Community Bancorp.

2019 Annual Report

Community Bancorp. and Subsidiary

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Dear Shareholders and Friends:

Community Bancorp. and Community National Bank had another excellent year in 2019, posting loan and deposit growth and improved profitability. As of year-end 2019, the Company's capital ratios exceeded all regulatory requirements, and we continue to be considered a "well-capitalized" institution. This designation is important to us, to our regulators and to you. We are very pleased with these results.

We share our current success with the bankers who came before us and who taught us the fundamentals of community banking that we continue to employ. We are grateful to our officers and employees for their competence and commitment to our bank, our customers and our shareholders.

Thank you to our shareholders and friends whose confidence and support allow us to continue our work.

Sincerely,

Kathryn M. Austin

Kathryn M. Austin
President and Chief Executive Officer
Community Bancorp. and Community National Bank

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Management of the Company is responsible for the preparation and fair presentation of the consolidated financial statements and other financial information contained in this Form 10-K. Management is also responsible for establishing and maintaining adequate internal control over financial reporting and for identifying the framework used to evaluate its effectiveness. Management has designed processes, internal control and a business culture that foster financial integrity and accurate reporting. The Company's comprehensive system of internal control over financial reporting was designed to provide reasonable assurances regarding the reliability of financial reporting and the preparation of the consolidated financial statements of the Company in accordance with generally accepted accounting principles. The Company's accounting policies and internal control over financial reporting, established and maintained by Management, are under the general oversight of the Company's Board of Directors, including the Board of Directors' Audit Committee.

Management has made a comprehensive review, evaluation, and assessment of the Company's internal control over financial reporting as of December 31, 2019. The standard measures adopted by Management in making its evaluation are the measures in the 2013 *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon its review and evaluation, Management concluded that the Company maintained effective internal control over financial reporting as of December 31, 2019.

Berry Dunn McNeil & Parker, LLC, an independent registered public accounting firm, which has audited and reported on the consolidated financial statements contained in this Form 10-K, has issued its written audit report on the Company's internal control over financial reporting which follows this report.

Kathryn M. Austin

Ms. Kathryn M. Austin, President & Chief Executive Officer
(Principal Executive Officer)

Louise Bonvechio

Ms. Louise M. Bonvechio, Corporate Secretary & Treasurer
(Principal Financial Officer)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Community Bancorp. and Subsidiary

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Community Bancorp. and Subsidiary (the Company) as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the financial statements). We have also audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in the *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Bancorp. and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by COSO.

Basis for Opinion

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting 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 the 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, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Berry Dunn McNeil & Parker, LLC

We have served as the Company's auditor since 2003.

Portland, Maine
March 16, 2020
Vermont Registration No. 92-0000278

Community Bancorp. and Subsidiary

Consolidated Balance Sheets

	December 31, 2019	December 31, 2018
Assets		
Cash and due from banks	$ 10,263,535	$ 14,906,529
Federal funds sold and overnight deposits	38,298,677	53,028,286
Total cash and cash equivalents	48,562,212	67,934,815
Securities available-for-sale	45,966,750	39,366,831
Restricted equity securities, at cost	1,431,850	1,749,450
Loans	606,988,937	578,450,517
Allowance for loan losses	(5,926,491)	(5,602,541)
Deferred net loan costs	362,415	363,614
Net loans	601,424,861	573,211,590
Bank premises and equipment, net	10,959,403	9,713,455
Accrued interest receivable	2,336,553	2,300,841
Bank owned life insurance	4,903,012	4,814,099
Goodwill	11,574,269	11,574,269
Other real estate owned	966,738	201,386
Other assets	9,829,671	9,480,762
Total assets	$ 737,955,319	$ 720,347,498
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, non-interest bearing	$ 125,089,403	$ 122,430,805
Interest-bearing transaction accounts	185,102,333	177,815,417
Money market funds	91,463,661	85,261,685
Savings	97,167,652	93,129,875
Time deposits, $250,000 and over	14,565,559	14,395,291
Other time deposits	101,632,760	115,783,492
Total deposits	615,021,368	608,816,565
Borrowed funds	2,650,000	1,550,000
Repurchase agreements	33,189,848	30,521,565
Junior subordinated debentures	12,887,000	12,887,000
Accrued interest and other liabilities	5,312,424	3,968,657
Total liabilities	669,060,640	657,743,787
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 15 and 20 shares issued and outstanding at December 31, 2019 and 2018, respectively ($100,000 liquidation value, per share)	1,500,000	2,000,000
Common stock - $2.50 par value; 15,000,000 shares authorized, 5,449,857 and 5,382,103 shares issued at December 31, 2019 and 2018, respectively (including 16,267 and 17,442 shares issued February 1, 2020 and 2019, respectively)	13,624,643	13,455,258
Additional paid-in capital	33,464,381	32,536,532
Retained earnings	22,667,949	17,882,282
Accumulated other comprehensive income (loss)	260,483	(647,584)
Less: treasury stock, at cost; 210,101 shares at December 31, 2019 and 2018	(2,622,777)	(2,622,777)
Total shareholders' equity	68,894,679	62,603,711
Total liabilities and shareholders' equity	$ 737,955,319	$ 720,347,498
Book value per common share outstanding	$ 12.86	$ 11.72

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income

	Years Ended December 31, 2019	Years Ended December 31, 2018
Interest income		
Interest and fees on loans	$ 29,883,352	$ 27,609,505
Interest on taxable debt securities	1,089,201	895,165
Dividends	100,609	125,973
Interest on federal funds sold and overnight deposits	685,646	483,960
Total interest income	31,758,808	29,114,603
Interest expense		
Interest on deposits	5,124,651	3,547,798
Interest on borrowed funds	24,550	95,936
Interest on repurchase agreements	299,347	190,993
Interest on junior subordinated debentures	694,573	650,361
Total interest expense	6,143,121	4,485,088
Net interest income	25,615,687	24,629,515
Provision for loan losses	1,066,167	780,000
Net interest income after provision for loan losses	24,549,520	23,849,515
Non-interest income		
Service fees	3,313,833	3,238,954
Income from sold loans	706,306	780,622
Other income from loans	904,156	879,887
Net realized loss on sale of securities AFS	(26,490)	(32,718)
Other income	1,048,261	1,314,563
Total non-interest income	5,946,066	6,181,308
Non-interest expense		
Salaries and wages	7,271,722	7,203,001
Employee benefits	3,118,631	2,880,048
Occupancy expenses, net	2,605,995	2,545,959
Other expenses	6,884,932	7,266,018
Total non-interest expense	19,881,280	19,895,026
Income before income taxes	10,614,306	10,135,797
Income tax expense	1,789,860	1,738,265
Net income	$ 8,824,446	$ 8,397,532
Earnings per common share	$ 1.68	$ 1.61
Weighted average number of common shares used in computing earnings per share	5,204,768	5,139,297
Dividends declared per common share	$ 0.76	$ 0.74

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Comprehensive Income

	Years Ended December 31,	
	2019	2018
Net income	$ 8,824,446	$ 8,397,532
Other comprehensive income (loss), net of tax:		
Unrealized holding gain (loss) on securities AFS arising during the period	1,122,961	(505,487)
Reclassification adjustment for loss realized in income	26,490	32,718
Unrealized gain (loss) during the period	1,149,451	(472,769)
Tax effect	(241,384)	99,282
Other comprehensive income (loss), net of tax	908,067	(373,487)
Total comprehensive income	$ 9,732,513	$ 8,024,045

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

Years Ended December 31, 2019 and 2018

	Common stock		Preferred stock	
	Shares	Amount	Shares	Amount
Balances, December 31, 2017	5,322,320	$ 13,305,800	25	$ 2,500,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive loss	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	59,783	149,458	0	0
Redemption of preferred stock	0	0	(5)	(500,000)
Balances, December 31, 2018	5,382,103	13,455,258	20	2,000,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive income	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	67,754	169,385	0	0
Redemption of preferred stock	0	0	(5)	(500,000)
Balances, December 31, 2019	5,449,857	$ 13,624,643	15	$ 1,500,000

Consolidated Statements of Changes in Shareholders' Equity (continued)

Years Ended December 31, 2019 and 2018

Additional paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Total shareholders' equity
$ 31,639,189	$ 13,387,739	$ (274,097)	$ (2,622,777)	$ 57,935,854
0	8,397,532	0	0	8,397,532
0	0	(373,487)	0	(373,487)
				8,024,045
0	(3,799,864)	0	0	(3,799,864)
0	(103,125)	0	0	(103,125)
897,343	0	0	0	1,046,801
0	0	0	0	(500,000)
32,536,532	17,882,282	(647,584)	(2,622,777)	62,603,711
0	8,824,446	0	0	8,824,446
0	0	908,067	0	908,067
				9,732,513
0	(3,951,279)	0	0	(3,951,279)
0	(87,500)	0	0	(87,500)
927,849	0	0	0	1,097,234
0	0	0	0	(500,000)
$ 33,464,381	$ 22,667,949	$ 260,483	$ (2,622,777)	$ 68,894,679

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2019	2018
Cash Flows from Operating Activities:		
Net income	$ 8,824,446	$ 8,397,532
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, bank premises and equipment	930,035	981,691
Provision for loan losses	1,066,167	780,000
Deferred income tax	96,236	(11,359)
Net realized loss on sale of securities AFS	26,490	32,718
Gain on sale of loans	(290,116)	(345,780)
Loss (gain) on sale of bank premises and equipment	30,797	(260,013)
Loss on sale of OREO	817	2,397
Income from CFS Partners	(588,696)	(514,485)
Amortization of bond premium, net	120,295	128,469
Write down of OREO	95,008	78,447
Proceeds from sales of loans held for sale	14,098,560	14,793,920
Originations of loans held for sale	(13,808,444)	(13,410,853)
Increase (decrease) in taxes payable	522	(23,758)
Increase in interest receivable	(35,712)	(248,923)
Decrease in mortgage servicing rights	65,371	78,338
Decrease in right-of-use assets	236,395	0
Decrease in operating lease liabilities	(227,606)	0
Decrease (increase) in other assets	335,167	(790,320)
Increase in cash surrender value of BOLI	(88,913)	(92,317)
Amortization of limited partnerships	312,106	411,061
Decrease (increase) in unamortized loan costs	1,199	(44,963)
Increase in interest payable	26,204	12,524
Increase in accrued expenses	66,100	149,648
(Decrease) increase in other liabilities	(45,772)	62,805
Net cash provided by operating activities	11,246,656	10,166,779
Cash Flows from Investing Activities:		
Investments - AFS		
Maturities, calls, pay downs and sales	19,998,076	8,543,078
Purchases	(25,595,329)	(10,093,214)
Proceeds from redemption of restricted equity securities	493,600	1,147,500
Purchases of restricted equity securities	(176,000)	(1,193,300)
Increase in limited partnership contributions payable	184,000	388,750
Investments in limited liability entities	(811,000)	(877,000)
Increase in loans, net	(30,365,217)	(27,835,972)
Capital expenditures net of proceeds from sales of bank premises and equipment	(952,396)	(90,957)
Proceeds from sales of OREO	105,561	335,056
Recoveries of loans charged off	117,842	126,462
Net cash used in investing activities	(37,000,863)	(29,549,597)

Consolidated Statements of Cash Flows (continued)

	2019	2018
Cash Flows from Financing Activities:		
Net increase in demand and interest-bearing transaction accounts	9,945,514	50,367,124
Net increase (decrease) in money market and savings accounts	10,239,753	(12,516,729)
Net (decrease) increase in time deposits	(13,980,464)	10,331,190
Net increase in repurchase agreements	2,668,283	1,873,717
Proceeds from long-term borrowings	1,100,000	0
Repayments on long-term borrowings	0	(2,000,000)
Decrease in finance lease obligations	(166,924)	(115,060)
Redemption of preferred stock	(500,000)	(500,000)
Dividends paid on preferred stock	(87,500)	(103,125)
Dividends paid on common stock	(2,837,058)	(2,672,985)
Net cash provided by financing activities	6,381,604	44,664,132
Net (decrease) increase in cash and cash equivalents	(19,372,603)	25,281,314
Cash and cash equivalents:		
Beginning	67,934,815	42,653,501
Ending	$ 48,562,212	$ 67,934,815
Supplemental Schedule of Cash Paid During the Period:		
Interest	$ 6,116,917	$ 4,472,564
Income taxes, net of refunds	$ 1,381,000	$ 1,365,000
Supplemental Schedule of Noncash Investing and Financing Activities:		
Change in unrealized gain (loss) on securities AFS	$ 1,149,451	$ (472,769)
Loans transferred to OREO	$ 966,738	$ 333,051
Common Shares Dividends Paid:		
Dividends declared	$ 3,951,279	$ 3,799,864
Increase in dividends payable attributable to dividends declared	(16,987)	(80,078)
Dividends reinvested	(1,097,234)	(1,046,801)
	$ 2,837,058	$ 2,672,985

The accompanying notes are an integral part of these consolidated financial statements.

Note 1. Significant Accounting Policies

The accounting policies of Community Bancorp. and Subsidiary (the Company) are in conformity, in all material respects, with U.S. generally accepted accounting principles (US GAAP) and general practices within the banking industry. The following is a description of the Company's significant accounting policies.

Basis of presentation and consolidation

In addition to the definitions provided elsewhere in this Annual Report, the definitions, acronyms and abbreviations identified below are used throughout this Annual Report, including these "Notes to Consolidated Financial Statements" and the section labeled "Management's Discussion and Analysis of Financial Condition and Results of Operations" immediately following. These definitions are intended to aid the reader and provide a reference page when reviewing this Annual Report.

ABS and OAS: Asset backed or other amortizing security
ACBB: Atlantic Community Bankers Bank
ACBI: Atlantic Community Bancshares, Inc.
ACH: Automated Clearing House
AFS: Available-for-sale
Agency MBS: MBS issued by a US government agency or GSE
ALCO: Asset Liability Committee
ALL: Allowance for loan losses
AML: Anti-money laundering laws
AOCI: Accumulated other comprehensive income
ASC: Accounting Standards Codification
ASU: Accounting Standards Update
ATMs: Automatic teller machines
Bancorp: Community Bancorp.
Bank: Community National Bank
BHG Bankers Healthcare Group
BIC: Borrower-in-Custody
Board: Board of Directors
BOLI: Bank owned life insurance
bp or bps: Basis point(s)
BSA: Bank Secrecy Act
CBLR: Community Bank Leverage Ratio
CDARS: Certificate of Deposit Accounts Registry Service of the Promontory Interfinancial Network
CDs: Certificates of deposit
CDI: Core deposit intangible
CECL: Current Expected Credit Loss
CEO: Credit Enhancement Obligation
CFPB: Consumer Financial Protection Bureau
CFSG: Community Financial Services Group, LLC
CFS Partners: Community Financial Services Partners, LLC
Company: Community Bancorp. and Subsidiary
CRA: Community Reinvestment Act
CRE: Commercial Real Estate
DDA or DDAs: Demand Deposit Account(s)
DIF: Deposit Insurance Fund
DTC: Depository Trust Company
DRIP: Dividend Reinvestment Plan
Exchange Act: Securities Exchange Act of 1934
FASB: Financial Accounting Standards Board
FDIA: Federal Deposit Insurance Act
FDIC: Federal Deposit Insurance Corporation
FDICIA: Federal Deposit Insurance Company Improvement Act of 1991
FHA: Federal Housing Administration
FHLBB: Federal Home Loan Bank of Boston
FHLMC : Federal Home Loan Mortgage Corporation
FICO: Financing Corporation
FLA: First Loss Account
FOMC: Federal Open Market Committee
FRB: Federal Reserve Board
FRBB: Federal Reserve Bank of Boston
GAAP: Generally Accepted Accounting Principles in the United States
GSE: Government sponsored enterprise
HMDA: Home Mortgage Disclosure Act
HTM: Held-to-maturity
ICS: Insured Cash Sweeps of the Promontory Interfinancial Network
IRS: Internal Revenue Service
JNE: Jobs for New England
Jr: Junior
LIBOR: London Interbank Offered Rate
LLC: Limited liability corporation
MBS: Mortgage-backed security
MPF: Mortgage Partnership Finance
MSAs Metropolitan Statistical Areas
MSRs: Mortgage servicing rights
NII: Net interest income
NMTC: New Market Tax Credits
OCI: Other comprehensive income (loss)
OFAC: Office of Foreign Asset Control
OREO: Other real estate owned
OTTI: Other-than-temporary impairment
PMI: Private mortgage insurance
QM(s): Qualified Mortgage(s)
RD: USDA Rural Development
RESPA: Real Estate Settlement Procedures Act
SBA: U.S. Small Business Administration
SEC: U.S. Securities and Exchange Commission
SERP: Supplemental Employee Retirement Plan
SOX: Sarbanes-Oxley Act of 2002
TDR: Troubled-debt restructuring
TILA: Truth in Lending Act
USDA: U.S. Department of Agriculture
VA: U.S. Veterans Administration
VIE: Variable interest entities
2017 Tax Act: Tax Cut and Jobs Act of 2017
2018 Regulatory Relief Act: Economic Growth, Regulatory Relief and Consumer Protection Act of 2018

The consolidated financial statements include the accounts of the Bancorp. and its wholly-owned subsidiary, the Bank. All significant intercompany accounts and transactions have been eliminated. The Company is considered a "smaller reporting company" under the disclosure rules of the SEC, as amended in 2018. Accordingly, the Company has elected to provide its audited consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for a two year, rather than a three year, period, and intends to provide smaller reporting company scaled disclosures where management deems it appropriate. Beginning with its periodic reports filed in 2018, the Company is considered an accelerated filer under the financial reporting rules of the SEC.

FASB ASC Topic 810, "Consolidation", in part, addresses limited purpose trusts formed to issue trust preferred securities. It also establishes the criteria used to identify VIE, and to determine whether or not to consolidate a VIE. In general, ASC Topic 810 provides that the enterprise with the controlling financial interest, known as the primary beneficiary, consolidates the VIE. In 2007, the Company formed CMTV Statutory Trust I for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The Company is not the primary beneficiary of CMTV Statutory Trust I; accordingly, the trust is not consolidated with the Company for financial reporting purposes. CMTV Statutory Trust I is considered an affiliate of the Company (see Note 11).

During the years 2011 through 2018, the Company was the sole owner of a LLC formed to facilitate the Company's purchase of federal NMTC under an investment structure designed by a local community development entity. The NMTC financing matured in the fourth quarter of 2018 and the Company exited the investment and terminated its interest in the LLC. Management evaluated the Company's interest in the LLC under the ASC guidance relating to VIEs in light of the overall structure and purpose of the NMTC financing transaction and concluded that the LLC should not be consolidated in the Company's financial statements for financial reporting purposes, as the Company was not the primary beneficiary of the NMTC structure, did not exercise control within the overall structure and was not obligated to absorb a majority of any losses of the NMTC structure (see Note 8).

Nature of operations

The Company provides a variety of deposit and lending services to individuals, municipalities, and business customers through its branches, ATMs and telephone, mobile and internet banking capabilities in northern and central Vermont, which is primarily a small business and agricultural area. The Company's primary deposit products are checking and savings accounts and certificates of deposit. Its primary lending products are commercial, real estate, municipal and consumer loans.

Concentration of risk

The Company's operations are affected by various risk factors, including interest rate risk, credit risk, and risk from geographic concentration of its deposit taking and lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities and repricing of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors inherent in management's estimate of credit risk and factors beyond the control of the Company. While the Company has a diversified loan portfolio by loan type, most of its lending activities are conducted within the geographic area where its banking offices are located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy in northern and central Vermont. In addition, a substantial portion of the Company's loans are secured by real estate, which is susceptible to a decline in value, especially during times of adverse economic conditions.

Use of estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses

during the reporting period. These estimates and assumptions involve inherent uncertainties. Accordingly, actual results could differ from those estimates and those differences could be material.

Material estimates that are particularly susceptible to significant change relate to the determination of the ALL and the valuation of OREO. In connection with evaluating loans for impairment or assigning the carrying value of OREO, management generally obtains independent evaluations or appraisals for significant properties. While the ALL and the carrying value of OREO are determined using management's best estimate of probable loan and OREO losses, respectively, as of the balance sheet date, the ultimate collection of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the fair value of OREO are susceptible to uncertainties and changes in a number of factors, especially local real estate market conditions. The amount of the change that is reasonably possible cannot be estimated.

While management uses available information to recognize losses on loans and OREO, future additions to the allowance or write-downs of OREO may be necessary based on changes in local economic conditions or other relevant factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans and the carrying value of OREO. Such agencies may require the Company to recognize additions to the allowance or write-downs of OREO based on their judgment about information available to them at the time of their examination.

MSRs associated with loans originated and sold in the secondary market, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheets. MSRs are amortized against non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying loans. The value of capitalized servicing rights represents the present estimated value of the future servicing fees arising from the right to service loans for third parties. The carrying value of the MSRs is periodically reviewed for impairment based on management's estimate of fair value as compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as a write down. Critical accounting policies for MSRs relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of MSRs requires the development and use of estimates, including anticipated principal amortization and prepayments. Events that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. Management uses a third party consultant to assist in estimating the fair value of the Company's MSRs.

Management evaluates securities for OTTI on at least a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors, including the length of time and the extent to which the fair value has been less than cost; the nature of the issuer and its financial condition and near-term prospects; and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The evaluation of these factors is a subjective process and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

Accounting for a business combination that was completed prior to 2009 requires the application of the purchase method of accounting. Under the purchase method, the Company was required to record the assets and liabilities acquired through the LyndonBank merger in 2007 at fair market value, with the excess of the purchase price over the fair value of the net assets recorded as goodwill and evaluated annually for impairment. Management uses various assumptions in evaluating goodwill for impairment.

Management utilizes numerous techniques to estimate the carrying value of various other assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. Management acknowledges that the use of different estimates or assumptions could produce different estimates of carrying values.

Presentation of cash flows

For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in process of clearing), federal funds sold (generally purchased and sold for one day periods) and overnight deposits.

Investment securities

Change in Accounting Principle

Prior to 2019, the entire balance of the Company's HTM investment portfolio consisted of Municipal notes. Effective January 1, 2019, and in accordance with ASC 250 (Accounting Changes and Error Corrections), the Company chose to reclassify these debt instruments from the investment portfolio into the loan portfolio. This change represents a voluntary reclassification of municipal debt instruments from classification as investment securities under ASC 320 (Investments – Debt and Equity Securities) to classification as loans under ASC 310 (Receivables). All periods presented have been restated to conform to this change. Accordingly, for all periods presented below, the Company's investment portfolio consists entirely of AFS investments and municipal debt obligations are reported as a component of the Company's loan portfolio (See Note 3). The reclassification of the municipal debt instruments in this portfolio did not have a material impact on the Company's consolidated financial statements or results of operations.

Debt securities the Company has purchased with the possible intent to sell before maturity are classified as AFS, and are carried at fair value, with unrealized gains and losses, net of tax and reclassification adjustments, reflected as a net amount in the shareholders' equity section of the consolidated balance sheets and in the statements of changes in shareholders' equity. Investment securities transactions are accounted for on a trade date basis. The specific identification method is used to determine realized gains and losses on sales of debt securities AFS and equity securities. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or call date. The Company does not hold any securities purchased for the purpose of selling in the near term and classified as trading. As a result of the reclassification noted in the first paragraph of this section, the Company does not hold any securities purchased with the positive intent and ability to hold to maturity and classified as HTM.

