caption, on the accompanying consolidated balance sheets by ASC 820 valuation hierarchy (as described above).

(Dollars in thousands)	Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2020:				
Securities available-for-sale:				
Agency obligations	$ 97,448	—	97,448	—
Agency MBS	163,470	—	163,470	—
State and political subdivisions	74,259	—	74,259	—
Total securities available-for-sale	335,177	—	335,177	—
Total assets at fair value	$ 335,177	—	335,177	—
December 31, 2019:				
Securities available-for-sale:				
Agency obligations	$ 50,708	—	50,708	—
Agency MBS	123,277	—	123,277	—
State and political subdivisions	61,917	—	61,917	—
Total securities available-for-sale	235,902	—	235,902	—
Total assets at fair value	$ 235,902	—	235,902	—

Assets and liabilities measured at fair value on a nonrecurring basis

Loans held for sale

Loans held for sale are carried at the lower of cost or fair value. Fair values of loans held for sale are determined using quoted market secondary market prices for similar loans. Loans held for sale are classified within Level 2 of the fair value hierarchy.

Impaired Loans

Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans can be measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent.

The fair value of impaired loans were primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Mortgage servicing rights, net

Mortgage servicing rights, net, included in other assets on the accompanying consolidated balance sheets, are carried at the lower of cost or estimated fair value. MSRs do not trade in an active market with readily observable prices. To determine the fair value of MSRs, the Company engages an independent third party. The independent third party's valuation model calculates the present value of estimated future net servicing income using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Periodically, the Company will review broker surveys and other market research to validate significant assumptions used in the model. The significant unobservable inputs include prepayment speeds or the constant prepayment rate ("CPR") and the weighted average discount rate. Because the valuation of MSRs requires the use of significant unobservable inputs, all of the Company's MSRs are classified within Level 3 of the valuation hierarchy.

The following table presents the balances of the assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2020 and 2019, respectively, by caption, on the accompanying consolidated balance sheets and by ASC 820 valuation hierarchy (as described above):

(Dollars in thousands)		Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2020:					
Loans held for sale	$	3,418	—	3,418	—
Loans, net[1]		319	—	—	319
Other assets [2]		1,330	—	—	1,330
Total assets at fair value	$	5,067	—	3,418	1,649
December 31, 2019:					
Loans held for sale	$	2,202	—	2,202	—
Loans, net[1]		99	—	—	99
Other assets [2]		1,299	—	—	1,299
Total assets at fair value	$	3,600	—	2,202	1,398

[1]Loans considered impaired under ASC 310-10-35 Receivables. This amount reflects the recorded investment in impaired loans, net of any related allowance for loan losses.

[2]Represents MSRs, net carried at lower of cost or estimated fair value.

At December 31, 2020 and 2019 and for the years then ended, the Company had no Level 3 assets measured at fair value on a recurring basis. For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2020 and 2019, the significant unobservable inputs used in the fair value measurements are presented below.

(Dollars in thousands)		Carrying Amount	Valuation Technique	Significant Unobservable Input	Range	Weighted Average of Input
December 31, 2020:						
Impaired loans	$	319	Appraisal	Appraisal discounts	10.0 - 10.0 %	10.0%
Mortgage servicing rights, net		1,330	Discounted cash flow	Prepayment speed or CPR	18.2 - 36.4 %	20.7%
				Discount rate	10.0 - 12.0 %	10.0%
December 31, 2019:						
Impaired loans	$	99	Appraisal	Appraisal discounts	10.0 - 10.0 %	10.0%
Mortgage servicing rights, net		1,299	Discounted cash flow	Prepayment speed or CPR	11.2 - 22.4 %	11.6%
				Discount rate	10.0 - 12.0 %	10.0%

Fair Value of Financial Instruments

ASC 825, *Financial Instruments*, requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow analyses. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Company's financial instruments, but rather are a good-faith estimate of the fair value of financial instruments held by the Company. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

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

Loans, net

Fair values for loans were calculated using discounted cash flows. The discount rates reflected current rates at which similar loans would be made for the same remaining maturities. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments. The fair value of loans was measured using an exit price notion.

Loans held for sale

Fair values of loans held for sale are determined using quoted market secondary market prices for similar loans.

Time Deposits

Fair values for time deposits were estimated using discounted cash flows. The discount rates were based on rates currently offered for deposits with similar remaining maturities.

