The Community
Financial Corporation

April 6, 2020

Dear Stockholder:

I am pleased to invite you to attend our annual meeting of stockholders of The Community Financial Corporation (the “Company”) to be held on Wednesday, May 20, 2020 at 10:00 a.m. In light of on-going developments related to coronavirus (COVID-19) and after careful consideration, the Board of Directors has determined that this year’s annual meeting will be a virtual meeting conducted exclusively via live webcast. You will be able to attend the annual meeting and vote and submit questions during the annual meeting via a live webcast by visiting www.virtualshareholdermeeting.com/TCFC2020.

The attached notice and proxy statement describe the formal business to be transacted at the annual meeting. Directors and officers of the Company, as well as a representative of the Company’s independent registered public accounting firm, Dixon Hughes Goodman LLP, will be present at the virtual annual meeting where they will have the opportunity to make a statement if they desire to do so, and will be available to respond to appropriate questions stockholders may have.

Your vote is important, regardless of the number of shares you own. **On behalf of the Board of Directors, I urge you to vote via the Internet, by telephone or by signing, dating and returning a proxy card as soon as possible, even if you plan to virtually attend the annual meeting.**

Sincerely,

Michael L. Middleton
Chairman of the Board

THE COMMUNITY FINANCIAL CORPORATION
3035 LEONARDTOWN ROAD
WALDORF, MARYLAND 20601
(301) 645-5601

NOTICE OF 2020 ANNUAL MEETING OF STOCKHOLDERS

TIME AND DATE	:	10:00 a.m. Eastern Time on Wednesday, May 20, 2020
PLACE	:	The 2020 Annual Meeting of The Community Financial Corporation (the "Company") will be a virtual meeting conducted exclusively via webcast at www.virtualshareholdermeeting.com/TCFC2020
ITEMS OF BUSINESS	:	(1) To elect four directors to serve for a term of three years; (2) To ratify the appointment of Dixon Hughes Goodman LLP as the independent registered public accounting firm for the year ending December 31, 2020; (3) To vote on a non-binding resolution to approve the compensation of the named executive officers; (4) To transact such other business as may properly come before the meeting or any adjournments or postponement thereof.
RECORD DATE	:	To vote, you must have been a stockholder at the close of business on March 23, 2020. The Board does not know of any business to be presented at the meeting.
PROXY VOTING	:	It is important that your shares be represented and voted at the virtual meeting. You can vote your shares via the Internet, by telephone or by completing and signing a proxy. Voting instructions are printed on your proxy or voting instruction card and included in the proxy statement. You can revoke a proxy at any time before the meeting by following the instructions in the proxy statement.

2020 ANNUAL STOCKHOLDER MEETING

In light of ongoing developments related to coronavirus (COVID-19) and after careful consideration, the Board of Directors has determined that this year's annual meeting will be a virtual meeting conducted exclusively via live webcast at www.virtualshareholdermeeting.com/TCFC2020. Adopting this format for this year's annual meeting will facilitate stockholder attendance and participation by enabling stockholders to safely participate from any location and at no cost. We believe this is the right choice for the Company at this time, as it enables engagement with our stockholders, regardless of size, resources, or physical location while safeguarding the health of our stockholders, Board, management and other partners. We are committed to ensuring that stockholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting. You will be able to attend the meeting online, vote your shares electronically and submit questions during the meeting. **To participate in the virtual meeting, you will need the 16-digit control number included on your Notice, proxy card or voting instruction form.** The meeting webcast will begin promptly at 10:00 a.m., Eastern Time. We encourage you to access the meeting prior to the start time to complete the check-in procedures. Online check-in will begin at 9:30 a.m., Eastern Time. If you encounter any difficulties accessing the virtual annual meeting during the check-in or meeting time, please call the technical support number that will be posted on the virtual shareholder meeting log-in page. Technical support will be available starting at 9:30 a.m. Eastern Time on May 20, 2020.

Christy Lombardi
Corporate Secretary
April 6, 2020

IMPORTANT: The prompt return of proxies will save the Company the expense of further requests for proxies to ensure a quorum. A self-addressed envelope is enclosed for your convenience. No postage is required if mailed in the United States.