For individual debt securities that the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to (1) credit loss is recognized in earnings and (2) other factors is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the interest rates at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the OTTI is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

Other investments

In December 2011, the Company made an equity investment in a NMTC financing structure, which was fully amortized in 2017 (see Note 8). The Company's investment in the NMTC financing structure was amortized using the effective yield method.

From time to time, the Company acquires partnership interests in limited partnerships for low income housing projects. New investments in limited partnerships are amortized using the proportional amortization method. All investments made before January 1, 2015 are amortized using the effective yield method.

The Company has a one-third ownership interest in CFS Partners, which in turn owns 100% of CFSG, a non-depository trust company (see Note 8). The Company's investment in CFS Partners is accounted for under the equity method of accounting.

Restricted equity securities

The Company holds certain restricted equity securities acquired for non-investment purposes, and required as a matter of law or as a condition to the receipt of certain financial products and services. These securities are carried at cost. As a member of the FRBB, the Company is required to invest in FRBB stock in an amount equal to 6% of the Bank's capital stock and surplus.

As a member of the FHLBB, the Company is required to invest in $100 par value stock of the FHLBB in an amount that approximates 1% of unpaid principal balances on qualifying loans, plus an additional amount to satisfy an activity based requirement. The stock is nonmarketable and redeemable at par value, subject to the FHLBB's right to temporarily suspend such redemptions. Members are subject to capital calls in some circumstances to ensure compliance with the FHLBB's capital plan.

In order to access correspondent banking services from the ACBB, the Company is required to invest in a minimum of 20 shares of the common stock of ACBB's parent company, ACBI.

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. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

As disclosed earlier in Note 1 under the heading "Investment Securities", effective January 1, 2019 and in accordance with ASC 250 (Accounting Changes and Error Corrections), the Company chose to reclassify its municipal debt instruments from the investment portfolio into the loan portfolio. This change represents a voluntary reclassification of municipal debt instruments by management from classification as investment securities under ASC 320 (Investments – Debt and Equity Securities) to classification as loans under ASC 310 (Receivables). As stated earlier in this section, the reclassification of this portfolio did not have a material impact on the Company's consolidated financial statements or results of operations.

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance, adjusted for any charge-offs, the ALL, loan premiums or discounts for acquired loans and any unearned fees or costs on originated loans.

Loan interest income is accrued daily on the outstanding balances. For all loan segments, the accrual of interest is discontinued when a loan is specifically determined to be impaired or when the loan is delinquent 90 days and management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is generally not recognized on specific impaired loans unless the likelihood of further loss is considered by management to be remote. Interest payments received on non-accrual loans are generally applied as a reduction of the loan principal balance. Loans are returned to accrual status when principal and interest payments are brought current and the customer has demonstrated the intent and ability to make future payments on a timely basis. Loans are written down or charged off when collection of principal is considered doubtful.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount is amortized as an adjustment of the related loan's yield. The Company generally amortizes these amounts over the contractual life of the loans.

Loan premiums and discounts on loans acquired in the merger with LyndonBank were amortized as an adjustment to yield on loans. At December 31, 2019, the remainder of these premiums and discounts were fully amortized.

Allowance for loan losses

The ALL is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes that future payments of a loan balance are unlikely. Subsequent recoveries, if any, are credited to the allowance.

Unsecured loans, primarily consumer loans, are charged off when they become uncollectible and no later than 120 days past due. Unsecured loans to customers who subsequently file bankruptcy are charged off within 30 days of receipt of the notification of filing or by the end of the month in which the loans become 120 days past due, whichever occurs first. For secured loans, both residential and commercial, the potential loss on impaired loans is carried as a loan loss reserve specific allocation; the loss portion is charged off when collection of the full loan appears unlikely. The unsecured portion of a real estate loan is that portion of the loan exceeding the “fair value” of the collateral less the estimated cost to sell. Value of the collateral is determined in accordance with the Company’s appraisal policy. The unsecured portion of an impaired real estate secured loan is charged off by the end of the month in which the loan becomes 180 days past due.

As described below, the allowance consists of general, specific and unallocated components. However, the entire allowance is available to absorb losses in the loan portfolio, regardless of specific, general and unallocated components considered in determining the amount of the allowance.

General component

The general component of the ALL is based on historical loss experience and various qualitative factors and is stratified by the following loan segments: commercial and industrial, CRE, residential real estate 1st lien, residential real estate Jr lien and consumer loans. The Company does not disaggregate its portfolio segments further into classes.

Loss ratios are calculated by loan segment for one year, two year, three year, four year and five year look back periods. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment in the current economic climate. During periods of economic stability, a relatively longer period (e.g., five years) may be appropriate. During periods of significant expansion or contraction, the Company may appropriately shorten the historical time period. The Company is currently using an extended look back period of five years.

Qualitative factors include the levels of and trends in delinquencies and non-performing loans, levels of and trends in loan risk groups, trends in volumes and terms of loans, effects of any changes in loan related policies, experience, ability and the depth of management, documentation and credit data exception levels, national and local economic trends, external factors such as competition and regulation and lastly, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments, and the geographic distribution of CRE loans. This evaluation is inherently subjective as it requires estimates that are susceptible to revision as more information becomes available.

The qualitative factors are determined based on the various risk characteristics of each loan segment. The Company has policies, procedures and internal controls that management believes are commensurate with the risk profile of each of these segments. Major risk characteristics relevant to each portfolio segment are as follows:

Commercial & Industrial – Loans in this segment include commercial and industrial loans and to a lesser extent loans to finance agricultural production. Commercial loans are made to businesses and are generally secured by assets of the business, including trade assets and equipment. While not the primary collateral, in many cases these loans may also be secured by the real estate of the business. Repayment is expected from the cash flows of the business. A weakened economy, soft consumer spending, unfavorable foreign trade conditions and the rising cost of labor or raw materials are examples of issues that can impact the credit quality in this segment.

Commercial Real Estate – Loans in this segment are principally made to businesses and are generally secured by either owner-occupied, or non-owner occupied CRE. A relatively small portion of this segment includes farm loans secured by farm land and buildings. As with commercial and industrial loans, repayment of owner-occupied CRE loans is expected from the cash flows of the business and the segment would be impacted by the same risk factors as commercial and industrial loans. The non-owner occupied CRE portion includes both residential and commercial construction loans, vacant land and real estate development loans, multi-family dwelling loans and commercial rental property loans. Repayment of construction loans is expected from permanent financing takeout; the Company generally requires a commitment or eligibility for the take-out financing prior to construction loan origination. Real estate development loans are generally repaid from the sale of the subject real property as the project progresses. Construction and development lending entail additional risks, including the project exceeding budget, not being constructed according to plans, not receiving permits, or the pre-leasing or occupancy rate not meeting expectations. Repayment of multi-family loans and commercial rental property loans is expected from the cash flow generated by rental payments received from the individuals or businesses occupying the real estate. CRE loans are impacted by factors such as competitive market forces, vacancy rates, cap rates, net operating incomes, lease renewals and overall economic demand. In addition, loans in the recreational and tourism sector can be affected by weather conditions, such as unseasonably low winter snowfalls. CRE lending also carries a higher degree of environmental risk than other real estate lending.

Municipal – Loans in this segment are made to local municipalities, attributable to municipal financing transactions and backed by the full faith and credit of town governments or dedicated governmental revenue sources, with no historical losses recognized by the Company.

Residential Real Estate - 1st Lien – All loans in this segment are collateralized by first mortgages on 1 – 4 family owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate – Jr Lien – All loans in this segment are collateralized by junior lien mortgages on 1 – 4 family residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Consumer – Loans in this segment are made to individuals for consumer and household purposes. This segment includes both loans secured by automobiles and other consumer goods, as well as loans that are unsecured. This segment also includes overdrafts, which are extensions of credit made to both individuals and businesses to cover temporary shortages in their deposit accounts and are generally unsecured. The Company maintains policies restricting the size and term of these extensions of credit. The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.

<u>Specific component</u>

The specific component of the ALL relates to loans that are impaired. Impaired loans are loan(s) to a borrower that in the aggregate are greater than $100,000 and that are in non-accrual status or are TDRs regardless of amount. A specific allowance is established for an impaired loan when its estimated impaired basis is less than the carrying value of the loan. For all loan segments, except consumer loans, a loan is considered impaired when, based on current information and events, in management's estimation it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant or temporary payment delays and payment shortfalls generally are not classified as impaired. Management evaluates the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and frequency of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the

shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Impaired loans also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. TDRs may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms, or a combination of the two.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, unless such loans are subject to a restructuring agreement.

Unallocated component

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

Bank premises and equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets. The cost of assets sold or otherwise disposed of, and the related accumulated depreciation, are eliminated from the accounts and the resulting gains or losses are reflected in the consolidated statements of income. Maintenance and repairs are charged to current expense as incurred and the cost of major renewals and betterments is capitalized.

Other real estate owned

Real estate properties acquired through or in lieu of loan foreclosure or properties no longer used for bank operations are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a broker's market value analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. During periods of declining market values, the Company will generally obtain a new appraisal or evaluation. Any write-down based on the asset's fair value at the date of acquisition or institution of foreclosure is charged to the ALL. After acquisition through or in lieu of foreclosure, these assets are carried at the lower of their new cost basis or fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals by an independent, qualified appraiser are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on OREO properties in the portfolio that are deemed less significant or less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

Intangible assets

Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) in the Company's 2007 acquisition of LyndonBank. Goodwill is not amortizable and is reviewed for impairment annually, or more frequently as events or circumstances warrant.

Income taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgments relating to the outcome of such asset.

Mortgage servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or retained upon the sale of loans. Capitalized servicing rights are reported in other assets and initially recorded at fair value, and are amortized against non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing rights are periodically evaluated for impairment, based upon the estimated fair value of the rights as compared to amortized cost. Impairment is determined by stratifying the rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance and is recorded as amortization of other assets, to the extent that estimated fair value is less than the capitalized amount at the valuation date. Subsequent improvement, if any, in the estimated fair value of impaired MSRs is reflected in a positive valuation adjustment and is recognized in other income up to (but not in excess of) the amount of the prior impairment.

Pension costs

Pension costs are charged to salaries and employee benefits expense and accrued over the active service period.

Advertising costs

The Company expenses advertising costs as incurred.

Comprehensive income

US GAAP generally requires recognized revenue, expenses, gains and losses to be included in net income. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on available-for-sale securities, are not reflected in the consolidated statement of income, but the cumulative effect of such items from period-to-period is reflected as a separate component of the shareholders' equity section of the consolidated balance sheet (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income, comprises the Company's total comprehensive income.

Preferred stock

In December, 2007 the Company issued 25 shares of fixed-to-floating rate non-cumulative perpetual preferred stock, without par value and having a liquidation preference of $100,000 per share. There were 15 shares and 20 shares of preferred stock outstanding as of December 31, 2019 and 2018, respectively. Under the terms of the preferred stock, the Company pays non-cumulative cash dividends quarterly, when, as and if declared by the Board. Dividends are payable at a variable dividend rate equal to the Wall Street Journal Prime Rate in effect on the first business day of each quarterly dividend period. A variable rate of 4.50% was in effect for the first quarter of 2018, with increases during 2018 on a quarterly basis, to a rate of 5.25% for the fourth quarter of 2018. The variable rate increased to 5.50% for the dividend payments due in each of the first three quarters of 2019, followed by a decrease to a rate of 5.00% for the dividend payment in the fourth quarter of 2019. The rate that will be in effect for the first quarter of 2020 is 4.75%. The Company redeemed five shares of preferred stock on March 31, 2019 and 2018, at a redemption price of $500,000 for each such partial redemption, plus accrued dividends.

Earnings per common share

Earnings per common share amounts are computed based on net income, net of dividends to preferred shareholders, and on the weighted average number of shares of common stock issued during the period, including DRIP shares issuable upon reinvestment of dividends (retroactively adjusted for stock splits and stock dividends, if any) and reduced for shares held in treasury.

The following table illustrates the calculation of earnings per common share for the periods presented, as adjusted for the cash dividends declared on the preferred stock:

Years Ended December 31,	2019	2018
Net income, as reported	$ 8,824,446	$ 8,397,532
Less: dividends to preferred shareholders	87,500	103,125
Net income available to common shareholders	$ 8,736,946	$ 8,294,407
Weighted average number of common shares used in calculating earnings per share	5,204,768	5,139,297
Earnings per common share	$ 1.68	$ 1.61

Off-balance-sheet financial instruments

In the ordinary course of business, the Company is a party to off-balance-sheet financial instruments consisting of commitments to extend credit, commercial and municipal letters of credit, standby letters of credit, and risk-sharing commitments on residential mortgage loans sold through the FHLBB's MPF program. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Impact of recently issued accounting standards

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In July 2018, the FASB amended the updated guidance and provided an additional transition method for adoption of the guidance. The ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The ASU and related guidance became effective for the Company on January 1, 2019. The impact of adopting this ASU was not material to the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss, or CECL model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available for sale, which will require that credit losses on

those securities be recorded through an allowance for credit losses rather than a write-down. The ASU and related guidance may have a material impact on the Company's consolidated financial statements upon adoption as it will require a change in the Company's methodology for calculating its ALL and allowance on unused commitments. The Company will transition from an incurred loss model to an expected loss model, which will likely result in an increase in the ALL upon adoption and may negatively impact the Company's and the Bank's regulatory capital ratios. The Company has formed a committee to assess the implications of this new pronouncement and transitioned to a software solution for preparing the ALL calculation and related reports that management believes provides the Company with stronger data integrity, ease and efficiency in ALL preparation. The new software solution also provides numerous training opportunities for the appropriate personnel within the Company. The Company has gathered and is continuing to analyze the historical data to serve as a basis for estimating the ALL under CECL and continues to evaluate the impact of the adoption of the ASU on its consolidated financial statements. As initially proposed, the ASU was to be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 15, 2018, including interim periods within such years. However, in November 2019, the FASB issued ASU No. 2019-10, *Financial Instruments-Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842).* The ASU extends the effective date for compliance with the ASU by smaller reporting companies, which are now required to comply with the ASU for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, with early adoption permitted. The Company qualifies for this extension and does not intend to early adopt the ASU at this time. Management will continue to evaluate the Company's CECL compliance and implementation timetable in light of the extension.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e., step one). As initially proposed, the ASU was to be effective for the Company on January 1, 2020; however similar to ASU No. 2016-13, the effective date for this ASU was also extended and will be effective for the Company on January 1, 2023. The Company has evaluated the impact of this ASU and as permitted, plans to early adopt on January 1, 2020, with no material impact expected on its consolidated financial statements.

The Company has goodwill from its acquisition of LyndonBank in 2007 and performs an impairment test annually or more frequently if circumstances warrant (see Note 7).

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.* This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of its disclosure framework project. The standard is effective for all entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The ASU became effective for the Company on January 1, 2020. The Company does not anticipate that adoption of this ASU will have any material impact on its consolidated financial statements.

Note 2. Investment Securities

<u>Change in Accounting Principle</u>

Prior to 2019, the entire balance of the Company's HTM investment portfolio consisted of Municipal notes. Effective January 1, 2019, and in accordance with ASC 250 (Accounting Changes and Error Corrections), the Company chose to reclassify these debt instruments from the investment portfolio into the loan portfolio. This change represents a voluntary reclassification of municipal debt instruments from classification as investment securities under ASC 320 (Investments – Debt and Equity Securities) to classification as loans under ASC 310 (Receivables). All periods presented have been restated to conform to this change. Accordingly, for all periods presented below, the Company's investment portfolio consists entirely of AFS investments and municipal debt obligations are reported as a component of the Company's loan portfolio (See Note 3). The reclassification of the

municipal debt instruments in this portfolio did not have a material impact on the Company's consolidated financial statements or results of operations.

Debt securities AFS consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
U.S. GSE debt securities	$ 18,002,549	$ 99,743	$ 40,672	$ 18,061,620
Agency MBS	16,169,819	86,874	51,318	16,205,375
ABS and OAS	2,799,657	55,418	2,166	2,852,909
Other investments	8,665,000	181,846	0	8,846,846
Total	$ 45,637,025	$ 423,881	$ 94,156	$ 45,966,750
December 31, 2018				
U.S. GSE debt securities	$ 14,010,100	$ 394	$ 259,391	$ 13,751,103
Agency MBS	16,020,892	2,701	449,068	15,574,525
ABS and OAS	1,988,565	3,806	6,242	1,986,129
Other investments	8,167,000	8,472	120,398	8,055,074
Total	$ 40,186,557	$ 15,373	$ 835,099	$ 39,366,831

Investments pledged as collateral for larger dollar repurchase agreement accounts and for other purposes as required or permitted by law consisted of U.S. GSE debt securities, Agency MBS, ABS and OAS, and CDs. These repurchase agreements mature daily. These investments as of the balance sheet dates were as follows:

	Amortized Cost	Fair Value
December 31, 2019	$ 45,637,025	$ 45,966,750
December 31, 2018	40,186,557	39,366,831

Proceeds from sales of debt securities AFS were $6,553,118 in 2019 and $5,715,525 in 2018 with gains of $1,570 and $0, respectively, and losses of $28,060 and $32,718, respectively.

The carrying amount and estimated fair value of securities by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may call or prepay obligations with or without call or prepayment penalties, pursuant to contractual terms. Because the actual maturities of Agency MBS usually differ from their contractual maturities due to the right of borrowers to prepay the underlying mortgage loans, usually without penalty, those securities are not presented in the following table by contractual maturity date.

The scheduled maturities of debt securities AFS at December 31, 2019 were as follows:

	Amortized Cost	Fair Value
Due in one year or less	$ 2,760,515	$ 2,766,254
Due from one to five years	9,674,948	9,862,450
Due from five to ten years	15,042,170	15,147,201
Due after ten years	1,989,573	1,985,470
Agency MBS	16,169,819	16,205,375
Total	$ 45,637,025	$ 45,966,750

Debt securities with unrealized losses as of the balance sheet dates are presented in the tables below.

	Less than 12 months		12 months or more		Totals		
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss
December 31, 2019							
U.S. GSE debt securities	$ 7,964,192	$ 40,672	$ 0	$ 0	7	$ 7,964,192	$ 40,672
Agency MBS	5,273,683	24,648	2,920,091	26,670	13	8,193,774	51,318
Other investments	1,000,490	2,166	0	0	1	1,000,490	2,166
Total	$ 14,238,365	$ 67,486	$ 2,920,091	$ 26,670	21	$ 17,158,456	$ 94,156
December 31, 2018							
U.S. GSE debt securities	$ 1,465,947	$ 6,752	$ 11,284,761	$ 252,639	11	$ 12,750,708	$ 259,391
Agency MBS	2,317,838	22,029	12,223,386	427,039	24	14,541,224	449,068
ABS and OAS	976,226	6,242	0	0	1	976,226	6,242
Other investments	1,956,914	20,086	4,113,688	100,312	25	6,070,602	120,398
Total	$ 6,716,925	$ 55,109	$ 27,621,835	$ 779,990	61	$ 34,338,760	$ 835,099

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions, or adverse developments relating to the issuer, warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

As the Company has the ability to hold its debt securities until maturity, or for the foreseeable future if classified as AFS, and it is more likely than not that the Company will not have to sell such securities before recovery of their cost basis, no declines in such securities were deemed to be other-than-temporary as of the balance sheet dates presented.

The Bank is a member of the FHLBB. The FHLBB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. The Company obtains much of its wholesale funding from the FHLBB. As a requirement of membership in the FHLBB, the Bank must own a minimum required amount of FHLBB stock, calculated periodically based primarily on the Bank's level of borrowings from the FHLBB. As a result of the Bank's level of borrowings during 2019 and 2018, the Bank was

required to purchase additional FHLBB stock in aggregate totaling $176,000 and $1,103,300, respectively. As a member of the FHLBB, the Company is also subject to future capital calls by the FHLBB in order to maintain compliance with its capital plan. During 2019 and 2018, FHLBB exercised capital call options with redemptions totaling $493,600 and $1,147,500, respectively, on the Company's portfolio of FHLBB stock. As of December 31, 2019 and 2018, the Company's investment in FHLBB stock was $753,700 and $1,071,300, respectively.

The Company periodically evaluates its investment in FHLBB stock for impairment based on, among other factors, the capital adequacy of the FHLBB and its overall financial condition. No impairment losses have been recorded through December 31, 2019.

The Company's investment in FRBB Stock was $588,150 at December 31, 2019 and 2018.

In 2018, the Company purchased 20 shares of common stock in ACBI at a purchase price of $90,000, for the purpose of obtaining access to correspondent banking services from ABCI's subsidiary, ACBB. These shares are subject to contractual resale restrictions and considered by management to be restricted and are recorded in the balance sheet at cost amounting to $90,000 at December 31, 2019 and 2018.

Note 3. Loans, Allowance for Loan Losses and Credit Quality

Change in Accounting Principle

As disclosed in Note 2 (Investment Securities), effective January 1, 2019 and in accordance with ASC 250 (Accounting Changes and Error Corrections), the Company chose to reclassify its municipal debt instruments from the investment portfolio into the loan portfolio. This change represents a voluntary reclassification of municipal debt instruments by management from classification as investment securities under ASC 320 (Investments – Debt and Equity Securities) to classification as loans under ASC 310 (Receivables). As stated in Note 2, the reclassification of this portfolio did not have a material impact on the Company's consolidated financial statements or results of operations.

The composition of net loans as of the balance sheet dates was as follows:

December 31,	**2019**	**2018**
Commercial & industrial	$ 98,930,831	$ 80,766,693
Commercial real estate	246,282,726	235,318,148
Municipal	55,817,206	47,067,023
Residential real estate - 1st lien	158,337,296	165,665,175
Residential real estate - Jr lien	43,230,873	44,544,987
Consumer	4,390,005	5,088,491
Total loans	606,988,937	578,450,517
Deduct (add):		
ALL	5,926,491	5,602,541
Deferred net loan costs	(362,415)	(363,614)
Net loans	$ 601,424,861	$ 573,211,590

The following is an age analysis of loans (including non-accrual), as of the balance sheet dates, by portfolio segment:

December 31, 2019	30-89 Days	90 Days or More	Total Past Due	Current	Total Loans	Non-Accrual Loans	90 Days or More and Accruing
Commercial & industrial	$ 68,532	$ 44,503	$ 113,035	$ 98,817,796	$ 98,930,831	$ 480,083	$ 0
Commercial real estate	1,690,307	151,723	1,842,030	244,440,696	246,282,726	1,600,827	0
Municipal	0	0	0	55,817,206	55,817,206	0	0
Residential real estate							
- 1st lien	3,871,045	1,217,098	5,088,143	153,249,153	158,337,296	2,112,267	530,046
- Jr lien	331,416	147,976	479,392	42,751,481	43,230,873	240,753	112,386
Consumer	49,607	0	49,607	4,340,398	4,390,005	0	0
Totals	$ 6,010,907	$ 1,561,300	$ 7,572,207	$ 599,416,730	$ 606,988,937	$ 4,433,930	$ 642,432

December 31, 2018	30-89 Days	90 Days or More	Total Past Due	Current	Total Loans	Non-Accrual Loans	90 Days or More and Accruing
Commercial & industrial	$ 217,385	$ 0	$ 217,385	$ 80,549,308	$ 80,766,693	$ 84,814	$ 0
Commercial real estate	1,509,839	190,789	1,700,628	233,617,520	235,318,148	1,742,993	0
Municipal	0	0	0	47,067,023	47,067,023	0	0
Residential real estate							
- 1st lien	4,108,319	1,371,061	5,479,380	160,185,795	165,665,175	2,026,939	622,486
- Jr lien	484,855	353,914	838,769	43,706,218	44,544,987	408,540	104,959
Consumer	43,277	1,661	44,938	5,043,553	5,088,491	0	1,661
Totals	$ 6,363,675	$ 1,917,425	$ 8,281,100	$ 570,169,417	$ 578,450,517	$ 4,263,286	$ 729,106

For all loan segments, loans over 30 days past due are considered delinquent.