				Fair Value Hierarchy		
(Dollars in thousands)	Carrying amount	Estimated fair value		Level 1 inputs	Level 2 inputs	Level 3 Inputs
December 31, 2020:						
Financial Assets:						
Loans, net (1)	$ 456,082	$ 451,816		$ —	$ —	$ 451,816
Loans held for sale	3,418	3,509		—	3,509	—
Financial Liabilities:						
Time Deposits	$ 160,401	$ 162,025		$ —	$ 162,025	$ —
December 31, 2019:						
Financial Assets:						
Loans, net (1)	$ 456,515	$ 453,705		$ —	$ —	$ 453,705
Loans held for sale	2,202	2,251		—	2,251	—
Financial Liabilities:						
Time Deposits	$ 167,199	$ 168,316		$ —	$ 168,316	$ —

(1) Represents loans, net of unearned income and the allowance for loan losses. The fair value of loans was measured using an exit price notion.

NOTE 16: RELATED PARTY TRANSACTIONS

The Bank has made, and expects in the future to continue to make in the ordinary course of business, loans to directors and executive officers of the Company, the Bank, and their affiliates. In management's opinion, these loans were made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than normal credit risk. An analysis of such outstanding loans is presented below.

(Dollars in thousands)		**Amount**
Loans outstanding at December 31, 2019	$	3,149
New loans/advances		871
Repayments		(2,433)
Changes in directors and executive officers		(351)
Loans outstanding at December 31, 2020	$	1,236

During 2020 and 2019, certain executive officers and directors of the Company and the Bank, including companies with which they are affiliated, were deposit customers of the bank. Total deposits for these persons at December 31, 2020 and 2019 amounted to $18.7 million and $19.1 million, respectively.

NOTE 17: REGULATORY RESTRICTIONS AND CAPITAL RATIOS

As required by the Economic Growth, Regulatory Relief, and Consumer Protection Act in August 2018, the Federal Reserve Board issued an interim final rule that expanded applicability of the Board's small bank holding company policy statement. The interim final rule raised the policy statement's asset threshold from $1 billion to $3 billion in total consolidated assets for a bank holding company or savings and loan holding company that: (1) is not engaged in significant nonbanking activities; (2) does not conduct significant off-balance sheet activities; and (3) does not have a material amount of debt or equity securities, other than trust-preferred securities, outstanding. The interim final rule provides that, if warranted for supervisory purposes, the Federal Reserve may exclude a company from the threshold increase. Management believes the Company meets the conditions of the Federal Reserve's small bank holding company policy statement and is therefore excluded from consolidated capital requirements at December 31, 2020.

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

As of December 31, 2020, the Bank is "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, total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. Management has not received any notification from the Bank's regulators that changes the Bank's regulatory capital status.

The actual capital amounts and ratios for the Bank and the aforementioned minimums as of December 31, 2020 and 2019 are presented below.

	Actual		Minimum for capital adequacy purposes		Minimum to be well capitalized	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
At December 31, 2020:						
Tier 1 Leverage Capital	$ 96,096	10.32 %	$ 37,263	4.00 %	$ 46,579	5.00 %
Common Equity Tier 1 Capital	96,096	17.27	25,042	4.50	36,171	6.50
Tier 1 Risk-Based Capital	96,096	17.27	33,389	6.00	44,519	8.00
Total Risk-Based Capital	101,906	18.31	44,519	8.00	55,648	10.00
At December 31, 2019:						
Tier 1 Leverage Capital	$ 92,778	11.23 %	$ 33,043	4.00 %	$ 41,303	5.00 %
Common Equity Tier 1 Capital	92,778	17.28	24,162	4.50	34,901	6.50
Tier 1 Risk-Based Capital	92,778	17.28	32,216	6.00	42,955	8.00
Total Risk-Based Capital	97,291	18.12	42,955	8.00	53,693	10.00

Dividends paid by the Bank are a principal source of funds available to the Company for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. State law and Federal Reserve policy restrict the Bank from declaring dividends in excess of the sum of the current year's earnings plus the retained net earnings from the preceding two years without prior approval. In addition to the formal statutes and regulations, regulatory authorities also consider the adequacy of the Bank's total capital in relation to its assets, deposits, and other such items. Capital adequacy considerations could further limit the availability of dividends from the Bank. At December 31, 2020, the Bank could have declared additional dividends of approximately $6.8 million without prior approval of regulatory authorities. As a result of this limitation, approximately $96.9 million of the Company's investment in the Bank was restricted from transfer in the form of dividends.