As of the balance sheet dates presented, residential mortgage loans in process of foreclosure consisted of the following:

	Number of loans	Balance
December 31, 2019	9	$ 495,943
December 31, 2018	12	961,709

The following summarizes changes in the ALL and select loan information, by portfolio segment:

As of or for the year ended December 31, 2019

	Commercial & Industrial	Commercial Real Estate	Municipal	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Unallocated	Total
ALL beginning balance	$ 697,469	$ 3,019,868	$ 0	$ 1,421,494	$ 273,445	$ 56,787	$ 133,478	$ 5,602,541
Charge-offs	(175,815)	(116,186)	0	(242,244)	(222,999)	(102,815)	0	(860,059)
Recoveries	10,768	50,388	0	15,776	2,200	38,710	0	117,842
Provision	304,344	227,576	0	193,538	237,038	59,111	44,560	1,066,167
ALL ending balance	$ 836,766	$ 3,181,646	$ 0	$ 1,388,564	$ 289,684	$ 51,793	$ 178,038	$ 5,926,491
ALL evaluated for impairment								
Individually	$ 0	$ 0	$ 0	$ 103,836	$ 712	$ 0	$ 0	$ 104,548
Collectively	836,766	3,181,646	0	1,284,728	288,972	51,793	178,038	5,821,943
Total	$ 836,766	$ 3,181,646	$ 0	$ 1,388,564	$ 289,684	$ 51,793	$ 178,038	$ 5,926,491
Loans evaluated for impairment								
Individually	$ 420,933	$ 1,699,238	$ 0	$ 4,471,902	$ 156,073	$ 0		$ 6,748,146
Collectively	98,509,898	244,583,488	55,817,206	153,865,394	43,074,800	4,390,005		600,240,791
Total	$ 98,930,831	$ 246,282,726	$ 55,817,206	$ 158,337,296	$ 43,230,873	$ 4,390,005		$ 606,988,937

As of or for the year ended December 31, 2018

	Commercial & Industrial	Commercial Real Estate	Municipal	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Unallocated	Total
ALL beginning balance	$ 675,687	$ 2,674,029	$ 0	$ 1,460,547	$ 316,982	$ 43,303	$ 267,551	$ 5,438,099
Charge-offs	(152,860)	(124,645)	0	(251,654)	(69,173)	(143,688)	0	(742,020)
Recoveries	60,192	0	0	26,832	1,420	38,018	0	126,462
Provision (credit)	114,450	470,484	0	185,769	24,216	119,154	(134,073)	780,000
ALL ending balance	$ 697,469	$3,019,868	$ 0	$ 1,421,494	$ 273,445	$ 56,787	$ 133,478	$ 5,602,541
ALL evaluated for impairment								
Individually	$ 0	$ 0	$ 0	$ 112,969	$ 1,757	$ 0	$ 0	$ 114,726
Collectively	697,469	3,019,868	0	1,308,525	271,688	56,787	133,478	5,487,815
Total	$ 697,469	$ 3,019,868	$ 0	$ 1,421,494	$ 273,445	$ 56,787	$ 133,478	$ 5,602,541
Loans evaluated for impairment								
Individually	$ 60,846	$ 1,746,894	$ 0	$ 4,392,060	$ 319,321	$ 0		$ 6,519,121
Collectively	80,705,847	233,571,254	47,067,023	161,273,115	44,225,666	5,088,491		571,931,396
Total	$ 80,766,693	$ 235,318,148	$ 47,067,023	$ 165,665,175	$ 44,544,987	$ 5,088,491		$ 578,450,517

Impaired loans as of the balance sheet dates, by portfolio segment were as follows:

	As of December 31, 2019			2019	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Related allowance recorded					
Commercial & industrial	$ 0	$ 0	$ 0	$ 32,466	$ 0
Commercial real estate	0	0	0	97,720	0
Residential real estate					
- 1st lien	878,439	902,000	103,836	982,158	86,039
- Jr lien	6,121	6,101	712	6,869	648
Total with related allowance	884,560	908,101	104,548	1,119,213	86,687
No related allowance recorded					
Commercial & industrial	420,933	445,509		307,208	6,396
Commercial real estate	1,699,772	2,031,764		1,812,836	21,591
Residential real estate					
- 1st lien	3,614,960	4,273,884		3,778,822	212,883
- Jr lien	149,972	157,754		224,938	4,524
Total with no related allowance	5,885,637	6,908,911		6,123,804	245,394
Total impaired loans	$ 6,770,197	$ 7,817,012	$ 104,548	$ 7,243,017	$ 332,081

In the table above, recorded investment in impaired loans as of December 31, 2019 includes accrued interest receivable and deferred net loan costs of $22,051.

	As of December 31, 2018			2018	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Related allowance recorded					
Commercial real estate	$ 0	$ 0	$ 0	$ 57,658	$ 0
Residential real estate					
- 1st lien	942,365	963,367	112,969	836,326	45,139
- Jr lien	7,271	7,248	1,757	77,555	351
Total with related allowance	949,636	970,615	114,726	971,539	45,490
No related allowance recorded					
Commercial & industrial	60,846	80,894		120,924	0
Commercial real estate	1,748,323	1,975,831		1,663,794	13,131
Residential real estate					
- 1st lien	3,465,117	4,082,637		3,497,772	94,313
- Jr lien	312,072	351,139		235,970	0
Total with no related allowance	5,586,358	6,490,501		5,518,460	107,444
Total impaired loans	$ 6,535,994	$ 7,461,116	$ 114,726	$ 6,489,999	$ 152,934

In the table above, recorded investment in impaired loans as of December 31, 2018 includes accrued interest receivable and deferred net loan costs of $16,873.

Credit Quality Grouping

In developing the ALL, management uses credit quality grouping to help evaluate trends in credit quality. The Company groups credit risk into Groups A, B and C. The manner the Company utilizes to assign risk grouping is driven by loan purpose. Commercial purpose loans are individually risk graded while the retail portion of the portfolio is generally grouped by delinquency pool.

Group A loans - Acceptable Risk – are loans that are expected to perform as agreed under their respective terms. Such loans carry a normal level of risk that does not require management attention beyond that warranted by the loan or loan relationship characteristics, such as loan size or relationship size. Group A loans include commercial purpose loans that are individually risk rated and retail loans that are rated by pool. Group A retail loans include performing consumer and residential real estate loans. Residential real estate loans are loans to individuals secured by 1-4 family homes, including first mortgages, home equity and home improvement loans. Loan balances fully secured by deposit accounts or that are fully guaranteed by the federal government are considered acceptable risk.

Group B loans – Management Involved - are loans that require greater attention than the acceptable risk loans in Group A. Characteristics of such loans may include, but are not limited to, borrowers that are experiencing negative operating trends such as reduced sales or margins, borrowers that have exposure to adverse market conditions such as increased competition or regulatory burden, or borrowers that have had unexpected or adverse changes in management. These loans have a greater likelihood of migrating to an unacceptable risk level if these characteristics are left unchecked. Group B is limited to commercial purpose loans that are individually risk rated.

Group C loans – Unacceptable Risk – are loans that have distinct shortcomings that require a greater degree of management attention. Examples of these shortcomings include a borrower's inadequate capacity to service debt, poor operating performance, or insolvency. These loans are more likely to result in repayment through collateral liquidation. Group C loans range from those that are likely to sustain some loss if the shortcomings are not corrected, to those for which loss is imminent and non-accrual treatment is warranted. Group C loans include individually rated commercial purpose loans and retail loans adversely rated in accordance with the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification Policy. Group C retail loans include 1-4 family residential real estate loans and home equity loans past due 90 days or more with loan-to-value ratios greater than 60%, home equity loans 90 days or more past due where the Bank does not hold first mortgage, irrespective of loan-to-value, loans in bankruptcy where repayment is likely but not yet established, and lastly consumer loans that are 90 days or more past due.

Commercial purpose loan ratings are assigned by the commercial account officer; for larger and more complex commercial loans, the credit rating is a collaborative assignment by the lender and the credit analyst. The credit risk rating is based on the borrower's expected performance, i.e., the likelihood that the borrower will be able to service its obligations in accordance with the loan terms. Credit risk ratings are meant to measure risk versus simply record history. Assessment of expected future payment performance requires consideration of numerous factors. While past performance is part of the overall evaluation, expected performance is based on an analysis of the borrower's financial strength, and historical and projected factors such as size and financing alternatives, capacity and cash flow, balance sheet and income statement trends, the quality and timeliness of financial reporting, and the quality of the borrower's management. Other factors influencing the credit risk rating to a lesser degree include collateral coverage and control, guarantor strength and commitment, documentation, structure and covenants and industry conditions. There are uncertainties inherent in this process.

Credit risk ratings are dynamic and require updating whenever relevant information is received. Risk ratings are assessed on an ongoing basis and at various points, including at delinquency or at the time of other adverse events. For larger, more complex or adversely rated loans, risk ratings are also assessed at the time of annual or periodic review. Lenders are required to make immediate disclosure to the Senior Credit Officer of any known increase in loan risk, even if considered temporary in nature.

The risk ratings within the loan portfolio, by segment, as of the balance sheet dates were as follows:

As of December 31, 2019

	Commercial & Industrial	Commercial Real Estate	Municipal	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Total
Group A	$ 93,774,871	$ 233,702,063	$ 55,817,206	$ 154,770,678	$ 42,725,543	$ 4,390,005	$ 585,180,366
Group B	3,295,223	4,517,811	0	0	0	0	7,813,034
Group C	1,860,737	8,062,852	0	3,566,618	505,330	0	13,995,537
Total	$ 98,930,831	$ 246,282,726	$ 55,817,206	$ 158,337,296	$ 43,230,873	$ 4,390,005	$ 606,988,937

As of December 31, 2018

	Commercial & Industrial	Commercial Real Estate	Municipal	Residential Real Estate 1st Lien	Residential Real Estate Jr Lien	Consumer	Total
Group A	$ 78,585,348	$ 226,785,919	$ 47,067,023	$ 161,293,233	$ 43,817,872	$ 5,086,830	$ 562,636,225
Group B	90,763	246,357	0	224,992	0	0	562,112
Group C	2,090,582	8,285,872	0	4,146,950	727,115	1,661	15,252,180
Total	$ 80,766,693	$ 235,318,148	$ 47,067,023	$ 165,665,175	$ 44,544,987	$ 5,088,491	$ 578,450,517

Modifications of Loans and TDRs

A loan is classified as a TDR if, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider.

The Company is deemed to have granted such a concession if it has modified a troubled loan in any of the following ways:

- Reduced accrued interest;
- Reduced the original contractual interest rate to a rate that is below the current market rate for the borrower;
- Converted a variable-rate loan to a fixed-rate loan;
- Extended the term of the loan beyond an insignificant delay;
- Deferred or forgiven principal in an amount greater than three months of payments; or
- Performed a refinancing and deferred or forgiven principal on the original loan.

An insignificant delay or insignificant shortfall in the amount of payments typically would not require the loan to be accounted for as a TDR. However, pursuant to regulatory guidance, any payment delay longer than three months is generally not considered insignificant. Management's assessment of whether a concession has been granted also takes into account payments expected to be received from third parties, including third-party guarantors, provided that the third party has the ability to perform on the guarantee.

The Company's TDRs are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only, on a limited basis, reduced interest rates for borrowers below the current market rate for the borrower. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings, nor has it converted variable rate terms to fixed rate terms. However, the Company evaluates each TDR situation on its own merits and does not foreclose the granting of any particular type of concession.

New TDRs, by portfolio segment, for the periods presented were as follows:

Year ended December 31, 2019

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial & industrial	6	$ 371,358	$ 372,259
Commercial real estate	1	19,266	21,628
Residential real estate			
- 1st lien	6	755,476	798,800
- Jr lien	1	55,557	57,415
	14	$ 1,201,657	$ 1,250,102

Year ended December 31, 2018

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate	1	$ 406,920	$ 406,920
Residential real estate - 1st lien	10	1,031,330	1,142,089
	11	$ 1,438,250	$ 1,549,009

The TDRs for which there was a payment default during the twelve month periods presented were as follows:

Year ended December 31, 2019

	Number of Contracts	Recorded Investment
Commercial & industrial	2	$ 27,818
Residential real estate - 1st lien	1	227,907
Residential real estate - Jr lien	1	55,010
	4	$ 310,735

Year ended December 31, 2018

	Number of Contracts	Recorded Investment
Commercial real estate	1	$ 400,646
Residential real estate - 1st lien	3	518,212
	4	$ 918,858

TDRs are treated as other impaired loans and carry individual specific reserves with respect to the calculation of the ALL. These loans are categorized as non-performing, may be past due, and are generally adversely risk rated. The TDRs that have defaulted under their restructured terms are generally in collection status and their reserve is typically calculated using the fair value of collateral method.

The specific allowances related to TDRs as of the balance sheet dates presented were as follows:

	2019	2018
Specific Allowance	$ 104,548	$ 114,726

As of the balance sheet dates, the Company evaluates whether it is contractually committed to lend additional funds to debtors with impaired, non-accrual or modified loans. The Company is contractually committed to lend under one SBA guaranteed line of credit to a borrower whose lending relationship was previously restructured.

Note 4. Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $167,673,467 and $176,083,984 at December 31, 2019 and 2018, respectively. Net gain realized on the sale of loans was $290,116 and $345,780 for the years ended December 31, 2019 and 2018, respectively.

The following table summarizes changes in MSRs for the years ended December 31,

	2019	2018
Balance at beginning of year	$ 1,004,948	$ 1,083,286
MSRs capitalized	114,580	110,209
MSRs amortized	(179,951)	(188,547)
Balance at end of year	$ 939,577	$ 1,004,948

There was no valuation allowance in the periods presented.

Note 5. Bank Premises and Equipment

The major classes of bank premises and equipment and accumulated depreciation and amortization at December 31 were as follows:

	2019	2018
Buildings and improvements	$ 10,575,514	$ 10,555,868
Land and land improvements	2,650,671	2,586,373
Furniture and equipment	6,848,263	6,460,625
Leasehold improvements	1,161,073	1,155,284
Finance lease	588,347	991,014
Operating leases	1,490,779	0
Other prepaid assets	159,914	55,406
	23,474,561	21,804,570
Less accumulated depreciation and amortization	(12,515,158)	(12,091,115)
Net bank premises and equipment	$ 10,959,403	$ 9,713,455

Note 6. Leases

The Company adopted ASU No. 2016-02 (Leases) on January 1, 2019 with no required adjustment to prior periods presented or cumulative-effect adjustment to retained earnings. The Company has operating and finance leases for some of its bank premises, with remaining lease terms of one year to seven years. Some of the operating leases have options to renew, which are reflected in the seven years. The Company's operating lease right-of-use assets and finance lease assets are included in "Bank premises and equipment, net" in the consolidated balance sheet and operating lease liabilities and finance lease liabilities are included in other liabilities in the consolidated balance sheet.

The components of lease expense for the periods presented were as follows:

Years Ended December 31,	2019	2018
Operating lease cost	$ 255,475	$ 230,888
Finance lease cost:		
Amortization of right-of-use assets	$ 70,667	$ 70,667
Interest on lease liabilities	16,705	26,399
Variable rent expense	33,940	33,940
Total finance lease cost	$ 121,312	$ 131,006

Total rental expense not associated with operating lease costs above amounted to $16,601 and $16,924 for the years ended December 31, 2019 and 2018, respectively.

Supplemental cash flow information related to right-of-use assets and for lease obligations recorded upon adoption of ASU No. 2016-02 (Note 1) was as follows:

Year Ended December 31,	2019
Operating Leases	$ 1,455,829

Supplemental balance sheet information related to leases was as follows:

December 31,	2019	2018
Operating Leases		
Operating lease right-of-use assets	$ 1,254,384	$ 0
Operating lease liabilities	$ 1,263,173	$ 0
Finance Leases		
Finance lease right-of-use assets	$ 124,347	$ 213,679
Finance lease liabilities	$ 99,823	$ 266,747

December 31,	2019	2018
Weighted Average Remaining Lease Term		
Operating Leases	4.4 Years	5.9 Years
Finance Leases	1.5 Years	2.0 Years
Weighted Average Discount Rate		
Operating Leases	1.28%	N/A
Finance Leases	7.50%	7.86%

Operating lease obligations

The Company is obligated under non-cancelable operating leases for bank premises expiring in various years through 2026, with options to renew. Minimum future rental payments for these leases with original terms in excess of one year as of December 31, 2019 for each of the next five years and in aggregate are:

2020	$ 257,039
2021	210,350
2022	207,380
2023	210,232
2024	186,448
Subsequent to 2024	249,424
Total	$ 1,320,873

Finance lease obligations

The following is a schedule by years of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of December 31, 2019:

2020	$ 67,060
2021	39,119
Total minimum lease payments	106,179
Less amount representing interest	(6,356)
Present value of net minimum lease payments	$ 99,823

A reconciliation of the undiscounted cash flows in the maturity analysis above and the lease liability recognized in the consolidated balance sheet as of December 31, 2019, is shown below:

	Operating Leases	Finance Leases
Undiscounted cash flows	$ 1,320,873	$ 106,179
Discount effect of cash flows	(57,700)	(6,356)
Lease liabilities	$ 1,263,173	$ 99,823

Note 7. Goodwill and Other Intangible Asset

As a result of the acquisition of LyndonBank on December 31, 2007, the Company recorded goodwill amounting to $11,574,269. The goodwill is not amortizable and is not deductible for tax purposes. Management evaluated goodwill for impairment at December 31, 2019 and 2018 and concluded that no impairment existed as of such dates.

Note 8. Other Investments

In 2011, the Company established a single-member LLC to facilitate the purchase of federal NMTC through an investment structure designed by a local community development entity. The equity investment was fully amortized at December 31, 2017, and the Company exited the equity investment, including termination of its interest in the LLC, during the last quarter of 2018.The LLC did not conduct any business apart from its role in the NMTC financing structure.

The Company purchases from time to time interests in various limited partnerships established to acquire, own and rent residential housing for low and moderate income residents of northeastern and central Vermont. The tax credits from these investments were $415,099 and $437,229 for the years ended December 31, 2019 and 2018, respectively. Expenses related to amortization of the investments in the limited partnerships are recognized as a component of income tax expense, and were $312,106 and $410,061 for 2019 and 2018, respectively. The carrying values of the limited partnership investments were $2,762,406 and $2,263,512 at December 31, 2019 and 2018, respectively, and are included in other assets.

The Bank has a one-third ownership interest in a non-depository trust company, CFSG, based in Newport, Vermont, which is held indirectly through CFS Partners, a Vermont LLC that owns 100% of the LLC equity interests of CFSG. The Bank accounts for its investment in CFS Partners under the equity method of accounting. The Company's investment in CFS Partners, included in other assets, amounted to $3,535,527 and $2,946,831 as of December 31, 2019 and 2018, respectively. The Company recognized income of $588,696 and $514,485 for 2019 and 2018, respectively, through CFS Partners from the operations of CFSG.

Note 9. Deposits

The following is a maturity distribution of time deposits at December 31, 2019:

2020	$ 55,256,906
2021	31,341,156
2022	12,249,473
2023	7,319,609
2024	10,031,175
Total CDs	$ 116,198,319

Total deposits in excess of the FDIC insurance level amounted to $178,997,035 as of December 31, 2019.

Note 10. Borrowed Funds

Outstanding advances for the Company as of the balance sheet dates presented were as follows:

	2019	2018
Long-Term Advances(1)		
FHLBB term advance, 0.00%, due February 26, 2021	$ 350,000	$ 350,000
FHLBB term advance, 0.00%, due November 22, 2021	1,000,000	1,000,000
FHLBB term advance, 0.00%, due September 22, 2023	200,000	200,000
FHLBB term advance, 0.00%, due November 12, 2025	300,000	0
FHLBB term advance, 0.00%, due November 13, 2028	800,000	0
	$ 2,650,000	$ 1,550,000

(1) The FHLBB is providing a subsidy, funded by the FHLBB's earnings, to write down interest rates to zero percent on JNE advances that finance qualifying loans to small businesses. JNE advances must support small business in New England that create and/or retain jobs, or otherwise contribute to overall economic development activities.

Borrowings from the FHLBB are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by 1-4 family residential properties, as well as certain qualifying CRE loans. Qualified collateral for these borrowings totaled $135,672,471 and $148,323,822 as of December 31, 2019 and 2018, respectively, and the Company's gross potential borrowing capacity under this arrangement was $97,358,249 and $108,736,234, respectively, before reduction for outstanding advances and collateral pledges.

Under a separate agreement with the FHLBB, the Company has the authority to collateralize public unit deposits, up to its available borrowing capacity, with letters of credit issued by the FHLBB. At December 31, 2019, $14,425,000 in FHLBB letters of credit was utilized as collateral for these deposits compared to $2,625,000 at December 31, 2018. Total fees paid by the Company in connection with issuance of these letters of credit were $41,069 for 2019 and $46,620 for 2018.

The Company also maintained a $500,000 IDEAL Way Line of Credit with the FHLBB at December 31, 2019 and 2018, with no outstanding advances under this line at either year-end date. Interest on these borrowings is at a rate determined daily by the FHLBB and payable monthly.

The Company also has a line of credit with the FRBB, which is intended to be used as a contingency funding source. For this BIC arrangement, the Company pledged eligible commercial and industrial loans, CRE loans

not pledged to FHLBB and home equity loans, resulting in an available line of $56,896,877 and $50,913,351 as of December 31, 2019 and 2018, respectively. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), which was 225 basis points as of December 31, 2019. As of December 31, 2019 and 2018, the Company had no outstanding advances against this line.

The Company has unsecured lines of credit with three correspondent banks, with aggregate available borrowing capacity totaling $12,500,000 at December 31, 2019 and 2018. The Company had no outstanding advances against these lines for the periods presented.

Note 11. Junior Subordinated Debentures

As of December 31, 2019 and 2018, the Company had outstanding $12,887,000 principal amount of Junior Subordinated Debentures due in 2037 (the Debentures). The Debentures bear a floating rate equal to the 3-month London Interbank Offered Rate plus 2.85%. During 2019, the floating rate averaged 5.33% per quarter compared to an average rate of 4.95% per quarter for 2018. The Debentures mature on December 15, 2037 and are subordinated and junior in right of payment to all senior indebtedness of the Company, as defined in the Indenture dated as of October 31, 2007 between the Company and Wilmington Trust Company, as Trustee. The Debentures first became redeemable, in whole or in part, by the Company on December 15, 2012. Interest paid on the Debentures for 2019 and 2018 was $694,573 and $650,361, respectively, and is deductible for tax purposes.

The Debentures were issued and sold to CMTV Statutory Trust I (the Trust). The Trust is a special purpose trust funded by a capital contribution of $387,000 from the Company, in exchange for 100% of the Trust's common equity. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities (Capital Securities) in the principal amount of $12.5 million to third-party investors and using the proceeds from the sale of such Capital Securities and the Company's initial capital contribution to purchase the Debentures. The Debentures are the sole asset of the Trust. Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the Debentures. The Company has entered into an agreement which, taken collectively, fully and unconditionally guarantees the payments on the Capital Securities, subject to the terms of the guarantee.

The Debentures are currently includable in the Company's Tier 1 capital up to 25% of core capital elements (see Note 21).

Note 12. Repurchase Agreements

Securities sold under agreements to repurchase mature daily and consisted of the following as of the balance sheet dates:

December 31,	**2019**	**2018**
Current balance	$ 33,189,848	$ 30,521,565
Average balance	33,545,527	30,554,953
Highest month-end balance	38,868,833	32,938,807
Weighted average interest rate	0.89%	0.63%
Pledged Investment (1)		
Amortized Cost	45,637,025	40,186,557
Fair Value	45,966,750	39,366,831

(1) U.S. GSE securities, Agency MBS, ABS and OAS, and CDs were pledged as collateral for the periods presented.

Note 13. Income Taxes

The Company prepares its income tax return on a consolidated basis. Income taxes are allocated to members of the consolidated group based on taxable income.

The components of the Provision for income taxes for the years ended December 31 were as follows:

	2019	2018
Currently paid or payable	$ 1,693,624	$ 1,749,624
Deferred expense (benefit)	96,236	(11,359)
Total income tax expense(1)	$ 1,789,860	$ 1,738,265

(1) Due to an increase of loan activity in 2019 in the state of New Hampshire, the Company is now subject to sales tax nexus on the income generated from this loan activity. An estimated tax payment of $10,000 was made to the state of New Hampshire during the fourth quarter of 2019 in anticipation of tax due for the 2019 tax year.

Total income tax expense differed from the amounts computed at the statutory federal income tax rate of 21% primarily due to the following for the years ended December 31:

	2019	2018
Computed expense at statutory rates	$ 2,236,904	$ 2,128,517
Tax exempt interest and BOLI	(306,073)	(291,550)
Disallowed interest	15,798	11,631
Partnership rehabilitation and tax credits	(415,099)	(437,229)
Low income housing investment amortization expense	246,564	323,948
Other	11,766	2,948
	$ 1,789,860	$ 1,738,265

The deferred income tax expense (benefit) consisted of the following items for the years ended December 31:

	2019	2018
Depreciation	$ 126,734	$ 25,782
MSRs	(13,728)	(16,451)
Deferred compensation	3,701	3,681
Bad debts	(68,029)	(34,533)
Limited partnership amortization	60,588	(20,129)
Investment in CFS Partners	(3,323)	(1,014)
Loan fair value	(6,171)	(2,228)
OREO write down	0	13,860
Prepaid expenses	(10,741)	(846)
Other	7,205	20,519
Change in deferred tax expense (benefit)	$ 96,236	$ (11,359)

Listed below are the significant components of the net deferred tax asset at December 31:

	2019	2018
Components of the deferred tax asset:		
Bad debts	$ 1,244,563	$ 1,176,534
Deferred compensation	12,898	16,599
Contingent liability - MPF program	17,838	17,838
Finance lease	11,930	23,287
Unrealized loss on debt securities AFS	0	172,143
Other	16,346	11,968
Total deferred tax asset	1,303,575	1,418,369
Components of the deferred tax liability:		
Depreciation	384,197	257,463
Limited partnerships	76,995	16,407
MSRs	197,311	211,039
Unrealized gain on debt securities AFS	69,242	0
Investment in CFS Partners	71,054	74,377
Operating lease	226	0
Prepaid expenses	68,738	79,479
Fair value adjustment on acquired loans	0	6,171
Total deferred tax liability	867,763	644,936
Net deferred tax asset	$ 435,812	$ 773,433

US GAAP provides for the recognition and measurement of deductible temporary differences (including general valuation allowances) to the extent that it is more likely than not that the deferred tax asset will be realized.

The net deferred tax asset is included in other assets in the consolidated balance sheets.

ASC Topic 740, Income Taxes, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the consolidated financial statements. The Company has adopted these provisions and there was no material effect on the consolidated financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2016 through 2018. The 2019 tax return has not yet been filed.

Note 14. 401(k) and Profit-Sharing Plan

The Company has a defined contribution plan covering all employees who meet certain age and service requirements. The pension expense was $624,000 and $617,800 for 2019 and 2018, respectively. These amounts represent discretionary matching contributions of a portion of the voluntary employee salary deferrals under the 401(k) plan and discretionary profit-sharing contributions under the plan.

Note 15. Deferred Compensation and Supplemental Employee Retirement Plans

The Company maintains a directors' deferred compensation plan and, prior to 2005, maintained a retirement plan for its directors. Participants are general unsecured creditors of the Company with respect to these benefits. The benefits accrued under these plans were $61,421 and $79,045 at December 31, 2019 and 2018, respectively. Expenses associated with these plans were $376 and $474 for the years ended December 31, 2019 and 2018, respectively.

Note 16. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees, commitments to sell loans and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the maximum extent of involvement the Company has in particular classes of financial instruments.

The Company's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Company applies the same credit policies and underwriting criteria in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company generally requires collateral or other security to support financial instruments with credit risk. At December 31, the following off-balance-sheet financial instruments representing credit risk were outstanding:

	Contract or Notional Amount	
	2019	2018
Unused portions of home equity lines of credit	$ 32,784,105	$ 31,328,881
Residential and commercial construction lines of credit	12,364,436	7,251,560
Commercial real estate commitments	24,377,588	26,588,950
Commercial and industrial commitments	47,659,341	45,135,452
Other commitments to extend credit	64,469,012	53,586,720
Standby letters of credit and commercial letters of credit	1,375,500	2,408,581
Recourse on sale of credit card portfolio	254,430	284,680
MPF credit enhancement obligation, net (See Note 17)	552,158	552,158

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. At December 31, 2019 and 2018, the Company had binding loan commitments to sell residential mortgages at fixed rates totaling $1,643,200 and $391,840, respectively (see Note 17). The recourse provision under the terms of the sale of the Company's credit card portfolio in 2007 is based on total lines, not balances outstanding. Based on historical losses, the Company does not expect any significant losses from this commitment.

The Company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit, or a commitment to extend credit, is based on management's credit evaluation of the counter-party. Collateral or other security held varies but may include real estate, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit or providing reimbursement guarantees for the benefit of the Company's commercial customers is essentially the same as that involved in extending loans to customers. The fair value of standby letters of credit and reimbursement guarantees on letters of credit has not been included in the balance sheets as the fair value is immaterial.

In connection with its 2007 trust preferred securities financing, the Company guaranteed the payment obligations under the $12,500,000 of capital securities of its subsidiary, the Trust. The source of funds for payments by the Trust on its capital trust securities is payments made by the Company on its debentures issued to the Trust. The Company's obligation under those debentures is fully reflected in the Company's consolidated balance sheet, in the gross amount of $12,887,000 as of the dates presented, of which $12,500,000 represents external financing through the issuance to investors of capital securities by the Trust (see Note 11).

Note 17. Contingent Liability

The Company sells first lien 1-4 family residential mortgage loans under the MPF program with the FHLBB. Under this program the Company shares in the credit risk of each mortgage loan, while receiving fee income in return. The Company is responsible for a CEO based on the credit quality of these loans. FHLBB funds a FLA based on the Company's outstanding MPF mortgage balances. This creates a laddered approach to sharing in any losses. In the event of default, homeowner's equity and private mortgage insurance, if any, are the first sources of repayment; the FHLBB's FLA funds are then utilized, followed by the participant's CEO, with the balance of losses absorbed by FHLBB. These loans must meet specific underwriting standards of the FHLBB. As of December 31, 2019 and 2018, the Company had $33,990,463 and $38,935,411, respectively, in loans sold through the MPF program and on which the Company had a CEO. As of December 31, 2019 and 2018, the notional amount of the maximum CEO related to this program was $637,102, and the accrued contingent liability for this CEO was $84,944. The contingent liability is calculated by management based on the methodology used in calculating the ALL, adjusted to reflect the risk sharing arrangements with the FHLBB.

Note 18. Legal Proceedings

In the normal course of business, the Company is involved in various claims and legal proceedings. In the opinion of the Company's management, any liabilities resulting from such proceedings are not expected to be material to the Company's consolidated financial condition or results of operations.

Note 19. Transactions with Related Parties

Aggregate loan transactions of the Company with directors, principal officers, their immediate families and affiliated companies in which they are principal owners (commonly referred to as related parties) as of December 31 were as follows:

	2019	2018
Balance, beginning of year	$ 6,730,842	$ 7,356,906
Loans - New Directors	0	936,445
New loans to existing Principal Officers/Directors	4,491,524	5,582,052
Repayment	(2,094,824)	(7,144,561)
Balance, end of year	$ 9,127,542	$ 6,730,842

Total funds of related parties on deposit with the Company were $8,942,886 and $6,179,453 at December 31, 2019 and 2018, respectively.

Prior to May 2018, the Company leased 2,253 square feet of condominium space in the state office building on Main Street in Newport, Vermont to its trust company affiliate, CFSG, for its principal offices. In May 2018, CFSG purchased the condominium space from the Company. CFSG also leases offices in the Company's Barre and Lyndonville branches. The amount of rental income received from CFSG for the years ended December 31, 2019 and 2018 was $9,821 and $30,365, respectively.

The Company utilizes the services of CFSG as an investment advisor for the Company's 401(k) plan. The Human Resources committee of the Board of Directors is the Trustee of the plan, and CFSG provides investment advice for the plan. CFSG also acts as custodian of the retirement funds and makes investments on behalf of the plan and its participants. In addition, prior to liquidation of the SERP assets, CFSG served as investment advisor and custodian of funds under the Company's SERP. The Company pays monthly management fees to CFSG for its services to the 401(k) plan amounting to $57,209 and $47,676, respectively, for the years ended December 31, 2019 and 2018.

Note 20. Restrictions on Cash and Due From Banks

In the ordinary course of business, the Company may, from time to time, maintain amounts due from correspondent banks that exceed federally insured limits. However, no losses have occurred in these accounts and the Company believes it is not exposed to any significant risk with respect to such accounts. The Company was required to maintain contracted balances with a correspondent bank of $30,000 at December 31, 2019 and 2018.

Note 21. Regulatory Capital Requirements

The Company (on a consolidated basis) and the Bank are subject to various 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 and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and 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. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Additional prompt corrective action capital requirements are applicable to banks, but not to bank holding companies.

Under current banking rules governing required regulatory capital, the Company and the Bank are required to maintain minimum amounts and ratios (set forth in the table on the following page) of Common equity tier 1, Tier 1 and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). The Company's non-cumulative Series A preferred stock ($1.5 million liquidation preference in 2019 and $2.0 million in 2018) is includable without limitation in its Common equity tier 1 and Tier 1 capital. The Company is allowed to include in Common equity tier 1 and Tier 1 capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity, less certain intangibles, including goodwill, net of any related deferred income tax liability, with the balance includable in Tier 2 capital. Management believes that, as of December 31, 2019, the Company and the Bank met all capital adequacy requirements to which they were subject.

Under the 2018 Regulatory Relief Act, these capital requirements have been simplified for qualifying community banks and bank holding companies. In September 2019, the OCC and the other federal bank regulators approved a final joint rule that permits a qualifying community banking organization to opt in to a simplified regulatory capital framework. A qualifying institution that elects to utilize the simplified framework must maintain a CBLR in excess of 9%, and will thereby be deemed to have satisfied the generally applicable risk-based and other leverage capital requirements and (if applicable) the FDIC's prompt corrective action framework. In order to utilize the CBLR framework, in addition to maintaining a CBLR of over 9%, a community banking organization must have less than $10 billion in total consolidated assets and must meet certain other criteria such as limitations on the amount of off-balance sheet exposures and on trading assets and liabilities. The CBLR will be calculated by dividing tangible equity capital by average total consolidated assets. The final rule became effective on January 1, 2020. Management believes that the Company and Bank would qualify to utilize the CBLR framework on a pro forma basis as of December 31, 2019 had it been in effect on that date.

Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer was fully phased-in on January 1, 2019 at 2.5% of risk-weighted assets. A banking organization with a conservation buffer of less than 2.5% is subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The Company and the Bank were fully compliant with a capital conservation buffer of 6.63% and 6.53%, respectively, in effect at December 31, 2019, and 6.08% and 5.97%, respectively, in effect at December 31, 2018.

As of December 31, 2019, the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action and the Company exceeded applicable consolidated regulatory guidelines for capital adequacy.

The following table shows the regulatory capital ratios for the Company and the Bank as of December 31:

	Actual		Minimum For Capital Adequacy Purposes:		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions(1):	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
December 31, 2019						
Common equity tier 1 capital (to risk-weighted assets)						
Company	$ 69,947	13.48%	$ 23,352	4.50%	N/A	N/A
Bank	$ 69,330	13.38%	$ 23,325	4.50%	$ 33,691	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	$ 69,947	13.48%	$ 31,135	6.00%	N/A	N/A
Bank	$ 69,330	13.38%	$ 31,099	6.00%	$ 41,466	8.00%
Total capital (to risk-weighted assets)						
Company	$ 75,943	14.63%	$ 41,514	8.00%	N/A	N/A
Bank	$ 75,326	14.53%	$ 41,466	8.00%	$ 51,832	10.00%
Tier 1 capital (to average assets)						
Company	$ 69,947	9.57%	$ 29,223	4.00%	N/A	N/A
Bank	$ 69,330	9.50%	$ 29,201	4.00%	$ 36,501	5.00%
December 31, 2018:						
Common equity tier 1 capital (to risk-weighted assets)						
Company	$ 64,564	12.94%	$ 22,446	4.50%	N/A	N/A
Bank	$ 63,960	12.84%	$ 22,419	4.50%	$ 32,384	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	$ 64,564	12.94%	$ 29,928	6.00%	N/A	N/A
Bank	$ 63,960	12.84%	$ 29,893	6.00%	$ 39,857	8.00%
Total capital (to risk-weighted assets)						
Company	$ 70,210	14.08%	$ 39,904	8.00%	N/A	N/A
Bank	$ 69,606	13.97%	$ 39,857	8.00%	$ 49,821	10.00%
Tier 1 capital (to average assets)						
Company	$ 64,564	9.26%	$ 27,890	4.00%	N/A	N/A
Bank	$ 63,960	9.18%	$ 27,867	4.00%	$ 34,834	5.00%

(1) Applicable to banks, but not bank holding companies.

The Company's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to the Company. The Bank is restricted by law as to the amount of dividends that can be paid. Dividends declared by national banks that exceed net income for the current and preceding two years must be approved by the Bank's primary banking regulator, the Office of the Comptroller of the Currency. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above.

Note 22. Fair Value

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. The fair values of some of these assets and liabilities are measured on a recurring basis while others are measured on a non-recurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available-for-sale are recorded at fair value on a recurring basis. Other assets, such as MSRs, loans held-for-sale, impaired loans, and OREO are recorded at fair value on a non-recurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with Level 1 considered highest and Level 3 considered lowest). A brief description of each level follows.

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes MSRs, collateral-dependent impaired loans and OREO.

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

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

Debt Securities AFS: Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds and default rates. Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include federal agency securities.

Impaired loans: Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. If the fair value is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the ALL. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of collateral-dependent loans using Level 2 inputs, such as the fair value of collateral based on independent third-party appraisals.

Loans held-for-sale: The fair value of loans held-for-sale is based upon an actual purchase and sale agreement between the Company and an independent market participant. The sale is executed within a reasonable period following quarter end at the stated fair value.

MSRs: MSRs represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method and compared to fair value for impairment. In evaluating the carrying values of MSRs, the Company obtains third party valuations based on loan level data including note rate, and the type and term of the underlying loans. The Company classifies MSRs as non-recurring Level 2.

OREO: Real estate acquired through or in lieu of foreclosure and bank properties no longer used as bank premises are initially recorded at fair value. The fair value of OREO is based on property appraisals and an analysis of similar properties currently available. The Company records OREO as non-recurring Level 2.

Assets Recorded at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis and reflected in the consolidated balance sheets at December 31, segregated by fair value hierarchy, are summarized below:

Level 2	**2019**	**2018**
Assets: (market approach)		
U.S. GSE debt securities	$ 18,061,620	$ 13,751,103
Agency MBS	16,205,375	15,574,525
ABS and OAS	2,852,909	1,986,129
Other investments	8,846,846	8,055,074
	$ 45,966,750	$ 39,366,831

There were no Level 1 or Level 3 assets or liabilities measured on a recurring basis as of the balance sheet dates presented, nor were there any transfers of assets between Levels during either 2019 or 2018.

Assets Recorded at Fair Value on a Non-Recurring Basis

The following table includes assets measured at fair value on a non-recurring basis that have had a fair value adjustment since their initial recognition. Impaired loans measured at fair value only include impaired loans with a related specific ALL and are presented net of specific allowances as disclosed in Note 3, there were none for 2019 and 2018.

Assets measured at fair value on a non-recurring basis and reflected in the consolidated balance sheets at December 31, segregated by fair value hierarchy, are summarized below:

Level 2	**2019**	**2018**
Assets: (market approach)		
MSRs (1)	$ 939,577	$ 1,004,948
OREO	966,738	201,386

(1) Represents MSRs at lower of cost or fair value, including MSRs deemed to be impaired and for which a valuation allowance was established to carry at fair value at December 31, 2019 and 2018.

There were no Level 1 or Level 3 assets or liabilities measured on a non-recurring basis as of the balance sheet dates presented, nor were there any transfers of assets between Levels during either 2019 or 2018.

FASB ASC Topic 825, “Financial Instruments”, requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not

available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The carrying amounts and estimated fair values of the Company's financial instruments were as follows:

December 31, 2019	**Carrying Amount**	**Fair Value Level 1**	**Fair Value Level 2**	**Fair Value Level 3**	**Fair Value Total**
	(Dollars in Thousands)				
Financial assets:					
Cash and cash equivalents	$ 48,562	$ 48,562	$ 0	$ 0	$ 48,562
Debt securities AFS	45,967	0	45,967	0	45,967
Restricted equity securities	1,432	0	1,432	0	1,432
Loans and loans held-for-sale, net of ALL					
Commercial & industrial	98,062	0	0	97,356	97,356
Commercial real estate	243,022	0	0	242,735	242,735
Municipal (1)	55,817	0	0	55,867	55,867
Residential real estate - 1st lien	156,897	0	0	156,520	156,520
Residential real estate - Jr lien	42,927	0	0	42,950	42,950
Consumer	4,337	0	0	4,306	4,306
MSRs (2)	940	0	1,250	0	1,250
Accrued interest receivable	2,337	0	2,337	0	2,337
Financial liabilities:					
Deposits					
Other deposits	603,872	0	604,267	0	604,267
Brokered deposits	11,149	0	11,153	0	11,153
Long-term borrowings	2,650	0	2,427	0	2,427
Repurchase agreements	33,190	0	33,190	0	33,190
Operating lease obligations	1,263	0	1,263	0	1,263
Finance lease obligations	100	0	100	0	100
Subordinated debentures	12,887	0	12,831	0	12,831
Accrued interest payable	139	0	139	0	139

(1) Prior to reclassification to the loan portfolio effective January 1, 2019, all loans in this category were reported as HTM securities as a component of Investment Securities. All prior periods have been restated to conform to the reclassification.

(2) Reported fair value represents all MSRs for loans serviced by the Company at December 31, 2019, regardless of carrying amount.

December 31, 2018	Carrying Amount	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3	Fair Value Total
	(Dollars in Thousands)				
Financial assets:					
Cash and cash equivalents	$ 67,935	$ 67,935	$ 0	$ 0	$ 67,935
Debt securities AFS	39,367	0	39,367	0	39,367
Restricted equity securities	1,749	0	1,749	0	1,749
Loans and loans held-for-sale, net of ALL					
Commercial & industrial	80,049	0	0	79,773	79,773
Commercial real estate	232,239	0	0	230,532	230,532
Municipal (1)	47,067	0	0	47,228	47,228
Residential real estate - 1st lien	164,202	0	0	161,068	161,068
Residential real estate - Jr lien	44,260	0	0	44,127	44,127
Consumer	5,031	0	0	5,063	5,063
MSRs (2)	1,005	0	1,481	0	1,481
Accrued interest receivable	2,301	0	2,301	0	2,301
Financial liabilities:					
Deposits					
Other deposits	573,525	0	571,952	0	571,952
Brokered deposits	35,292	0	35,247	0	35,247
Long-term borrowings	1,550	0	1,425	0	1,425
Repurchase agreements	30,522	0	30,522	0	30,522
Capital lease obligations	267	0	267	0	267
Subordinated debentures	12,887	0	12,807	0	12,807
Accrued interest payable	113	0	113	0	113

(1) Prior to reclassification to the loan portfolio effective January 1, 2019, all loans in this category were reported as HTM securities as a component of Investment Securities. All prior periods have been restated to conform to the reclassification.

(2) Reported fair value represents all MSRs for loans serviced by the Company at December 31, 2018, regardless of carrying amount.

The estimated fair values of commitments to extend credit, letters of credit and financial guarantees for the benefit of customers were immaterial at December 31, 2019 and 2018.

Note 23. Condensed Financial Information (Parent Company Only)

The following condensed financial statements are for Community Bancorp. (Parent Company Only), and should be read in conjunction with the consolidated financial statements of the Company.

Community Bancorp. (Parent Company Only) Balance Sheets	**December 31, 2019**	**December 31, 2018**
Assets		
Cash	$ 744,687	$ 720,620
Investment in subsidiary - Community National Bank	81,164,447	74,886,386
Investment in Capital Trust	387,000	387,000
Income taxes receivable	213,071	207,244
Total assets	$ 82,509,205	$ 76,201,250
Liabilities and Shareholders' Equity		
Liabilities		
Junior subordinated debentures	$ 12,887,000	$ 12,887,000
Dividends payable	727,526	710,539
Total liabilities	13,614,526	13,597,539
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 15 and 20 shares issued and outstanding at December 31, 2019 and 2018, respectively ($100,000 liquidation value, per share)	1,500,000	2,000,000
Common stock - $2.50 par value; 15,000,000 shares authorized, 5,449,857 and 5,382,103 shares issued at December 31, 2019 and 2018, respectively (including 16,267 and 17,442 shares issued February 1, 2020 and 2019, respectively)	13,624,643	13,455,258
Additional paid-in capital	33,464,381	32,536,532
Retained earnings	22,667,949	17,882,282
Accumulated other comprehensive income (loss)	260,483	(647,584)
Less: treasury stock, at cost; 210,101 shares at December 31, 2019 and 2018	(2,622,777)	(2,622,777)
Total shareholders' equity	68,894,679	62,603,711
Total liabilities and shareholders' equity	$ 82,509,205	$ 76,201,250

The investment in the subsidiary bank is carried under the equity method of accounting. The investment and cash, which is on deposit with the Bank, have been eliminated in consolidation.