NOTE 18: AUBURN NATIONAL BANCORPORATION (PARENT COMPANY)

The Parent Company's condensed balance sheets and related condensed statements of earnings and cash flows are as follows.

CONDENSED BALANCE SHEETS

	December 31	
(Dollars in thousands)	2020	2019
Assets:		
Cash and due from banks	$ 4,049	4,119
Investment in bank subsidiary	103,695	94,837
Other assets	631	625
Total assets	$ 108,375	99,581
Liabilities:		
Accrued expenses and other liabilities	$ 685	1,253
Total liabilities	685	1,253
Stockholders' equity	107,690	98,328
Total liabilities and stockholders' equity	$ 108,375	99,581

CONDENSED STATEMENTS OF EARNINGS

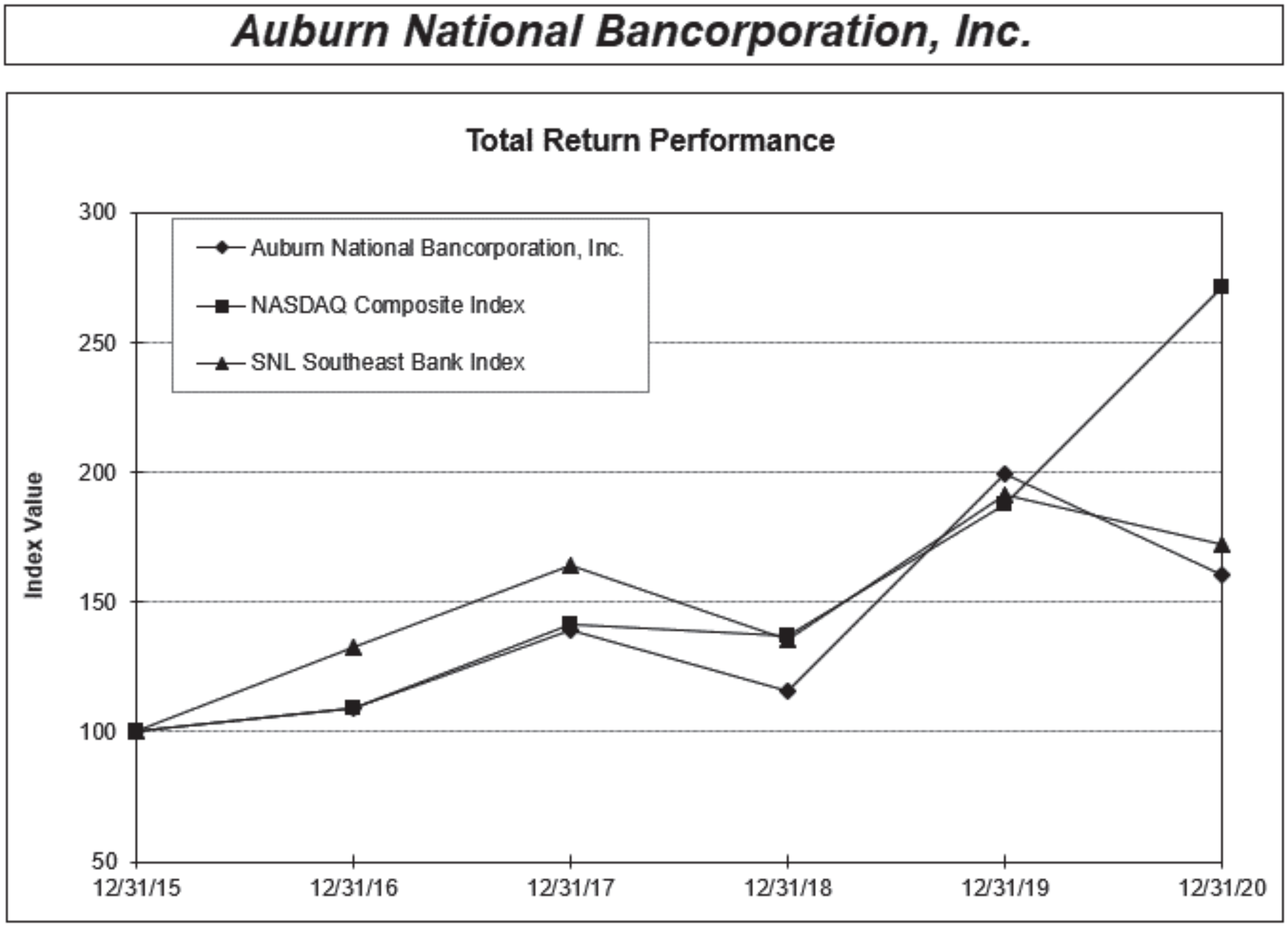
(Dollars in thousands)		Year ended December 31 2020	2019
Income:			
Dividends from bank subsidiary	$	3,638	8,574
Noninterest income		862	346
Total income		4,500	8,920
Expense:			
Noninterest expense		255	212
Total expense		255	212
Earnings before income tax expense and equity in undistributed earnings of bank subsidiary		4,245	8,708
Income tax expense		110	26
Earnings before equity in undistributed earnings of bank subsidiary		4,135	8,682
Equity in undistributed earnings of bank subsidiary		3,319	1,059
Net earnings	$	7,454	9,741

CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)		Year ended December 31 2020	2019
Cash flows from operating activities:			
Net earnings	$	7,454	9,741
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Net (increase) decrease in other assets		(6)	7
Net decrease in other liabilities		(561)	(215)
Equity in undistributed earnings of bank subsidiary		(3,319)	(1,059)
Net cash provided by operating activities		3,568	8,474
Cash flows from financing activities:			
Dividends paid		(3,638)	(3,575)
Stock repurchases		—	(2,721)
Net cash used in financing activities		(3,638)	(6,296)
Net change in cash and cash equivalents		(70)	2,178
Cash and cash equivalents at beginning of period		4,119	1,941
Cash and cash equivalents at end of period	$	4,049	4,119

Stock Performance Graph

The following performance graph compares the cumulative, total return on the Company's Common Stock from December 31, 2015 to December 31, 2020, with that of the Nasdaq Composite Index and SNL Southeast Bank Index (assuming a $100 investment on December 31, 2015). Cumulative total return represents the change in stock price and the amount of dividends received over the indicated period, assuming the reinvestment of dividends.



	Period Ending					
Index	**12/31/2015**	**12/31/2016**	**12/31/2017**	**12/31/2018**	**12/31/2019**	**12/31/2020**
Auburn National Bancorporation, Inc.	100.00	109.08	139.15	115.94	199.43	160.34
NASDAQ Composite Index	100.00	108.87	141.13	137.12	187.44	271.64
SNL Southeast Bank Index	100.00	132.75	164.21	135.67	191.06	172.07

Auburn National Bancorporation, Inc.

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Independent Auditors

Elliott Davis LLC/PLLC
200 East Broad Street
Greenville, SC 29601

Shareholder Services

Shareholders desiring to change the name, address or ownership of Auburn National Bancorporation, Inc. common stock or to report lost certificates should contact our Transfer Agent:

Computershare
P.O. Box 505000
Louisville, KY 40233
Phone: 1-800-368-5948

For frequently asked questions, visit the Transfer Agent's home page at: computershare.com

Annual Meeting

Tuesday, May 11, 2021
3:00 p.m. (Central Time)

The meeting will be conducted virtually through a live online webcast. For more information, please visit aubnproxy.com or our website auburnbank.com.

Investor Relations

A copy of the Company's annual report on Form 10-K, filed with the Securities and Exchange Commission (SEC), as well as our other SEC filings and our latest press releases are available free of charge through a link on our website at auburnbank.com. Requests for these documents may also be made by emailing Investor Relations at investorrelations@auburnbank.com or by contacting Investor Relations by telephone or mail at the Company's headquarters.

Common Stock Listing

Auburn National Bancorporation Inc. Common Stock is traded on the Nasdaq Global Market under the symbol AUBN.

Dividend Reinvestment and Stock Purchase Plan

Auburn National Bancorporation Inc. offers a Dividend Reinvestment Plan (DRIP) for automatic reinvestment of dividends in the stock of the company. Participants in the DRIP may also purchase additional shares with optional cash payments. For additional information or for an authorization form, please contact Investor Relations.

Direct Deposit of Dividends

Dividends may be automatically deposited into a shareholder's checking or savings account free of charge. For more information, contact Investor Relations.

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