Community Bancorp. (Parent Company Only) Condensed Statements of Income	Years Ended December 31, 2019	2018
Income		
Bank subsidiary distributions	$ 4,256,000	$ 4,137,000
Dividends on Capital Trust	20,858	19,530
Total income	4,276,858	4,156,530
Expense		
Interest on junior subordinated debentures	694,573	650,361
Administrative and other	340,904	356,055
Total expense	1,035,477	1,006,416
Income before applicable income tax benefit and equity in undistributed net income of subsidiary	3,241,381	3,150,114
Income tax benefit	213,071	207,244
Income before equity in undistributed net income of subsidiary	3,454,452	3,357,358
Equity in undistributed net income of subsidiary	5,369,994	5,040,174
Net income	$ 8,824,446	$ 8,397,532

Community Bancorp. (Parent Company Only) Condensed Statements of Cash Flows	Years Ended December 31, 2019	2018
Cash Flows from Operating Activities		
Net income	$ 8,824,446	$ 8,397,532
Adjustments to reconcile net income to net cash provided by operating activities		
Equity in undistributed net income of subsidiary	(5,369,994)	(5,040,174)
(Increase) decrease in income taxes receivable	(5,827)	82,980
Net cash provided by operating activities	3,448,625	3,440,338
Cash Flows from Financing Activities		
Redemption of preferred stock	(500,000)	(500,000)
Dividends paid on preferred stock	(87,500)	(103,125)
Dividends paid on common stock	(2,837,058)	(2,672,985)
Net cash used in financing activities	(3,424,558)	(3,276,110)
Net increase in cash	24,067	164,228
Cash		
Beginning	720,620	556,392
Ending	$ 744,687	$ 720,620
Cash Received for Income Taxes	$ 207,244	$ 290,224
Cash Paid for Interest	$ 694,573	$ 650,361
Dividends paid:		
Dividends declared	$ 3,951,279	$ 3,799,864
Increase in dividends payable attributable to dividends declared	(16,987)	(80,078)
Dividends reinvested	(1,097,234)	(1,046,801)
	$ 2,837,058	$ 2,672,985

Note 24. Quarterly Financial Data (Unaudited)

A summary of financial data for the four quarters of 2019 and 2018 is presented below:

2019	March 31,	June 30,	September 30,	December 31,
Interest income	$ 7,698,368	$ 8,262,422	$ 7,906,454	$ 7,891,564
Interest expense	1,538,540	1,546,953	1,509,033	1,548,595
Provision for loan losses	212,503	141,666	412,499	299,499
Non-interest income	1,318,700	1,434,138	1,597,332	1,595,896
Non-interest expense	5,155,924	5,079,060	4,863,716	4,782,580
Net income	1,771,905	2,419,298	2,261,943	2,371,300
Earnings per common share	0.34	0.46	0.43	0.45

2018	March 31,	June 30,	September 30,	December 31,
Interest income	$ 6,776,838	$ 7,028,859	$ 7,517,022	$ 7,791,884
Interest expense	868,749	938,499	1,220,145	1,457,695
Provision for loan losses	180,000	180,000	210,000	210,000
Non-interest income	1,395,670	1,690,161	1,542,793	1,552,684
Non-interest expense	4,731,116	5,103,975	4,874,332	5,185,603
Net income	1,982,543	2,002,654	2,269,732	2,142,603
Earnings per common share	0.38	0.39	0.44	0.40

Note 25. Other Income and Other Expenses

The components of other income and other expenses which are in excess of one percent of total revenues in either of the two years disclosed are as follows:

	2019	2018
Income		
Income from investment in CFS Partners	$588,696	$514,485
Expenses		
Outsourcing expense	$428,668	$480,563
Service contracts - administration	539,510	512,902
Marketing	450,533	552,617
State deposit tax	669,502	633,185
ATM fees	434,270	412,813

Note 26. Subsequent Events

Declaration of Cash Dividend

On December 16, 2019, the Company declared a cash dividend of $0.19 per share payable February 1, 2020 to shareholders of record as of January 15, 2020. On March 11, 2020, the Company declared a cash dividend of $0.19 per share payable May 1, 2020 to shareholders of record as of April 15, 2020. These dividends have been recorded as of each declaration date, including shares issuable under the DRIP.

For purposes of accrual or disclosure in these financial statements, the Company has evaluated subsequent events through the date of issuance of these financial statements.

For the Years Ended December 31, 2019 and 2018

The following discussion analyzes the consolidated financial condition of the Company and its wholly-owned subsidiary, Community National Bank, as of December 31, 2019 and 2018, and its consolidated results of operations for the years then ended. The Company is considered a "smaller reporting company" under the disclosure rules of the SEC (as amended in 2018). Accordingly, the Company has elected to provide its audited statements of income, comprehensive income, cash flows and changes in shareholders' equity for a two year, rather than a three year, period and intends to provide smaller reporting company scaled disclosures where management deems it appropriate. Beginning with its periodic reports filed in 2018, the Company is also considered an accelerated filer under the financial reporting rules of the SEC.

The following discussion should be read in conjunction with the Company's audited consolidated financial statements and related notes. Please refer to Note 1 in the accompanying audited consolidated financial statements for a listing of acronyms and defined terms used throughout the following discussion.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements about the results of operations, financial condition and business of the Company and its subsidiary. Words used in the discussion below such as "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements included in this discussion include, but are not limited to, estimated contingent liability related to assumptions made within the asset/liability management process, management's expectations as to the future interest rate environment and the Company's related liquidity level, credit risk expectations relating to the Company's loan portfolio and its participation in the FHLBB MPF program, and management's general outlook for the future performance of the Company or the local or national economy. Although forward-looking statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. In addition, the factors set forth in Part I, Item 1A-Risk Factors in this report and other cautionary statements and information contained in this report should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiary.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities:

- general economic or business conditions, either nationally, regionally or locally, deteriorate, resulting in a decline in credit quality or a diminished demand for the Company's products and services;
- competitive pressures increase among financial service providers in the Company's northern New England market area or in the financial services industry generally, including competitive pressures from non-bank financial service providers, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems;
- interest rates change in such a way as to negatively affect the Company's net income, asset valuations or margins;
- changes in laws or government rules, including the rules of the federal Consumer Financial Protection Bureau, or the way in which courts or government agencies interpret or implement those laws or rules, increase our costs of doing business, causing us to limit or change our product offerings or pricing, or otherwise adversely affect the Company's business;
- changes in federal or state tax laws or policy;

- changes in the level of nonperforming assets and charge-offs;
- changes in applicable accounting policies, practices and standards, including, without limitation, implementation of pending changes to the measurement of credit losses in financial statements under US GAAP pursuant to the CECL model;
- changes in consumer and business spending, borrowing and savings habits;
- reductions in deposit levels, which necessitate increased borrowings to fund loans and investments;
- the geographic concentration of the Company's loan portfolio and deposit base;
- losses due to the fraudulent or negligent conduct of third parties, including the Company's service providers, customers and employees;
- cybersecurity risks could adversely affect the Company's business, financial performance or reputation and could result in financial liability for losses incurred by customers or others due to data breaches or other compromise of the Company's information security systems;
- higher-than-expected costs are incurred relating to information technology or difficulties arise in implementing technological enhancements;
- management's risk management measures may not be completely effective;
- changes in the United States monetary and fiscal policies, including the interest rate policies of the FRB and its regulation of the money supply;
- adverse changes in the credit rating of U.S. government debt; and
- the planned phase out the London Interbank Offered Rate (LIBOR) by the end of 2021, which could adversely affect the Company's interest costs in future periods on its $12,887,000 in principal amount of Junior Subordinated Debentures due December 12, 2037, which bear interest at a variable rate, adjusted quarterly, equal to 3-month LIBOR, plus 2.85%.

Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company does not undertake, and disclaims any obligation, to revise or update any forward-looking statements to reflect the occurrence or anticipated occurrence of events or circumstances after the date of this Report, except as required by applicable law. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

NON-GAAP FINANCIAL MEASURES

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with GAAP must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company's reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, three non-GAAP financial measures commonly used by financial institutions, namely tax-equivalent net interest income and tax-equivalent net interest margin (as presented in the tables in the section labeled Interest Income Versus Interest Expense (NII)) and core earnings (as defined and discussed in the Results of Operations section), have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC would regard those measures as subject to Regulation G.

Management believes that these non-GAAP financial measures are useful in evaluating the Company's financial performance and facilitate comparisons with the performance of other financial institutions. However, that information should be considered supplemental in nature and not as a substitute for related financial information prepared in accordance with GAAP.

OVERVIEW

The Company's consolidated assets at year-end 2019 were $738.0 million compared to $720.3 million at year-end 2018, an increase of 2.4%. Net loans increased 4.9% to $601.4 million, driven primarily by an increase in commercial and municipal, loans with a combined increase of $29.1 million year over year, to $345.2 million. Loan growth during 2019 was also enhanced with approximately $7.2 million in purchased commercial loans from BHG and two commercial real estate loans participations totaling $5.4 million with the ACBB. Funding for these

increases was provided, in part, by a $6.2 million net increase in deposits, primarily in the form of core non-maturity deposits, as well as a decrease in cash of $19.4 million. The AFS portfolio increased $6.6 million, or 16.8% for year over year. As noted in Note 1 to the accompanying audited consolidated financial statements, the Company chose to reclassify its HTM investment portfolio, which is made up entirely of obligations to local municipalities, into the loan portfolio, effective January 1, 2019. All prior period information has been adjusted accordingly. The Company had no loans held-for-sale at either year-end reporting period. Average non-maturity deposit balances increased year over year, offset in part by a modest 1.3% decline in retail CD balances as rate competition began to increase during the year, drawing away some rate-sensitive accounts. Capital grew to $68.9 million with a book value of $12.86 per common share on December 31, 2019, compared to $62.6 million in capital and a book value of $11.72 per common share on December 31, 2018.

The purchased loan volume mentioned above was through a new loan purchasing program with BHG. BHG originates commercial loans to medical professionals nationwide and sells them individually to a secondary market, primarily banks, through a bid process. The Bank has established conservative credit parameters and expects a low risk of default in this portfolio. Average loan size is approximately $200,000, with average term of 100 months. With average duration expected to be slightly longer than the commercial portfolio average, the Company's participation in the BHG program reduces exposure to falling rates in the near term. In addition, this portfolio supports asset growth and provides geographic diversification.

The Company's net income of $8.8 million, or $1.68 per common share, for 2019 was up 5.1%, compared to net income of $8.4 million, or $1.61 per common share, in 2018. Net interest income contributed significantly to the Company's increase in earnings. Average earning-assets increased $34.0 million, or 5.4%, in 2019, and tax-equivalent interest income increased by $2.7 million, or 9.1%, resulting in an increase in average yield on interest-earning assets of 16 basis points. The increase in interest income is due in part to a $440,000 prepayment penalty received in the second quarter of 2019, as well as increases in short-term rates. While the increase in short-term rates has had a positive impact on interest income earlier in the year, it later put upward pressure on interest rates paid on deposit accounts and other borrowings. This pressure has lessened somewhat, at least in the near term, as short-term rates later declined in the third quarter. Please refer to the interest rate sensitivity discussion in the Interest Rate Risk and Asset and Liability Management section for more information on the impact that changes in interest rates and in the yield curve could have on net interest income.

Average interest-bearing liabilities increased $23.2 million, or 4.6%, during the year, and the average rate paid on interest-bearing liabilities increased 28 basis points, resulting in an increase in interest expense of $1.7 million. The combined effect of the changes in average yield and in average rate paid resulted in an increase of $1.0 million in tax-equivalent net interest income, and a slight decrease in net interest margin from 3.95% to 3.90% year over year.

Growth of the loan portfolio combined with charge off activity related to write-down adjustments on several loans in workout required a provision for loan losses of $1,066,167 for 2019 compared to $780,000 for 2018, an increase of 36.7%. Please refer to the ALL and provisions discussion in the Credit Risk section for more information on these increases.

Non-interest income decreased $235,242, or 3.8%, year over year due mostly to a one-time gain during 2018 of $263,118 from the sale of certain office premises to the Company's affiliate CFSG. While increases are noted in salaries, wages and employee benefits, both periods were positively impacted by a decrease in other expenses due to the distribution of $164,007 in Small Bank deposit-insurance assessment credits issued by the FDIC, representing 69.5% of the Company's total FDIC assessment for 2019. Please refer to the Non-interest Income and Non-interest Expense sections for more information on these changes.

According to the State of Vermont Department of Labor, Vermont's unemployment rate for December, 2019 was 2.3%, compared to 2.7% in December, 2018, and remains well below the national average of 3.5%. General business conditions remain stable to improving with improvements mainly in the Chittenden and Washington Counties, offset by some continued weakness in rural markets. Of the Company's primary market areas, Orleans, Caledonia, and Essex Counties continue to have the highest unemployment rates in the state, while Washington and Franklin Counties are showing some signs of improvement running slightly below the state average. While

employment numbers continue to look good, business expansion is challenged by a lack of skilled workforce. In response to the workforce challenges, the Vermont Department of Labor has placed labor force expansion at the top of its priority list and has created a State Registered Apprenticeship Program, which is an employer-sponsored training program that includes both work experience and industry-specific instruction. Travel and tourism continues to be a focus of the Vermont economy with Orleans, Caledonia and Essex Counties, in particular, focusing on the outdoor recreation economy. The 2019-2020 winter season has been favorable for outdoor recreation with plenty of snowfall and relatively mild temperatures.

The Company declared dividends of $0.76 per common share in 2019 compared to $0.74 per common share in 2018. As of December 31, 2019, the Company reported retained earnings of $22.7 million, compared to $17.9 million as of December 31, 2018 and total shareholders' equity of $68.9 million and $62.6 million, respectively. The Company is committed to remaining a well-capitalized community bank, working to meet the needs of our customers while providing a fair return to our shareholders.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared according to US GAAP. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities in the consolidated financial statements and related notes. The SEC has defined a company's critical accounting policies as those that are most important to the portrayal of the Company's financial condition and results of operations, and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Because of the significance of these estimates and assumptions, there is a high likelihood that materially different amounts would be reported for the Company under different conditions or using different assumptions or estimates. Management evaluates on an ongoing basis its judgment as to which policies are considered to be critical.

ALL - Management believes that the calculation of the ALL is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the ALL, management considers historical experience as well as other qualitative factors, including the effect of current economic indicators and their probable impact on borrowers and collateral, trends in delinquent and non-performing loans, trends in criticized and classified assets, levels of exceptions, the impact of competition in the market, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments and the geographic distribution of CRE loans. Management's estimates used in calculating the ALL may increase or decrease based on changes in these factors, which in turn will affect the amount of the Company's provision for loan losses charged against current period income. This evaluation is inherently subjective and actual results could differ significantly from these estimates under different assumptions, judgments or conditions.

OREO – Real estate properties acquired through or in lieu of foreclosure or properties no longer used for bank operations, are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a broker's market value analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. During periods of declining market values, the Company will generally obtain a new appraisal or evaluation. The amount, if any, by which the recorded amount of the loan exceeds the fair value, less estimated cost to sell, is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. The recorded amount of the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest. After acquisition through or in lieu of foreclosure, these assets are carried at the lower of their new cost basis or fair value. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals by an independent, qualified appraiser are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on properties in the portfolio that are deemed less significant or less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

Investment Securities - Management performs quarterly reviews of individual debt securities in the investment portfolio to determine whether a decline in the fair value of a security is other than temporary. A review of OTTI requires management to make certain judgments regarding the materiality of the decline and the probability, extent and timing of a valuation recovery, the Company's intent to continue to hold the security and, in the case of debt securities, the likelihood that the Company will not have to sell the security before recovery of its cost basis. Management assesses fair value declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition and business prospects, or to market-related or other external factors, such as interest rates, and in the case of debt securities, the extent to which the impairment relates to credit losses of the issuer, as compared to other factors. Declines in the fair value of debt securities below their cost that are deemed to be other than temporary, and declines in fair value of debt securities below their cost that are related to credit losses, are recorded in earnings as realized losses, net of tax effect. The non-credit loss portion of an other than temporary decline in the fair value of debt securities below their cost basis (generally, the difference between the fair value and the estimated net present value of expected future cash flows from the debt security) is recognized in other comprehensive income as an unrealized loss, provided that the Company does not intend to sell the security and it is more likely than not that the Company will not have to sell the security before recovery of its reduced basis.

MSRs - MSRs associated with loans originated and sold, where servicing is retained, are required to be capitalized and initially recorded at fair value on the acquisition date and are subsequently accounted for using the "amortization method". Mortgage servicing rights are amortized against non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. The value of capitalized servicing rights represents the estimated present value of the future servicing fees arising from the right to service loans for third parties. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of estimated fair value compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as a reduction of non-interest income. Subsequent improvement (if any) in the estimated fair value of impaired mortgage servicing rights is reflected in a positive valuation adjustment and is recognized in non-interest income up to (but not in excess of) the amount of the prior impairment. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments. Factors that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. The Company analyzes and accounts for the value of its servicing rights with the assistance of a third party consultant.

Goodwill - Goodwill from an acquisition accounted for under the purchase accounting method, such as the Company's 2007 acquisition of LyndonBank, is subject to ongoing periodic impairment evaluation, which includes an analysis of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions. This evaluation is inherently subjective.

Other - Management utilizes numerous techniques to estimate the carrying value of various assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. The use of different estimates or assumptions could produce different estimates of carrying values and those differences could be material in some circumstances.

RESULTS OF OPERATIONS

The Company's net income increased $426,914, or 5.1%, from 2018 to 2019, resulting in earnings per common share of $1.68 for 2019 versus $1.61 for 2018. Net interest income (core earnings) increased $986,172, or 4.0%, for 2019 compared to 2018. This increase in core earnings is attributable to an increase of $2.6 million, or 9.1% in interest income, which included a $440,000 prepayment penalty, versus an increase of $1.7 million, or 37.0%, in interest expense, year over year. The increase in interest expense is largely the result of higher rates paid on deposit accounts, which have lagged behind increases in the Fed funds rate during the prior year.

Non-interest income decreased $235,242, or 3.8%, from 2018 to 2019. A one-time gain of $263,118 in 2018, on the Company's sale of an office condominium unit to CFSG that it was renting prior to the one-time sale, accounted for most of this decrease in 2019 versus 2018. The largest component of non-interest income for 2019 was deposit service fee income, which noted a moderate increase of $74,879, or 2.3%, primarily from an increase in fee income from interchange fees and overdraft charges. This increase was offset by a decrease in income from sold loans of $74,316, or 9.5% year over year. Originations of residential mortgage loans sold in the secondary market totaled $13.8 million in 2019 compared to $13.4 million in 2018, a 3.0% increase, with net gains from the sales of these mortgages of $290,116 in 2019, compared to $345,780 in 2018, a decrease of $55,664, or 16.1%. Servicing released loans, a component of secondary market loans, generate more income at origination due to the lack of serving income over the life of the loan. The volume of originations of these loans decreased in 2019 compared to 2018, accounting for most of the $55,664 decrease in net gains from sales of loans. Income from fees related to other loan activity increased $24,269, or 2.8%, and while increased commercial loan activity resulted in an increase in commercial loan documentation fees of $43,297, or 8.8%, decreased residential mortgage loan volume resulted in a decrease in residential loan related fees, including home equity loan related fees of $28,290, or 13.5%.

Non-interest expense decreased by $13,746, or 0.1%. While some operating expenses increased, most notably an increase in employee benefits of $238,583, or 8.3%, however, increases were partially offset by a $205,320 decrease in FDIC Insurance due to the Small Bank deposit-insurance assessment credits issued by the FDIC in the third quarter. Please refer to the non-interest income and non-interest expense section of this report for more details on other significant changes.

Return on average assets, which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity, which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings.

The following table shows these ratios, as well as other equity ratios, for each of the last three fiscal years:

December 31,	**2019**	**2018**	**2017**
Return on average assets	1.24%	1.24%	0.96%
Return on average equity	13.91%	14.08%	11.16%
Dividend payout ratio (1)	45.24%	45.96%	56.20%
Average equity to average assets ratio	8.92%	8.83%	8.58%

(1) Dividends declared per common share divided by earnings per common share.

The following table summarizes the earnings performance and certain balance sheet and per share data of the Company during each of the last five fiscal years:

As of December 31,	2019	2018	2017	2016	2015
Balance Sheet Data					
Net loans (1)	$ 601,424,861	$ 573,211,590	$ 546,570,168	$ 532,167,542	$ 496,778,461
Total assets	737,955,319	720,347,498	667,045,595	637,653,665	596,134,709
Total deposits	615,021,368	608,816,565	560,634,980	504,735,032	495,485,562
Borrowed funds	2,650,000	1,550,000	3,550,000	31,550,000	10,000,000
Junior subordinated debentures	12,887,000	12,887,000	12,887,000	12,887,000	12,887,000
Total liabilities	669,060,640	657,743,787	609,109,741	583,202,148	544,720,053
Total shareholders' equity	68,894,679	62,603,711	57,935,854	54,451,517	51,414,656
Years Ended December 31,					
Operating Data					
Total interest income	$ 31,758,808	$ 29,114,603	$ 26,440,949	$ 24,248,114	$ 23,406,689
Total interest expense	6,143,121	4,485,088	3,068,390	2,699,299	2,645,650
Net interest income	25,615,687	24,629,515	23,372,559	21,548,815	20,761,039
Provision for loan losses	1,066,167	780,000	650,000	500,000	510,000
Net interest income after provision for loan losses	24,549,520	23,849,515	22,722,559	21,048,815	20,251,039
Non-interest income	5,946,066	6,181,308	5,584,392	5,501,899	5,150,155
Non-interest expense	19,881,280	19,895,026	19,166,323	19,142,524	18,810,973
Income before income taxes	10,614,306	10,135,797	9,140,628	7,408,190	6,590,221
Applicable income tax expense (2)	1,789,860	1,738,265	2,909,330	1,923,912	1,764,630
Net income	$ 8,824,446	$ 8,397,532	$ 6,231,298	$ 5,484,278	$ 4,825,591
Per Share Data					
Earnings per common share (3)	$ 1.68	$ 1.61	$ 1.21	$ 1.07	$ 0.96
Dividends declared per common share	$ 0.76	$ 0.74	$ 0.68	$ 0.64	$ 0.64
Book value per common share outstanding	$ 12.86	$ 11.72	$ 10.84	$ 10.27	$ 9.79
Weighted average number of common shares outstanding	5,204,768	5,139,297	5,084,102	5,024,270	4,961,972
Number of common shares outstanding, period end	5,239,756	5,172,002	5,112,219	5,058,952	4,994,416

(1) Net loans reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative information presented for all prior periods. See Note 1 to the accompanying audited consolidated financial statements for additional information.
(2) Applicable income tax expense assumes a 21% tax rate for 2019 and 2018 and a 34% tax rate for 2017, 2016 and 2015.
(3) Computed based on the weighted average number of common shares outstanding during the periods presented.

INTEREST INCOME VERSUS INTEREST EXPENSE (NET INTEREST INCOME)

The largest component of the Company's operating income is net interest income, which is the difference between interest earned on loans and investments versus the interest paid on deposits and other sources of funds (i.e., other borrowings). The Company's level of net interest income can fluctuate over time due to changes in the level and mix of earning assets, and sources of funds (volume) and from changes in the yield earned and the cost of funds (rate paid). A portion of the Company's income from municipal loans is not subject to income taxes. Because the proportion of tax-exempt items in the Company's portfolio varies from year-to-year, to improve comparability of information across years, the non-taxable income shown in the tables below has been converted to a tax equivalent basis. The Company's corporate tax rate was 21% for 2019 and 2018, and 34% for previous years. Therefore, to equalize tax-free and taxable income in the comparison, we divide the tax-free income by 79% for 2019 and 2018, and 66% for prior years, with the result that every tax-free dollar is equivalent to $1.27 and $1.52 in taxable income, respectively.

Tax-exempt income is derived from municipal loans, amounting to $55.8 million, $47.1 million and $48.8 million, at December 31, 2019, 2018 and 2017, respectively.

The following table provides the reconciliation between net interest income presented in the consolidated statements of income and the non-GAAP tax equivalent net interest income presented in the table immediately following for each of the last three years.

Years Ended December 31,	**2019**	**2018**	**2017**
	(Dollars in Thousands)		
Net interest income as presented	$ 25,616	$ 24,630	$ 23,373
Effect of tax-exempt income	364	344	684
Net interest income, tax equivalent	$ 25,980	$ 24,974	$ 24,057

The following table presents average earning assets and average interest-bearing liabilities supporting earning assets for each of the last three fiscal years. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield.

	Years Ended December 31,								
	2019			2018			2017		
	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield
	(Dollars in Thousands)								
Interest-Earning Assets									
Loans (1)	$ 591,616	$ 30,247	5.11%	$ 568,511	$ 27,954	4.92%	$ 549,974	$ 26,116	4.75%
Taxable investment securities	43,334	1,089	2.51%	38,372	895	2.33%	35,758	676	1.89%
Sweep and interest-earning accounts	29,625	686	2.32%	23,256	484	2.08%	12,331	160	1.30%
Other investments (2)	1,784	101	5.66%	2,249	126	5.60%	2,430	173	7.12%
Total	$ 666,359	$ 32,123	4.82%	$ 632,388	$ 29,459	4.66%	$ 600,493	$ 27,125	4.52%
Interest-Bearing Liabilities									
Interest-bearing transaction accounts	$ 161,887	$ 1,523	0.94%	$ 137,547	$ 865	0.63%	$ 122,521	$ 324	0.26%
Money market accounts	94,704	1,451	1.53%	91,641	1,057	1.15%	86,142	782	0.91%
Savings deposits	96,088	162	0.17%	98,154	136	0.14%	96,551	124	0.13%
Time deposits	120,937	1,988	1.64%	122,499	1,489	1.22%	124,134	1,126	0.91%
Borrowed funds	1,996	8	0.40%	5,462	70	1.28%	9,975	65	0.65%
Repurchase agreements	33,546	299	0.89%	30,555	191	0.63%	28,950	87	0.30%
Finance lease obligations	197	17	8.63%	320	27	8.44%	430	35	8.14%
Junior subordinated debentures	12,887	695	5.39%	12,887	650	5.04%	12,887	525	4.07%
Total	$ 522,242	$ 6,143	1.18%	$ 499,065	$ 4,485	0.90%	$ 481,590	$ 3,068	0.64%
Net interest income		$ 25,980			$ 24,974			$ 24,057	
Net interest spread (3)			3.64%			3.76%			3.88%
Net interest margin (4)			3.90%			3.95%			4.01%

(1) Included in gross loans are non-accrual loans with an average balance of $5.1 million, $4.0 million and $2.6 million for the years ended December 31, 2019, 2018 and 2017, respectively. Loans are stated before deduction of unearned discount and ALL, less loans held-for-sale and includes tax-exempt loans to local municipalities with average balances of $49.2 million, $48.8 million and $52.1 million for the years ended December 31, 2019, 2018, 2017, respectively which were reclassified from the investment portfolio effective January 1, 2019, and restated for the 2018 and 2017 comparison periods. See Note 1 to the accompanying audited consolidated financial statements for additional information.
(2) Included in other investments is the Company's FHLBB Stock with an average balance of $1.0 million, $1.2 million and $1.5 million, respectively, for 2019, 2018 and 2017 and a dividend rate of approximately 6.04%, 5.92% and 4.24%, respectively.
(3) Net interest spread is the difference between the average yield on average earning assets and the average rate paid on average interest-bearing liabilities.
(4) Net interest margin is net interest income divided by average earning assets.

The average volume of interest-earning assets for the year ended December 31, 2019 increased 5.4% compared to December 31, 2018, which increased 5.3% compared to December 31, 2017. Average yield on interest-earning assets increased 16 basis points and 14 basis points for the respective comparison periods.

The average volume of loans increased 4.1% for 2019 versus 2018, and 3.4% for 2018 versus 2017, while the average yield on loans increased 19 basis points to 5.11% for 2019 compared to an increase of 17 basis points, to 4.92% for 2018 versus 2017. The increase in yield during 2019 was partially due to a $440 thousand loan prepayment penalty which added 6 basis points to the annual yield. The remaining increase was due to loans

repricing higher during the year, and a shift in asset mix toward commercial loans; however, this increase was partially offset by continued pressure on medium term (5-10 year) fixed rates. The growth in the average volume of loans during each of the last three years, along with the increase in average yield on loans, were reflected in increases in interest earned on the loan portfolio of $2.3 million in 2019 compared to 2018 and $1.8 million in 2018 compared to 2017. Interest earned on the loan portfolio as a percentage of total interest income was approximately 94.2%, 94.9% and 96.3%, respectively for 2019, 2018 and 2017.

The average volume of the taxable investment portfolio (classified as AFS) increased 21.7% for 2019 versus 2018 and 7.3% for 2018 versus 2017, and the average yield on the taxable investment portfolio increased 18 basis points and 44 basis points, respectively. The increase in both comparison periods is due primarily to an effort to continue to grow the investment portfolio incrementally as the balance sheet grows in order to provide additional liquidity and pledge quality assets.

The average volume of sweep and interest-earning accounts, which consists primarily of an interest-bearing account at the FRBB and two correspondent banks, increased 27.4% during 2019 and 88.6% during 2018. This increase in volume is attributable to a higher balance of cash periodically held on hand in anticipation of funding loan growth and other liquidity needs. The average yield on these funds increased 24 basis points and 78 basis points, respectively, reflecting the changes in Fed Funds rate throughout the comparison periods.

The average volume of interest-bearing liabilities for the year ended December 31, 2019 increased 4.6% compared to December 31, 2018, and increased 3.6% at December 31, 2018 compared to December 31, 2017. The average rate paid on interest-bearing liabilities increased 28 basis points during 2019 and 26 basis points during 2018.

The average volume of interest-bearing transaction accounts increased 17.7% for 2019 versus 2018 and 12.3% for 2018 versus 2017, reflecting strong deposit growth during both periods. The average rate paid on these accounts increased 31 basis points for 2019 versus 2018 and 37 basis points for 2018 versus 2017, reflecting the rising rate environment and competitive pressures on deposit pricing.

The average volume of money market accounts increased 3.4% during 2019 and 6.4% during 2018, and the average rate paid on these deposits increased 38 basis points during 2019 and 24 basis points during 2018.

The average volume of savings accounts decreased by 2.1% for 2019 versus 2018, but increased by 1.7% for 2018 versus 2017, while the average rate paid on these accounts remained relatively stable. With the recovery in market CD rates, funds have begun migrating back toward CDs, which typically impacts savings account balances.

The average volume of time deposits decreased 1.3% for 2019 and 2018, while the average rate paid increased 42 basis points and 31 basis points, respectively. Interest paid on time deposits as a percentage of total interest expense was 32.4%, 33.2% and 36.7%, respectively for 2019, 2018 and 2017. Following the increase in short term rates, there was pressure for higher rates from the more rate sensitive deposit holders with the local market willing to pay higher rates on deposit products. This pressure has lessened with the reduction in interest rates in the third quarter of 2019. Management still considers the brokered deposit market to be a beneficial source of funding to help smooth out the fluctuations in core deposit balances without the need to disrupt deposit pricing in the Company’s local markets. These funds can be obtained relatively quickly on an as-needed basis, making them a valuable alternative to traditional term borrowings from the FHLBB.

The average volume of borrowed funds decreased 63.5% for 2019 versus 2018 and 45.2% for 2018 versus 2017, reflecting an increase in core deposits and brokered deposits to fund loan growth during both periods. The average rate paid on these accounts decreased 88 basis points during 2019 to 0.40%, but increased 63 basis points to 1.28% during 2018 compared 0.65% for 2017.

The average volume of repurchase agreements increased 9.8% during 2019 and 5.5% during 2018, and the average rate paid on repurchase agreements increased 26 basis points to 0.89% for 2019 versus 2018 and 33 basis points to 0.63% for 2018 versus 2017.

In summary, the average yield on interest-earning assets increased 16 basis points during 2019, while the average rate paid on interest-bearing liabilities increased 28 basis points. During 2018, the average yield on interest-earning assets increased 14 basis points, while the average rate paid on interest-bearing liabilities increased 26 basis points. Net interest spread decreased 12 basis points in both comparison periods with 3.64% for 2019 compared to 3.76% for 2018, and 3.88% for 2017. Net interest margin decreased five basis points during 2019 to 3.90%, and six basis points to 3.95% for 2018, compared to 4.01% for 2017.

The following table summarizes the variances in income for the years presented, resulting from volume changes in interest-earning assets and interest-bearing liabilities and fluctuations in rates earned and paid compared to the prior year.

	2019 versus 2018			2018 versus 2017		
	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance
	(Dollars in Thousands)					
Average Interest-Earning Assets						
Loans (2)	$ 1,156	$ 1,137	$ 2,293	$ 957	$ 881	$ 1,838
Taxable investment securities	78	116	194	170	49	219
Sweep and interest-earning accounts	70	132	202	182	142	324
Other investments	1	(26)	(25)	(37)	(10)	(47)
Total	$ 1,305	$ 1,359	$ 2,664	$ 1,272	$ 1,062	$ 2,334
Average Interest-Bearing Liabilities						
Interest-bearing transaction accounts	$ 505	$ 153	$ 658	$ 502	$ 39	$ 541
Money market accounts	359	35	394	225	50	275
Savings deposits	30	(4)	26	10	2	12
Time deposits	525	(26)	499	383	(20)	363
Borrowed funds	(48)	(14)	(62)	63	(58)	5
Repurchase agreements	89	19	108	99	5	104
Finance lease obligations	1	(11)	(10)	1	(9)	(8)
Junior subordinated debentures	45	0	45	125	0	125
Total	$ 1,506	$ 152	$ 1,658	$ 1,408	$ 9	$ 1,417
Changes in net interest income	$ (201)	$ 1,207	$ 1,006	$ (136)	$ 1,053	$ 917

(1) Items which have shown a year-to-year increase in volume have variances allocated as follows:
Variance due to rate = Change in rate x new volume
Variance due to volume = Change in volume x old rate
Items which have shown a year-to-year decrease in volume have variances allocated as follows:
Variance due to rate = Change in rate x old volume
Variances due to volume = Change in volume x new rate

(2) Reflects reclassification of obligations of local municipalities from investment securities to loans effective January 1, 2019, and restated for the 2018 and 2017 comparison periods. See Note 1 to the accompanying audited consolidated financial statements for additional information.

NON-INTEREST INCOME AND NON-INTEREST EXPENSE

Non-interest Income

The components of non-interest income for the annual periods presented are as follows:

	Year Ended December 31,		Change	
	2019	2018	Income	Percent
Service fees	$ 3,313,833	$ 3,238,954	$ 74,879	2.31%
Income from sold loans	706,306	780,622	(74,316)	-9.52%
Other income from loans	904,156	879,887	24,269	2.76%
Net realized loss on sale of securities AFS	(26,490)	(32,718)	6,228	19.04%
Other income				
Income from CFS Partners	588,696	514,486	74,210	14.42%
Rental income	9,821	30,365	(20,544)	-67.66%
Gain on sale of property	0	263,118	(263,118)	100.00%
VISA card commission	70,994	93,377	(22,383)	-23.97%
Service fee NMTC	0	43,602	(43,602)	-100.00%
Other miscellaneous income	378,750	369,615	9,135	2.47%
Total non-interest income	$ 5,946,066	$ 6,181,308	$ (235,242)	-3.81%

Total non-interest income decreased by $235,242 for the year ended December 31, 2019 compared to the same period 2018, with significant changes noted in the following:

- Interchange fees, a component of Service Fees, increased $55,279 for the year due to an increase in debit card transaction activity, accounting for most of the increase year over year.
- Income from sold loans decreased $74,316, or 9.5% as a result of a slowdown in residential mortgage lending activity, as well as the decrease in originations of servicing released loans as mentioned earlier in the Results of Operations section.
- Realized losses on the sale of debt securities AFS of $26,490 for 2019 and $32,718 for 2018, resulted in a 19.0% reduction in net realized loss on sale of such securities between periods. During 2019, the Company continued to sell off low-yielding, short-duration securities held in the Company's AFS portfolio, which were replaced with higher-yielding investments available in the current market.
- Income from the Company's trust and investment management affiliate, CFS Partners, increased $74,210, or 14.4%, for the year. This increase was mostly due to strong new business development during the year that provided an increase in fee income.
- Rental income decreased $20,544, or 67.7%, for 2019 due to the Company's sale of an office condominium unit to CFS Partner's subsidiary, CFSG, during the second quarter of 2018. Prior to the sale, CFSG had rented this unit from the Company since its formation in 2002.
- Gain on sale of property of $263,118 during 2018 was attributable to the sale of an office condominium unit to the Company's affiliate, CFSG, during the second quarter of 2018. There was no activity in 2019 that resulted in a gain on sale of property.
- VISA card commission income decreased $22,383 in 2019. The incentive premium program began in 2018, and included a higher "1st year" incentive premium.
- A servicing fee of $43,602, related to a NMTC investment, was recorded in 2018. There was no servicing fee in 2019 as the Company exited this investment in 2018.

Non-interest Expense

The components of non-interest expense for the annual periods presented are as follows:

	Year Ended December 31,		Change	
	2019	2018	Expense	Percent
Salaries and wages	$ 7,271,722	$ 7,203,001	$ 68,721	0.95%
Employee benefits	3,118,631	2,880,048	238,583	8.28%
Occupancy expenses, net	2,605,995	2,545,959	60,036	2.36%
Other expenses				
Outsourcing expense	428,668	480,563	(51,895)	-10.80%
Service contracts - administrative	539,510	512,902	26,608	5.19%
Marketing expense	450,533	552,617	(102,084)	-18.47%
FDIC insurance	69,452	274,772	(205,320)	-74.72%
Audit fees	407,303	448,439	(41,136)	-9.17%
Consultant services	217,352	276,972	(59,620)	-21.53%
Collection & non-accruing loan expense	185,963	145,009	40,954	28.24%
Subsequent write downs on OREO	95,008	78,447	16,561	21.11%
Other miscellaneous expenses	4,491,143	4,496,297	(5,154)	-0.11%
Total non-interest expense	$ 19,881,280	$ 19,895,026	$ (13,746)	-0.07%

Total non-interest expense decreased $13,746, or 0.1%, for the year 2019 compared to the same period in 2018, with significant changes in "Other expenses" categories noted in the following:

- Employee benefits increased $238,583, or 8.3%, due to an increase in the cost of the employee health insurance plan.
- Outsourcing expense decreased $51,895, or 10.8%, year over year primarily due to credits received from the company core processing system toward current year expense.
- Marketing expense decreased $102,084, or 18.5%, year over year due to a delay in the scheduled creation of promotional television commercials.
- FDIC insurance decreased $205,320, or 74.7%, due in part to the "Small Bank Assessment Credit" issued during the third quarter of 2019, as well as a reduction in the multiplier used to calculate the quarterly assessments. This credit eliminated the assessments due during the third and fourth quarters of 2019, and the remainder of the credit ($56,113) will be applied to the assessment due in the first quarter of 2020.
- Audit fees decreased $41,136, or 9.2%, year over year due mostly to increased audit requirements in 2018 on internal control over financial reporting as the Company transitioned to accelerated filer status for SEC reporting purposes, as well as multiple audits during the 2018 calendar year resulting from a change in Information Security audit vendors.
- Consultant services decreased $59,620, or 21.5%, year over year mostly due to the completion of some technology projects in 2018.
- Collections & non-accruing loan expense increased $40,954, or 28.2%, year over year mostly due to an increase in the non-performing assets portfolio and the length of time, and the associated costs, it takes to go through the foreclosure process.
- The Company recorded write downs of two OREO properties in 2019 compared to one OREO property in 2018, all of which were subsequently sold.

APPLICABLE INCOME TAXES

Income before income taxes increased $478,509, or 4.7% for 2019 compared to 2018, accounting for the increase in the provision for income taxes of $51,595, or 3.0%. Tax credits from affordable housing investments decreased $22,130, or 5.1%, from $437,229 in 2018 to $415,099 in 2019.

Amortization expense related to limited partnership investments is included as a component of income tax expense and amounted to $312,106 and $410,061 for 2019 and 2018, respectively. These investments provide tax benefits, including tax credits, and are designed to provide an effective yield between 7% and 10%.

CHANGES IN FINANCIAL CONDITION

The following table provides a visual comparison of the breakdown of average assets and average liabilities as well as average shareholders' equity for the comparison periods and should be reviewed in conjunction with the table on the following page which provides volume changes and percent of change by category.

Years Ended December 31,	2019		2018		2017	
	Balance	%	Balance	%	Balance	%
	(Dollars in Thousands)					
Average Assets						
Cash and due from banks						
Non-interest bearing	$ 11,043	1.55%	$ 10,838	1.61%	$ 16,427	2.53%
Federal funds sold and overnight deposits	29,625	4.17%	23,256	3.44%	12,331	1.90%
Taxable investment securities	43,591	6.13%	38,372	5.69%	35,758	5.50%
Other securities	1,397	0.20%	1,862	0.28%	2,043	0.31%
Total investment securities	44,988	6.33%	40,234	5.97%	37,801	5.81%
Gross loans (1)	591,908	83.23%	568,860	84.29%	550,490	84.65%
ALL and deferred net loan costs	(5,444)	-0.77%	(5,176)	-0.77%	(5,073)	-0.78%
Premises and equipment	10,973	1.54%	9,958	1.47%	10,619	1.63%
OREO	188	0.03%	278	0.04%	377	0.06%
Investment in Capital Trust	387	0.05%	387	0.06%	387	0.06%
BOLI	4,855	0.68%	4,765	0.71%	4,670	0.72%
CDI	0	0.00%	0	0.00%	129	0.02%
Goodwill	11,574	1.63%	11,574	1.71%	11,574	1.78%
Other assets	11,067	1.56%	9,835	1.46%	10,574	1.63%
Total average assets	$ 711,164	100%	$ 674,809	100%	$ 650,306	100%
Average Liabilities						
Demand deposits	$ 120,689	16.97%	$ 113,412	16.81%	$ 109,920	16.90%
Interest-bearing transaction accounts	161,887	22.76%	137,547	20.38%	122,521	18.84%
Money market funds	94,704	13.32%	91,642	13.58%	86,141	13.25%
Savings accounts	96,088	13.51%	98,154	14.55%	96,551	14.85%
Time deposits	120,937	17.01%	122,499	18.15%	124,134	19.09%
Total average deposits	594,305	83.57%	563,254	83.47%	539,267	82.93%
Borrowed funds	1,996	0.28%	5,462	0.81%	9,975	1.53%
Repurchase agreements	33,546	4.72%	30,555	4.53%	28,950	4.45%
Junior subordinated debentures	12,887	1.81%	12,887	1.91%	12,887	1.98%
Other liabilities	4,998	0.70%	3,019	0.45%	3,408	0.53%
Total average liabilities	647,732	91.08%	615,177	91.17%	594,487	91.42%
Average Shareholders' Equity						
Preferred stock	1,618	0.23%	2,119	0.31%	2,500	0.38%
Common stock	13,527	1.90%	13,367	1.98%	13,230	2.03%
Additional paid-in capital	32,925	4.63%	32,000	4.74%	31,159	4.79%
Retained earnings	18,061	2.54%	15,563	2.31%	11,623	1.79%
Less: Treasury stock	(2,623)	-0.37%	(2,623)	-0.39%	(2,623)	-0.40%
Accumulated other comprehensive loss	(76)	-0.01%	(794)	-0.12%	(70)	-0.01%
Total average shareholders' equity	63,432	8.92%	59,632	8.83%	55,819	8.58%
Total average liabilities and shareholders' equity	$ 711,164	100%	$ 674,809	100%	$ 650,306	100%

(1) Gross loans reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative 2018 and 2017 information presented. See Note 1 to the accompanying audited consolidated financial statements for additional information.

The following table provides a breakdown of volume changes and percent of change by category for the table on the preceding page. Please refer to the sections labeled "Interest Income and Interest Expense (Net Interest Income)" and "Liquidity and Capital Resources" for more in-depth discussion of significant changes.

Years Ended December 31,	2019	2018	2017	2019 vs 2018		2018 vs 2017	
Average Assets	Average Balance	Average Balance	Average Balance	Volume Change	% of Change	Volume Change	% of Change
	(Dollars in Thousands)						
Cash and due from banks							
Non-interest bearing	$ 11,043	$ 10,838	$ 16,427	$ 205	1.89%	$ (5,589)	-34.02%
Federal funds sold and overnight deposits	29,625	23,256	12,331	6,369	27.39%	10,925	88.60%
Taxable investment securities	43,591	38,372	35,758	5,219	13.60%	2,614	7.31%
Other securities	1,397	1,862	2,043	(465)	-24.97%	(181)	-8.86%
Total investment securities	44,988	40,234	37,801	4,754	11.82%	2,433	6.44%
Gross loans (1)	591,908	568,860	550,490	23,048	4.05%	18,370	3.34%
ALL and deferred net loan costs	(5,444)	(5,176)	(5,073)	(268)	5.18%	(103)	2.03%
Premises and equipment	10,973	9,958	10,619	1,015	10.19%	(661)	-6.22%
OREO	188	278	377	(90)	-32.37%	(99)	-26.26%
Investment in Capital Trust	387	387	387	0	0.00%	0	0.00%
BOLI	4,855	4,765	4,670	90	1.89%	95	2.03%
CDI	0	0	129	0	0.00%	(129)	-100.00%
Goodwill	11,574	11,574	11,574	0	0.00%	0	0.00%
Other assets	11,067	9,835	10,574	1,232	12.53%	(739)	-6.99%
Total average assets	$ 711,164	$ 674,809	$ 650,306	$ 36,355	5.39%	$ 24,503	3.77%
Average Liabilities							
Demand deposits	$ 120,689	$ 113,412	$ 109,920	$ 7,277	6.42%	$ 3,492	3.18%
Interest-bearing transaction accounts	161,887	137,547	122,521	24,340	17.70%	15,026	12.26%
Money market funds	94,704	91,642	86,141	3,062	3.34%	5,501	6.39%
Savings accounts	96,088	98,154	96,551	(2,066)	-2.10%	1,603	1.66%
Time deposits	120,937	122,499	124,134	(1,562)	-1.28%	(1,635)	-1.32%
Total average deposits	594,305	563,254	539,267	31,051	5.51%	23,987	4.45%
Borrowed funds	1,996	5,462	9,975	(3,466)	-63.46%	(4,513)	-45.24%
Repurchase agreements	33,546	30,555	28,950	2,991	9.79%	1,605	5.54%
Junior subordinated debentures	12,887	12,887	12,887	0	0.00%	0	0.00%
Other liabilities	4,998	3,019	3,408	1,979	65.55%	(389)	-11.41%
Total average liabilities	647,732	615,177	594,487	32,555	5.29%	20,690	3.48%
Average Shareholders' Equity							
Preferred stock	1,618	2,119	2,500	(501)	-23.64%	(381)	-15.24%
Common stock	13,527	13,367	13,230	160	1.20%	137	1.04%
Additional paid-in capital	32,925	32,000	31,159	925	2.89%	841	2.70%
Retained earnings	18,061	15,563	11,623	2,498	16.05%	3,940	33.90%
Less: Treasury stock	(2,623)	(2,623)	(2,623)	0	0.00%	0	0.00%
Accumulated other comprehensive loss	(76)	(794)	(70)	718	-90.43%	(724)	1034.29%
Total average shareholders' equity	63,432	59,632	55,819	3,800	6.37%	3,813	6.83%
Total average liabilities and shareholders' equity	$ 711,164	$ 674,809	$ 650,306	$ 36,355	5.39%	$ 24,503	3.77%

(1) Gross loans reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative 2018 and 2017 information presented. See Note 1 to the accompanying audited consolidated financial statements for additional information.

CERTAIN TIME DEPOSITS

Increments of maturity of time CDs of $100,000 or more outstanding on December 31, 2019 are summarized as follows:

3 months or less	$ 13,658,775
Over 3 through 6 months	6,910,082
Over 6 through 12 months	9,390,244
Over 12 months	34,613,090
	$ 64,572,191

RISK MANAGEMENT

Interest Rate Risk and Asset and Liability Management - Management actively monitors and manages the Company's interest rate risk exposure and attempts to structure the balance sheet to maximize net interest income while controlling its exposure to interest rate risk. The Company's ALCO is made up of the Executive Officers and certain Vice Presidents of the Bank representing major business lines. The ALCO formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity and various business strategies. The ALCO meets at least quarterly to review financial statements, liquidity levels, yields and spreads to better understand, measure, monitor and control the Company's interest rate risk. In the ALCO process, the committee members apply policy limits set forth in the Asset Liability, Liquidity and Investment policies approved and periodically reviewed by the Company's Board of Directors. The ALCO's methods for evaluating interest rate risk include an analysis of the effects of interest rate changes on net interest income and an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the entire balance sheet. The ALCO Policy also includes a contingency funding plan to help management prepare for unforeseen liquidity restrictions, including hypothetical severe liquidity crises.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's financial instruments also change, thereby impacting NII, the primary component of the Company's earnings. Fluctuations in interest rates can also have an impact on liquidity. The ALCO uses an outside consultant to perform rate shock simulations to the Company's net interest income, as well as a variety of other analyses. It is the ALCO's function to provide the assumptions used in the modeling process. Assumptions used in prior period simulation models are regularly tested by comparing projected NII with actual NII. The ALCO utilizes the results of the simulation model to quantify the estimated exposure of NII and liquidity to sustained interest rate changes. The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. The model also simulates the balance sheet's sensitivity to a prolonged flat rate environment. All rate scenarios are simulated assuming a parallel shift of the yield curve; however further simulations are performed utilizing non-parallel changes in the yield curve. The results of this sensitivity analysis are compared to the ALCO policy limits which specify a maximum tolerance level for NII exposure over a 1-year horizon, assuming no balance sheet growth, given a 200 bp shift upward and a 100 bp shift downward in interest rates.

Under the Company's interest rate sensitivity modeling, with the continued asset sensitive balance sheet, in a rising rate environment NII is expected to trend upward as the short-term asset base (cash and adjustable rate loans) quickly cycle upward while the retail funding base (deposits) lags the market. If rates paid on deposits have to be increased more and/or more quickly than projected due to competitive pressures, the expected benefit to rising rates would be reduced. In a falling rate environment, NII is expected to trend slightly downward compared with the current rate environment scenario for the first year of the simulation as asset yield erosion is not fully offset by decreasing funding costs. Thereafter, net interest income is projected to experience sustained downward pressure as funding costs reach their assumed floors and asset yields continue to reprice into the lower rate environment. Management expects that the recent decreases in the federal funds rate, including three 25 basis point cuts in 2019, will continue to generate a negative impact to the Company's NII in 2020 as variable rate loans reprice during the year; This, coupled with the downward pressure on the long end of the yield curve, will continue to adversely impact margins going forward.

The following table summarizes the estimated impact on the Company's NII over a twelve month period, assuming a gradual parallel shift of the yield curve beginning December 31, 2019:

One Year Horizon		Two Year Horizon	
Rate Change	Percent Change in NII	Rate Change	Percent Change in NII
Down 100 basis points	-1.4%	Down 100 basis points	-5.3%
Up 200 basis points	1.8%	Up 200 basis points	9.8%

The amounts shown in the table are within the ALCO Policy limits. However, those amounts do not represent a forecast and should not be relied upon as indicative of future results. While assumptions used in the ALCO process, including the interest rate simulation analyses, are developed based upon current economic and local market conditions, and expected future conditions, the Company cannot provide any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change. As the market rates continue to increase, the impact of a falling rate environment is more pronounced, and the possibility more plausible than during the last several years of near zero short rates.

As of December 31, 2019, the Company had outstanding $12,887,000 in principal amount of Junior Subordinated Debentures due December 15, 2037, which bear a quarterly floating rate of interest equal to the 3-month London Interbank Offered Rate (LIBOR), plus 2.85%. During 2017, the financial authorities in the United Kingdom that administer LIBOR announced that LIBOR will be phased out by the end of 2021. The Company has reviewed the pertinent language in the Indenture governing the Debentures and believes that the Debenture Trustee has sufficient authority under the Indenture to establish a substitute interest rate benchmark without the need to amend the Indenture. However, the Debenture Trustee has not yet informed the Company as to how it intends to proceed. Aside from the Debentures, the Company does not have any other exposures to the phase out of LIBOR. The Company has not generally utilized LIBOR as an interest rate benchmark for its variable rate commercial, residential or other loans and does not utilize derivatives or other financial instruments tied to LIBOR for hedging or investment purposes. Accordingly, management expects that the Company's exposure to the phase out of LIBOR will be limited to the effect on the interest rate paid on its Debentures.

Credit Risk - As a financial institution, one of the primary risks the Company manages is credit risk, the risk of loss stemming from borrowers' failure to repay loans or inability to meet other contractual obligations. The Company's Board of Directors prescribes policies for managing credit risk, including Loan, Appraisal and Environmental policies. These policies are supplemented by comprehensive underwriting standards and procedures. The Company maintains a Credit Administration department whose function includes credit analysis and monitoring of and reporting on the status of the loan portfolio, including delinquent and non-performing loan trends. The Company also monitors concentration of credit risk in a variety of areas, including portfolio mix, the level of loans to individual borrowers and their related interest, loans to industry segments, and the geographic distribution of CRE loans. Loans are reviewed periodically by an independent loan review firm to help ensure accuracy of the Company's internal risk ratings and compliance with various internal policies, procedures and regulatory guidance.

Residential mortgages represented 33.2% of the Company's loan balances at December 31, 2019. The percentage of residential mortgage loans to total loans has been on a gradual decline in recent years, with a strategic shift to commercial lending. The Company maintains a residential mortgage loan portfolio of traditional mortgage products and does not engage in higher risk loans such as option adjustable rate mortgage products, high loan-to-value products, interest only mortgages, subprime loans and products with deeply discounted teaser rates. Residential mortgages with loan-to-values exceeding 80% are generally covered by PMI. A 90% loan-to-value residential mortgage product without PMI is only available to borrowers with excellent credit and low debt-to-income ratios and has not been widely originated. Junior lien home equity products make up 21.5% of the residential mortgage portfolio with maximum loan-to-value ratios (including prior liens) of 80%. The Company also originates some home equity loans greater than 80% under an insured loan program with stringent underwriting criteria.

Consistent with the strategic focus on commercial lending, the commercial and CRE loan portfolios have seen solid growth over recent years. Commercial & industrial, CRE and Municipal loans collectively comprised 59.8% of the Company's loan portfolio at December 31, 2019, compared to 54.3% at December 31, 2018.

The Municipal loan portfolio consists of tax-exempt obligations of local municipalities, and is made up of three types of borrowings; term lending, tax anticipation lending, non-arbitrage borrowing. The portfolio increased $8.8 million, or 18.6%, to $55.8 million as of December 31, 2019 compared to $47.1 million at December 31, 2018. During 2019, term lending increased $2.3 million, or 9.3%, tax anticipation lending decreased $3.1 million, or 93.5%, and non-arbitrage borrowing increased $9.6 million, or 49.5%. The non-arbitrage and tax anticipation loans to municipalities are issued annually on a competitive bid basis; as a result the portfolio can fluctuate considerably from year to year based on changes in competitive pressures.

Growth in the CRE portfolio in recent years has been principally driven by new loan volume in Chittenden County and northern Windsor County around the White River Junction, I91-I93 interchange area. Credits in the Chittenden County market are being managed by two commercial lenders out of the Company's Burlington loan production office that know the area well, while Windsor County is being served by a commercial lender from the St. Johnsbury office with previous lending experience serving the greater White River Junction area. On May 1, 2019, the Company opened a loan production office in Lebanon, New Hampshire to provide a presence in the greater White River Junction area including Grafton County, New Hampshire. Larger transactions continue to be centrally underwritten and monitored through the Company's commercial credit department. The types of CRE transactions driving the growth have been a mix of construction, land and development, multifamily, and other non-owner occupied CRE properties including hotels, retail, office, and industrial properties. The largest components of the $246 million CRE portfolio at December 31, 2019 were approximately $93 million in owner-occupied CRE and $85 million in non-owner occupied CRE.

The Company's home equity and commercial line of credit portfolios contain for the most part variable rate loans with the Wall Street Journal Prime rate as the underlying index and rates repricing monthly. The Wall Street Journal Prime index fell to 3.25% in 2008 and remained there until December 2015. Since 2015 numerous rate hikes have increased the Wall Street Journal Prime index by 225 percentage points to 5.5%, before falling 75 percentage points in 2019 to 4.75%. The home equity portfolio and commercial line of credit portfolio have weathered these increases and continue to perform well. Commercial and industrial term loans are generally written on a fixed rate basis with limited risk associated with rising interest rates. CRE loans generally have included an initial fixed rate period typically of 5 years, then enter a variable rate period, again usually tied to Wall Street Prime. Approximately $163 million of CRE loans are scheduled to reprice over the next five years with sizeable rate increases projected based on the current Prime rate index. Many of these loans will ultimately refinance or renegotiate pricing, while the increase may adversely impact the repayment capacity of those CRE loans of lesser credit quality and may ultimately result in higher non-performing loans and losses.

The following table reflects the composition of the Company's loan portfolio, by portfolio segment, as a percentage of total loans as of December 31,

	2019		2018		2017		2016		2015	
	(Dollars in Thousands)									
Real estate loans										
Construction & land development	$ 21,085	3.47%	$ 26,826	4.64%	$ 21,968	3.98%	$ 14,991	2.79%	$ 21,445	4.28%
Farm land	13,054	2.15%	10,209	1.76%	10,477	1.90%	13,011	2.42%	12,570	2.51%
1-4 Family residential -										
1st lien	158,337	26.09%	165,665	28.64%	168,184	30.48%	166,692	31.03%	162,760	32.46%
Jr lien	43,231	7.12%	44,545	7.70%	45,257	8.20%	42,927	7.99%	44,720	8.92%
Commercial real estate	212,145	34.95%	198,283	34.28%	174,599	31.65%	173,727	32.34%	144,192	28.75%
Loans to finance agricultural production	3,675	0.61%	2,797	0.48%	887	0.16%	996	0.19%	2,508	0.50%
Commercial & industrial	95,255	15.69%	77,970	13.48%	76,224	13.82%	67,734	12.61%	62,683	12.50%
Municipal	55,817	9.20%	47,067	8.14%	48,825	8.85%	49,887	9.29%	43,354	8.64%
Consumer	4,390	0.72%	5,088	0.88%	5,269	0.96%	7,171	1.34%	7,241	1.44%
Gross loans	606,989	100%	578,450	100%	551,690	100%	537,136	100%	501,473	100%
Less:										
ALL and deferred net loan costs	(5,564)		(5,238)		(5,120)		(4,968)		(4,695)	
Net loans	$601,425		$573,212		$546,570		$532,168		$496,778	

(1) Gross loans reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative prior period information presented. See Note 1 to the accompanying audited consolidated financial statements for additional information.

The following table shows the estimated maturity of the Company's commercial loan portfolio as of December 31, 2019.

	Fixed Rate Loans				Variable Rate Loans			
	Within 1 Year	2 - 5 Years	After 5 Years	Total	Within 1 Year	2 - 5 Years	After 5 Years	Total
	(Dollars in Thousands)							
Real estate								
Construction & land development	$ 1,226	$ 294	$ 2,943	$ 4,463	$ 1,320	$ 253	$ 15,049	$ 16,622
Secured by farm land	0	459	47	506	116	471	11,961	12,548
Commercial real estate	643	2,715	16,390	19,748	7,266	3,961	181,170	192,397
Loans to finance agricultural production	146	205	33	384	608	1,365	1,318	3,291
Commercial & industrial	1,215	21,646	19,730	42,591	25,968	18,353	8,343	52,664
Municipal	33,085	5,171	6,337	44,593	0	0	11,224	11,224
	$ 36,315	$ 30,490	$ 45,480	$112,285	$ 35,278	$ 24,403	$229,065	$288,746

Risk in the Company's commercial and CRE loan portfolios is mitigated in part by government guarantees issued by federal agencies such as the SBA and RD. At December 31, 2019 and 2018, although the mix of loans by category varied, in total, the Company had approximately $28.4 million in guaranteed loans with guaranteed balances of approximately $21.0 million.

The Company works actively with customers early in the delinquency process to help them to avoid default and foreclosure. Commercial & industrial and CRE loans are generally placed on non-accrual status when there is deterioration in the financial position of the borrower, payment in full of principal and interest is not expected, and/or principal or interest has been in default for 90 days or more. However, such a loan need not be placed on non-accrual status if it is both well secured and in the process of collection. Residential mortgages and home equity loans are considered for non-accrual status at 90 days past due and are evaluated on a case-by-case basis. The Company obtains current property appraisals or market value analyses and considers the cost to carry and sell collateral in order to assess the level of specific allocations required. Consumer loans are generally not placed in non-accrual but are charged off by the time they reach 120 days past due. When a loan is placed in non-accrual status, the Company reverses the accrued interest against current period income and discontinues the accrual of interest until the borrower clearly demonstrates the ability and intention to resume normal payments, typically demonstrated by regular timely payments for a period of not less than six months. Interest payments received on non-accrual or impaired loans are generally applied as a reduction of the loan book balance.

During the five year period presented in the following table, the level of non-performing assets fluctuated, with the highest level reported in 2015, followed by a substantial decrease in 2016 in large part due to the restoration to accrual status of one large CRE relationship and another commercial relationship secured by multiple residential properties. Other reductions occurred through the foreclosure process or through borrower initiated payments and payoffs. 2017 increases in non-performing assets generally resulted from numerous smaller loans across the CRE and residential 1st lien portfolios. The increase in 2018 was primarily attributable to higher delinquency in the residential portfolio, and the decline of credit quality in two CRE loans, while the increase in 2019 was primarily due to a large CRE loan being transferred into the Company's OREO portfolio.

Non-performing assets at the end of each of the last five fiscal years consisted of the following:

December 31,	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Accruing loans past due 90 days or more(1):					
Commercial & industrial	$ 0	$ 0	$ 0	$ 26	$ 14
Commercial real estate	0	0	0	0	45
Residential real estate - 1st lien	530	622	1,249	1,068	801
Residential real estate - Jr lien	112	105	0	28	63
Consumer	0	2	1	2	0
Total past due 90 days or more	642	729	1,250	1,124	923
Non-accrual loans(1):					
Commercial & industrial	480	85	99	143	441
Commercial real estate	1,601	1,743	1,065	766	2,401
Residential real estate - 1st lien	2,112	2,027	1,585	1,227	2,009
Residential real estate - Jr lien	241	408	347	339	386
Total non-accrual loans	4,434	4,263	3,096	2,475	5,237
Total non-accrual and past due loans	5,076	4,992	4,346	3,599	6,160
Other real estate owned	967	201	284	394	262
Total non-performing assets	$ 6,043	$ 5,193	$ 4,630	$ 3,993	$ 6,422
Percentage by segment of non-performing loans:					
Commercial & industrial	9.46%	1.70%	2.28%	4.70%	7.39%
Commercial real estate	31.54%	34.92%	24.51%	21.28%	39.71%
Residential real estate - 1st lien	52.05%	53.06%	65.21%	63.77%	45.62%
Residential real estate - Jr lien	6.95%	10.28%	7.98%	10.20%	7.29%
Consumer	0.00%	0.04%	0.02%	0.06%	0.00%
	100.00%	100.00%	100.00%	100.00%	100.00%
Percent of gross loans	1.00%	0.90%	0.84%	0.74%	1.28%
Reserve coverage of non-performing assets	98.07%	107.87%	117.45%	132.18%	78.04%

(1) No municipal loans were past due 90 days or more, and no municipal or consumer loans were in non-accrual status as of any of the consolidated balance sheet dates. In accordance with Company policy, delinquent consumer loans are charged off at 120 days past due.

The Company's OREO portfolio at December 31, 2019 consisted of one residential and three commercial properties compared to two commercial properties at December 31, 2018. The residential property was acquired through the normal foreclosure process. Both properties held at December 31, 2018 were sold during 2019, and all the properties transferred to OREO in 2019 remain in the portfolio and are listed for sale.

The Company's TDRs are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only infrequently reduced interest rates for borrowers below the current market rates. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings. Management evaluates each TDR situation on its own merits and does not foreclose the granting of any particular type of concession.

The Non-Performing Assets in the preceding table include the following TDRs that were past due 90 days or more or in non-accrual status as of the dates presented:

	December 31, 2019		December 31, 2018	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
Commercial & industrial	6	$ 331,767	1	$ 24,685
Commercial real estate	4	772,894	4	862,713
Residential real estate - 1st lien	14	1,468,415	12	1,082,187
Residential real estate - Jr lien	1	55,011	0	0
Total	25	$ 2,628,085	17	$ 1,969,585

The remainder of the Company's TDRs were performing in accordance with their modified terms as of the date presented and consisted of the following:

	December 31, 2019		December 31, 2018	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance
Commercial real estate	2	$ 106,913	1	$ 102,292
Residential real estate - 1st lien	30	2,459,649	31	2,544,728
Residential real estate - Jr lien	1	6,101	1	7,248
Total	33	$ 2,572,663	33	$ 2,654,268

As of the balance sheet dates, the Company evaluates whether it is contractually committed to lend additional funds to debtors with impaired, non-accrual or modified loans. The Company is contractually committed to lend under one SBA guaranteed line of credit to a borrower whose lending relationship was previously restructured.

ALL and provisions - The Company maintains an ALL at a level that management believes is appropriate to absorb losses inherent in the loan portfolio as of the measurement date (See Note 3 to the accompanying audited consolidated financial statements). Although the Company, in establishing the ALL, considers the inherent losses in individual loans and pools of loans, the ALL is a general reserve available to absorb all credit losses in the loan portfolio. No part of the ALL is segregated to absorb losses from any particular loan or segment of loans.

When establishing the ALL each quarter, the Company applies a combination of historical loss factors and qualitative factors to loan segments, including residential first and junior lien mortgages, CRE, commercial & industrial, and consumer loan portfolios. The Company's municipal portfolio has no historical losses, therefore no allocation is calculated on this portfolio. Other than the municipal portfolio, the Company applies numerous qualitative factors to each segment of the loan portfolio. Those factors include the levels of and trends in delinquencies and non-accrual loans, criticized and classified assets, volumes and terms of loans, and the impact of any loan policy changes. Experience, ability and depth of lending personnel, levels of policy and documentation exceptions, national and local economic trends, the competitive environment, and concentrations of credit are also factors considered.

Specific allocations to the ALL are made for certain impaired loans. Impaired loans include all troubled debt restructurings regardless of amount, and all loans to a borrower that in aggregate are greater than $100,000 and that are in non-accrual status. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due, including interest and principal, according to the contractual terms of the loan agreement. The Company will review all the facts and circumstances surrounding non-accrual loans and on a case-by-case basis may consider loans below the threshold as impaired when such treatment is material to the financial statements. See Note 3 to the accompanying audited consolidated financial statements for information on the recorded investment in impaired loans and their related allocations.

The following table summarizes the Company's loan loss experience for each of the last five years.

As of or Years Ended December 31,	**2019**	**2018**	**2017**	**2016**	**2015**
	(Dollars in Thousands)				
Loans outstanding, end of year (1)	$606,989	$578,450	$551,690	$537,136	$501,473
Average loans outstanding during year (1)	$591,616	$568,511	$549,974	$521,973	$499,309
Non-accruing loans, end of year	$ 4,434	$ 4,263	$ 3,096	$ 2,475	$ 5,237
Non-accruing loans, net of government guarantees	$ 4,074	$ 3,887	$ 3,037	$ 2,328	$ 4,551
ALL, beginning of year	$ 5,602	$ 5,438	$ 5,278	$ 5,012	$ 4,906
Loans charged off:					
Commercial & industrial	(176)	(153)	(20)	(49)	(201)
Commercial real estate	(116)	(124)	(160)	0	(15)
Residential real estate - 1st lien	(242)	(252)	(160)	(244)	(151)
Residential real estate - Jr lien	(223)	(69)	(118)	0	(66)
Consumer	(103)	(144)	(124)	(16)	(69)
	(860)	(742)	(582)	(309)	(502)
Recoveries:					
Commercial & industrial	11	60	27	25	59
Commercial real estate	50	0	0	0	0
Residential real estate - 1st lien	16	27	27	24	6
Residential real estate - Jr lien	2	1	1	0	0
Consumer	39	38	37	26	33
	118	126	92	75	98
Net loans charged off	(742)	(616)	(490)	(234)	(404)
Provision charged to income	1,066	780	650	500	510
ALL, end of year	$ 5,926	$ 5,602	$ 5,438	$ 5,278	$ 5,012
Net charge offs to average loans outstanding	0.13%	0.11%	0.09%	0.04%	0.08%
Provision charged to income as a percent of average loans	0.18%	0.14%	0.12%	0.10%	0.10%
ALL to average loans outstanding	1.00%	0.99%	0.99%	1.01%	1.00%
ALL to non-accruing loans	133.65%	131.41%	175.65%	213.25%	95.70%
ALL to non-accruing loans, net of government guarantees	145.46%	144.12%	179.06%	226.72%	110.13%

(1) Reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative 2018 – 2015 information presented. See Note 1 to the accompanying audited consolidated financial statements for additional information.

The 2015 provision was maintained at a level consistent with portfolio growth and higher levels of non-performing loans. Despite lower net losses during 2016 and sharply lower non-performing loans, the 2016 provision held steady at $500,000 to support the strong loan growth, particularly in the CRE portfolio. The 2017 provision increased to $650,000, principally to cover higher loan losses experienced during the year, some qualitative adjustment increases related to classified loan levels, along with solid loan portfolio growth. As in 2017, the 2018 provision was increased principally to support strong CRE loan growth along with the higher dollar volume of losses in the Company's growing loan portfolio. The 2019 provision increased significantly due to increase in the loan portfolio combined with higher than anticipated loan charge off activity during the third quarter of 2019 related to write-down

adjustments on several loans in workout. The Company has an experienced collections department that continues to work actively with borrowers to resolve problem loans and manage the OREO portfolio, and management continues to monitor the loan portfolio closely.

The fourth quarter ALL analysis indicates that the reserve balance of $5.9 million at December 31, 2019 is sufficient to cover losses that are probable and estimable as of the measurement date, with an unallocated reserve of approximately $178,000. Management believes that the reserve balance and unallocated amount continue to be directionally consistent with the overall risk profile of the Company's loan portfolio and credit risk appetite. The portion of the ALL termed "unallocated" is established to absorb inherent losses that exist as of the measurement date although not specifically identified through management's process for estimating credit losses. While the ALL is described as consisting of separate allocated portions, the entire ALL is available to support loan losses, regardless of category. Unallocated reserves are considered by management to be appropriate in light of the Company's continued growth strategy and shift in the portfolio from residential loans to commercial and CRE loans and the risk associated with the relatively new, unseasoned loans in those portfolios. The adequacy of the ALL is reviewed quarterly by the risk management committee of the Board and then presented to the full Board for approval.

The following table shows the allocation of the ALL, as well as the percent of each loan category to the total loan portfolio, as of the balance sheet dates for each of the last five years:

December 31,	**2019**	**%**	**2018**	**%**	**2017**	**%**	**2016**	**%**	**2015**	**%**
	(Dollars in Thousands)									
Domestic										
Commercial & industrial	$ 837	16%	$ 697	14%	$ 676	14%	$ 726	13%	$ 713	13%
Commercial real estate	3,181	41%	3,020	41%	2,674	38%	2,496	38%	2,152	36%
Municipal (1)	0	9%	0	8%	0	9%	0	9%	0	9%
Residential real estate										
1st lien	1,388	26%	1,422	28%	1,461	30%	1,370	31%	1,368	32%
Jr lien	290	7%	273	8%	317	8%	371	8%	423	9%
Consumer	52	1%	57	1%	43	1%	84	1%	76	1%
Unallocated	178	0%	133	0%	267	0%	231	0%	280	0%
	$ 5,926	100%	$ 5,602	100%	$ 5,438	100%	$ 5,278	100%	$ 5,012	100%

(1) Gross loans reflects reclassification of obligations of local municipalities from the investment portfolio into the loan portfolio as of January 1, 2019 and conforming changes to the comparative 2018 – 2015 information presented. See Note 1 to the accompanying audited consolidated financial statements for additional information.

In addition to credit risk in the Company's loan portfolio and liquidity risk in its loan and deposit-taking operations, the Company's business activities also generate market risk. Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Declining capital markets can result in fair value adjustments necessary to record decreases in the value of the investment portfolio for other-than-temporary-impairment. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit taking activities. During recessionary periods, a declining housing market can result in an increase in loan loss reserves or ultimately an increase in foreclosures. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to loan prepayment risks, early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes vary by product. As discussed above under "Interest Rate Risk and Asset and Liability Management", the Company actively monitors and manages its interest rate risk through the ALCO process.

INVESTMENT SECURITIES

The Company maintains an investment portfolio of various securities to diversify its revenue sources, as well as to provide interest rate risk and credit risk diversification and to provide for its liquidity and funding needs. The Company's portfolio of AFS debt securities increased $6.6 million, or 16.8% in 2019 to $46.0 million at December 31, 2019 from $39.4 million at December 31, 2018, and increased just under $1.0 million, or 2.4%, during 2018 from $38.5 million at December 31, 2017.

Accounting standards require banks to recognize all appreciation or depreciation of investments classified as either trading securities or AFS, either through the income statement or on the balance sheet even though a gain or loss has not been realized. Securities classified as trading securities are marked to market with any gain or loss net of tax effect, charged to income. The Company's investment policy does not permit the holding of trading securities. Debt securities classified as HTM are recorded at book value, subject to adjustment for OTTI. As noted previously, effective as of January 1, 2019, tax-exempt loans to municipalities, which were previously classified as securities HTM and constituted the entire HTM portfolio, were reclassified to the loan portfolio, with prior period information restated accordingly. Therefore, the Company did not hold any securities HTM as of December 31, 2019, 2018 or 2017.

Debt securities classified as AFS are marked to market with any gain or loss after taxes charged to shareholders' equity in the consolidated balance sheets. These adjustments in the AFS portfolio resulted in an accumulated unrealized income net of taxes of $260,483 in 2019, compared to accumulated unrealized loss net of taxes of $647,584 in 2018, and $274,097 in 2017. Included in the 2017 accumulated unrealized loss is a reclassification adjustment of $45,106 for the deferred tax asset revaluation beginning in 2018. Other than the 2017 deferred tax asset reclassification adjustment, the fluctuations in unrealized gains and losses are due to market interest rate changes, and are not based on any deterioration in credit quality of the underlying issuers. The Company's investment portfolio includes Agency MBS in order to realize a more favorable yield in the portfolio and diversify the holdings. Although classified as AFS, we anticipate holding these securities until maturity. The unrealized loss positions within the investment portfolio as of the balance sheet dates presented are considered by management to be temporary.

The restricted equity securities comprise the Company's membership stock in the FRBB, FHLBB and ACBI. Membership in the FRBB and FHLBB requires the purchase of their stock in specified amounts. On December 31, 2019, 2018 and 2017, the Company held $588,150 in FRBB stock and $753,700, $1.1 million and $1.1 million, respectively, in FHLBB stock. In addition, as disclosed in Note 2 of the accompanying audited consolidated financial statements, during 2018 the Company purchased $90,000 in stock in ACBI, a holding company for ACBB, a correspondent bank. The purchase of ACBI stock is required for receipt of correspondent banking services from ACBB at more favorable pricing. These restricted securities in the FRBB, FHLBB and ACBI are typically held for an extended period of time and are subject to strict limitations on resales. FRBB stock may only be sold back to the issuer, while FHLBB stock may only be repurchased by the FHLBB or resold to a member institution and ACBI stock may only be resold to other depository institutions or their holding companies or subsidiaries, or to the FDIC. Restricted equity stock is generally sold and redeemed at par. Due to the unique nature of the restricted equity stock, including the non-investment purpose for owning it, the ownership structure and restrictions and the absence of a trading market for the stock, these securities are not marked to market, but carried at par. The FHLBB stock is subject to capital call provisions.

Some of the Company's debt securities have a call feature, meaning that the issuer may call in the investment before maturity, at predetermined call dates and prices. In 2019, there were ten call features exercised by the issuer, compared to no calls exercised during 2018 or 2017.

The Company's debt securities AFS as of December 31 in each of the last three fiscal years were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2019				
U.S. GSE debt securities	$ 18,003	$ 100	$ 41	$ 18,062
Agency MBS	16,169	87	51	16,205
ABS and OAS	2,800	55	2	2,853
Other investments	8,665	182	0	8,847
	$ 45,637	$ 424	$ 94	$ 45,967
Restricted Equity Securities (1)	$ 1,432	$ 0	$ 0	$ 1,432
Total	$ 47,069	$ 424	$ 94	$ 47,399

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2018				
U.S. GSE debt securities	$ 14,010	$ 0	$ 259	$ 13,751
Agency MBS	16,021	3	449	15,575
ABS and OAS	1,988	4	6	1,986
Other investments	8,167	8	120	8,055
	$ 40,186	$ 15	$ 834	$ 39,367
Restricted Equity Securities (1)	$ 1,749	$ 0	$ 0	$ 1,749
Total	$ 41,935	$ 15	$ 834	$ 41,116

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in Thousands)			
December 31, 2017				
U.S. GSE debt securities	$ 17,308	$ 0	$ 149	$ 17,159
Agency MBS	16,782	11	180	16,613
Other investments	4,707	0	29	4,678
	$ 38,797	$ 11	$ 358	$ 38,450
Restricted Equity Securities (1)	$ 1,704	$ 0	$ 0	$ 1,704
Total	$ 40,501	$ 11	$ 358	$ 40,154

(1) Required equity purchases for membership in the FRB System and the FHLB System and for access to correspondent banking services from ACBB.

The Company did not have investments totaling more than 10% of Shareholders' equity in any one issuer during any of the periods presented.

Realized gains and losses in the Company's AFS portfolio are presented in the table below for 2019, 2018 and 2017.

	Realized gains			Realized losses		
	2019	2018	2017	2019	2018	2017
U.S. GSE debt securities	$ 0	$ 0	$ 2,021	$ 7,200	$ 32,718	$ 1,804
Agency MBS	1,570	0	0	20,860	0	0
Other investments	0	0	6,366	0	0	3,199
Total	$ 1,570	$ 0	$ 8,387	$ 28,060	$ 32,718	$ 5,003

The following is an analysis of the maturities and yields of the debt securities in the Company's investment portfolio for each of the last three fiscal years:

December 31,	2019		2018		2017	
	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield
	(Dollars in Thousands)					
U.S. GSE debt securities						
Due in one year or less	$ 2,020	1.81%	$ 0	0.00%	$ 3,740	1.30%
Due from one to five years	2,007	2.25%	4,944	1.69%	6,978	1.64%
Due from five to ten years	12,049	2.81%	8,807	2.84%	6,441	2.62%
Due after ten years	1,986	2.70%	0	0.00%	0	0.00%
Total	$ 18,062	2.63%	$ 13,751	2.42%	$ 17,159	1.93%
ABS/AOS						
Due from five to ten years	$ 2,853	2.94%	$ 1,986	3.33%	$ 0	0.00%
Other Investments						
Due in one year or less	$ 746	2.03%	$ 0	0.00%	$ 0	0.00%
Due from one to five years	7,856	2.72%	7,575	2.63%	4,190	2.25%
Due from five to ten years	245	2.50%	480	2.50%	488	2.50%
Total	$ 8,847	2.65%	$ 8,055	2.62%	$ 4,678	2.28%
Agency MBS (1)	$ 16,205	2.55%	$ 15,575	2.33%	$ 16,613	2.08%
FRBB Stock (2)	$ 588	6.00%	$ 588	6.00%	$ 588	6.00%
FHLBB Stock (2)	$ 754	6.04%	$ 1,071	5.92%	$ 1,116	5.53%
ACBI Stock (2)(3)	$ 90	1.16%	$ 90	0.00%	$ 0	0.00%

(1) Agency MBS are not due at a single maturity date and have not been allocated to maturity groupings for purposes of the maturity table.
(2) Required equity purchases for membership in the FRB System and FHLB System and for access to correspondent banking services from ACBB.
(3) The Company's holdings of ACBI stock were purchased during the fourth quarter of 2018 and the first declared dividend was paid during the first quarter of 2019, accounting for the absence in yield for 2018.

COMMITMENTS, CONTINGENCIES AND OFF-BALANCE-SHEET ARRANGEMENTS

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. During 2019, the Company did not engage in any activity that created any additional types of off-balance-sheet risk.

The Company generally requires collateral or other security to support financial instruments with credit risk. The Company's financial instruments whose contract amount represents credit risk are disclosed in Note 16 to the accompanying audited consolidated financial statements.

EFFECTS OF INFLATION

Rates of inflation affect the reported financial condition and results of operations of all industries, including the banking industry. The effect of monetary inflation is generally magnified in bank financial and operating statements because most of a bank's assets and liabilities are monetary in nature and, as costs and prices rise, cash and credit demands of individuals and businesses increase, while the purchasing power of net monetary assets declines. During the economic downturn that began in 2008, the capital and credit markets experienced significant volatility and disruption, with the federal government taking unprecedented steps to deal with the economic situation. These measures included significant deficit spending as well as quantitative easing of the money supply by the FRB. With the improvement in the economy during the last three years, the FOMC took steps to increase interest rates in 2018 but the second half of 2019 brought a decrease in interest rates as the economy showed signs of slowing.

The impact of inflation on the Company's financial results is affected by management's ability to react to changes in interest rates in order to reduce inflationary effect on performance. Interest rates do not necessarily move in conjunction with changes in the prices of other goods and services. As discussed above, management seeks to manage the relationship between interest-sensitive assets and liabilities in order to protect against significant interest rate fluctuations, including those resulting from inflation. With inflation holding under or near the 2% target despite the unemployment rate remaining at cycle lows, the Fed has recently softened its intentions to further tighten policy during 2020, in an effort to avoid possibly creating a recession, which has typically been the case in past cycles.

LIQUIDITY AND CAPITAL RESOURCES

Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity management refers to the ability of the Company to adequately cover fluctuations in assets and liabilities. Meeting loan demand (assets) and covering the withdrawal of deposit funds (liabilities) are two key components of the liquidity management process. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities, sales of loans available-for-sale, and earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to roll over risk on deposits and limits reliance on volatile short-term borrowed funds. Short-term funding needs arise from declines in deposits or other funding sources and funding requirements for loan commitments. The Company's strategy is to fund assets to the maximum extent possible with core deposits that provide a sizable source of relatively stable and low-cost funds.

The Company recognizes that, at times, when loan demand exceeds deposit growth or the Company has other liquidity demands, it may be desirable to utilize alternative sources of deposit funding to augment retail deposits and borrowings. One-way deposits acquired through the CDARS program provide an alternative funding source when needed. The Company had one-way CDARS outstanding totaling $4.0 million and $723,774 at December 31, 2019

and 2018, respectively. In addition, two-way (that is, reciprocal) CDARS deposits, as well as reciprocal ICS money market and demand deposits, allow the Company to provide FDIC deposit insurance to its customers in excess of account coverage limits by exchanging deposits with other participating FDIC-insured financial institutions. Until 2018, these reciprocal deposits were considered a form of brokered deposits, which are treated less favorably than other deposits for certain purposes; however, a provision of the 2018 Regulatory Relief Act provides that reciprocal deposits held by a well-capitalized and well managed bank are no longer classified as brokered deposits. At December 31, 2019 and 2018, the Company reported $6.8 million and $3.5 million, respectively, in reciprocal CDARS deposits. The balance in ICS reciprocal money market deposits was $22.6 million and $23.9 million at December 31, 2019 and 2018, respectively, and the balance in ICS reciprocal demand deposits as of those dates was $39.7 million and $45.7 million, respectively.

During 2019 and 2018, the Company continued its use of brokered deposits outside of the CDARS program to satisfy a portion of its short-term funding needs. These are typically short term certificates of deposit with maturity less than one year purchased through a prominent broker of public and institutional funds from across the country, along with the addition of DTC Brokered CD issuance during 2018. During the third quarter of 2018, the Company issued two blocks of DTC Brokered CDs totaling $30 million, with maturities in January 2019 and August 2019. During the first quarter of 2019, the Company partially replaced the $20.0 million block that matured in January with purchases of two blocks of DTC Brokered CDs totaling $15.0 million and having maturities in July, 2019 and January, 2020. The Company did not replace the blocks that matured in July and August of 2019, leaving $6.2 million outstanding as of December 31, 2019. Additionally, the Company had brokered deposits from another source totaling approximately $1.0 million and $4.6 million at December 31, 2019 and 2018, respectively. These relationships have provided increased access to short term funding that is easily accessible without any detrimental effect on the pricing of the core deposit base. In total, the Company had $11.1 million and $35.3 million of brokered CDs outstanding at December 31, 2019 and December 31, 2018, respectively.

At December 31, 2019 and 2018, gross borrowing capacity of approximately $97.4 million and $108.7 million, respectively, was available through the FHLBB, secured by the Company's qualifying loan portfolio (generally, residential mortgage and commercial loans), reduced by outstanding advances and collateral pledges. The Company also has an unsecured Federal Funds line with the FHLBB with an available balance of $500,000, with no advances against it at December 31, 2019 or 2018. Interest is chargeable at a rate determined daily approximately 25 basis points higher than the rate paid on federal funds sold.

Under a separate agreement with the FHLBB, the Company has the authority to collateralize public unit deposits up to its FHLBB borrowing capacity ($97.4 million and $108.7 million at December 31, 2019 and 2018, respectively, less outstanding advances and collateral pledges) with letters of credit issued by the FHLBB. The Company offers a Government Agency Account to its municipal customers collateralized with these FHLBB letters of credit. At December 31, 2019 and 2018, approximately $14.4 million and $2.6 million, respectively, of qualifying residential real estate loans were pledged as collateral to the FHLBB for these collateralized governmental unit deposits, which reduced dollar-for-dollar the available borrowing capacity under the FHLBB line of credit. Total fees paid by the Company to the FHLBB in connection with these letters of credit were $41,069 for 2019 and $46,620 for 2018.

The Company has a BIC arrangement with the FRBB secured by eligible commercial loans, CRE loans and home equity loans, resulting in an available line of $56.9 million and $50.9 million, respectively, at December 31, 2019 and 2018. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), which was 225 basis points at December 31, 2019. At December 31, 2019 and 2018, the Company had no outstanding advances against this line.

The Company has unsecured lines of credit with three correspondent banks with aggregate available borrowing capacity of $12.5 million at December 31, 2019 and 2018. The Company had no outstanding advances against these lines for the periods presented.

Securities sold under agreements to repurchase amounted to $33.2 million, $30.5 million and $28.6 million as of December 31, 2019, 2018 and 2017, respectively. The average daily balance of these repurchase agreements was $33.5 million, $30.6 million and $28.9 million during 2019, 2018, and 2017, respectively. The maximum borrowings

outstanding on these agreements at any month-end reporting period of the Company were $38.9 million, $32.9 million and $31.7 million during 2019, 2018 and 2017, respectively. These repurchase agreements mature daily and carried a weighted average interest rate of 0.89% during 2019, 0.63% during 2018 and 0.33% during 2017.

The following table illustrates the changes in shareholders' equity from December 31, 2018 to December 31, 2019:

Balance at December 31, 2018 (book value $11.72 per common share)	$ 62,603,711
Net income	8,824,446
Issuance of stock through the DRIP	1,097,234
Redemption of preferred stock	(500,000)
Dividends declared on common stock	(3,951,279)
Dividends declared on preferred stock	(87,500)
Change in AOCI on AFS securities, net of tax	908,067
Balance at December 31, 2019 (book value $12.86 per common share)	$ 68,894,679

In December, 2019, the Board of the Company declared a $0.19 per common share cash dividend, payable February 1, 2020 to shareholders of record as of January 15, 2020, requiring the Company to accrue a liability of $727,526 for this dividend in the fourth quarter of 2019. In March, 2020, the Board of the Company approved a cash dividend of $0.19 per common share, payable on May 1, 2020 to shareholders of record as of April 15, 2020. The declaration of this dividend required the Company to accrue a liability of $995,538 in the first quarter of 2020.

The Company (on a consolidated basis) and the Bank are subject to various 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 and the Bank's financial statements. Under capital adequacy guidelines, the Company and 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. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Additional Prompt Corrective Action capital requirements are applicable to banks, but not bank holding companies. (See Note 21 to the accompanying audited consolidated financial statements.)

Common Stock Performance by Quarter*

Trade Price	2019 First	2019 Second	2019 Third	2019 Fourth	2018 First	2018 Second	2018 Third	2018 Fourth
High	$ 17.20	$ 17.95	$ 17.00	$ 17.90	$ 18.50	$ 18.25	$ 18.90	$ 19.39
Low	$ 15.94	$ 16.34	$ 15.07	$ 15.15	$ 16.55	$ 16.50	$ 16.91	$ 16.00

Bid Price	2019 First	2019 Second	2019 Third	2019 Fourth	2018 First	2018 Second	2018 Third	2018 Fourth
High	$ 17.20	$ 17.40	$ 16.88	$ 17.00	$ 18.10	$ 17.55	$ 18.80	$ 18.25
Low	$ 16.12	$ 16.34	$ 15.14	$ 15.40	$ 16.55	$ 16.60	$ 16.95	$ 16.00
Cash Dividends Declared	$ 0.19	$ 0.19	$ 0.19	$ 0.19	$ 0.17	$ 0.19	$ 0.19	$ 0.19

*The Company's common stock is not traded on any exchange. However, the Company's common stock is included in the OTCQX® marketplace tier maintained by the OTC Markets Group Inc. Trade and bid information for the stock appears in the OTC's interdealer quotation system, OTC Link ATS®. The trade price and bid information in the table above is based on information reported by participating FINRA-registered brokers in the OTC Link ATS® system and may not represent all trades or high and low bids during the relevant periods. Such price quotations reflect inter-dealer prices without retail mark-up, mark-down or commission and bid prices do not necessarily represent actual transactions. The OTC trading symbol for the Company's common stock is CMTV.

As of February 1, 2020, there were 5,239,675 shares of the Corporation's common stock ($2.50 par value) outstanding, owned by 832 shareholders of record.

Form 10-K

A copy of the Form 10-K Report filed with the Securities and Exchange Commission may be obtained without charge upon written request to:

Kathryn M. Austin, President & CEO
Community Bancorp.
4811 US Route 5
Newport, Vermont 05855

Shareholder Services

For shareholder services or information contact:

Melissa Tinker, Assistant Corporate Secretary
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4811 US Route 5
Newport, Vermont 05855
(802) 334-7915

Transfer Agent:

Computershare Investor Services
PO Box 43078
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Annual Shareholders' Meeting

The 2020 Annual Shareholders' Meeting, which had previously been scheduled for May 19, 2020, has been postponed due to mandated COVID-19 response measures. We will notify you when the rescheduled date has been determined.

Notes

Notes

Notes

Board of Directors
Community Bancorp. and
Community National Bank

Thomas E. Adams, President, NPC Realty, Inc.

Kathryn M. Austin, President and Chief Executive Officer, Community Bancorp. and Community National Bank

David Bouffard, Co-Owner, Derby Village Store

Aminta K. Conant, Business Consulting, USA and Europe

Jacques R. Couture, Owner, Dairy Farm/Maple Products

David P. Laforce, President and Owner, Built by Newport

Rosemary Lalime, Owner and Partner, RE/MAX All Seasons Realty

Stephen P. Marsh, Board Chair, Community Bancorp. and Community National Bank

Emma L. Marvin, Co-Owner, Butternut Mountain Farm

Dorothy R. Mitchell, Board Chair, Vermont Student Assistance Corporation

Jeffrey L. Moore, President and Owner, Quest Industries, Inc.

Fredric Oeschger, President and Principal, Fred's Energy, Inc. and D&C Transportation, Inc.

James G. Wheeler, Jr., Attorney and Principal, Downs Rachlin Martin, PLLC.

Executive Officers
Community Bancorp. and
Community National Bank

Kathryn M. Austin, President and Chief Executive Officer, Community Bancorp., and Community National Bank

Louise M. Bonvechio, Corporate Secretary and Treasurer, Community Bancorp., and Executive Vice President, Chief Financial Officer, Cashier and Corporate Secretary, Community National Bank

Other Officers
Community National Bank

Sarah Barrup, Special Asset Officer

Laura J. Bennett, Derby Office Manager

Justin Bourgeois, Regional Vice President and Commercial Loan Officer

Nikole B. Brainard, Asset Liability Manager

Timothy B. Bronson, Senior Vice President and Senior Lender

Theresa P. Carpenter, Assistant Vice President and Retail Loan Underwriting Officer

Jane P. Clark, Vice President, Deposit Operations and Training Director

Michelle Cleveland, Price Chopper Office Manager

Mark S. Clough, Vice President and Commercial Loan Officer

Hope K. Colburn, Vice President, Commercial Loan Officer and CRA Officer

Robin Coulter, Newport Officer Manager

Jennifer J. Daigle, Vice President and Senior Credit Officer

Lorilee Drown, Central Vermont Offices Manager

Janet C. Gratton, Electronic Banking Officer

Laurie Gray, Information Security Officer

William Hamilton, Vice President and Commercial Loan Officer

Regan Howard, Vice President and Commercial Loan Officer

Penelope L. Johnson, Assistant Vice President and Residential Lending Officer

Cindy L. LaGue, Senior Vice President, Retail Banking

Rosemary Lalime, Vice President and Lead Outside Director

Shelly Morey, Community Circle Director

Theresa B. Morin, Vice President, Senior Loan Operations Officer

Candace A. Patenaude, Financial Officer and Controller

Kelly A. Paul, Vice President, Compliance, BSA and Security Officer, Enterprise Risk Manager and Audit Committee Liaison

Amanda Pepin, Credit Administration Officer

Kimico Perry, Vice President, Human Resources

Brandon Poginy, Vice President and Commercial Loan Officer

Tracy D. Roberts, Vice President and Marketing Director

Edward Ropple, Vice President and Chief Technology Officer

Dave Rubel, Commercial Loan Officer

Lori Wells, Barton Office Manager

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TRADING SYMBOL: CMTV
(traded on the OTCQX)

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