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PROXY STATEMENT
OF
THE COMMUNITY FINANCIAL CORPORATION
3035 LEONARDTOWN ROAD
WALDORF, MARYLAND 20601
(301) 645-5601

GENERAL INFORMATION

On June 28, 2018, the Securities and Exchange Commission adopted amendments that raised the thresholds in the definition of a “smaller reporting company”, thereby expanding the number of smaller companies eligible to comply with scaled disclosure requirements in several Regulation S-K and Regulation S-X items. Under the 2018 smaller reporting company definition, a company with less than $250 million of public float as of the last business day of its second fiscal quarter qualifies as a smaller reporting company and is eligible to take advantage of the scaled disclosures. The Community Financial Corporation continues to meet the qualification of a smaller reporting company and therefore, this proxy statement reflects several of the scaled disclosure requirements.

We are providing this proxy statement to you in connection with the solicitation of proxies by the Board of Directors of The Community Financial Corporation for the 2020 annual meeting of stockholders and for any adjournment or postponement of the meeting. In this proxy statement, we may also refer to The Community Financial Corporation as the “Company,” “we,” “our” or “us.”

The Community Financial Corporation is the holding company for Community Bank of the Chesapeake. In this proxy statement, we may also refer to Community Bank of the Chesapeake as the “Bank.”

We are holding the 2020 annual meeting as a virtual meeting conducted exclusively via live webcast on Wednesday, May 20, 2020 at 10:00 a.m., local time.

We intend to provide access to this proxy statement and a proxy card to stockholders of record beginning on or about April 6, 2020.

HOW TO ATTEND THE ANNUAL MEETING

This year’s annual meeting will be a virtual meeting conducted exclusively via live webcast at www.virtualshareholdermeeting.com/TCFC2020. Adopting this format for this year’s annual meeting will facilitate stockholder attendance and participation by enabling stockholders to safely participate from any location and at no cost. In light of ongoing developments related to COVID-19, we believe this is the right choice for the Company at this time, as it enables engagement with our stockholders, regardless of size, resources, or physical location while safeguarding the health of our stockholders, Board, management and other partners. You will be able to attend the meeting online, vote your shares electronically and submit questions during the meeting. To participate in the virtual meeting, you will need the 16-digit control number included on your Notice, proxy card or voting instruction form. The meeting webcast will begin promptly at 10:00 a.m., Eastern Time. We encourage you to access the meeting prior to the start time to complete the check-in procedures. Online check-in will begin at 9:30 a.m., Eastern Time. If you encounter any difficulties accessing the virtual annual meeting during the check-in or meeting time, please call the technical support number that will be posted on the virtual shareholder meeting log-in page. Technical support will be available starting at 9:30 a.m. Eastern Time on May 20, 2020. We intend to provide access to this proxy statement and a proxy card to stockholders of record beginning on or about April 6, 2020.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE STOCKHOLDERS MEETING TO BE HELD ON MAY 20, 2020

The Proxy Statement and Annual Report to Stockholders are available at:
https://www.cbtc.com/about/investor-relations/proxyandannualreport

INFORMATION ABOUT VOTING

Who Can Vote at the Meeting. You are entitled to vote the shares of the Company's common stock that you owned as of the close of business on March 23, 2020. As of the close of business on March 23, 2020, 5,910,064 shares of Company common stock were outstanding. Each share of common stock has one vote.

Voting by Proxy. This proxy statement is being sent to you by the Board of Directors of the Company to request that you allow your shares of The Community Financial Corporation common stock to be represented at the annual meeting by the persons named in the enclosed proxy card. All shares of the Company's common stock represented at the meeting by properly executed, dated proxies will be voted according to the instructions indicated on the proxy card. If you sign, date and return a proxy card without giving voting instructions, your shares will be voted as recommended by the Company's Board of Directors. The Board of Directors recommends that you vote:

- **"FOR"** each of the nominees for director;
- **"FOR"** ratification of the appointment of Dixon Hughes Goodman LLP as the Company's independent registered public accounting firm; and
- **"FOR"** the approval of the compensation of the named executive officers.

If any matters not described in this proxy statement are properly presented at the annual meeting, the persons named in the proxy card will use their judgment to determine how to vote your shares. This includes a motion to adjourn or postpone the meeting to solicit additional proxies. If the annual meeting is postponed or adjourned, your common stock may also be voted by the persons named on the proxy card on the new meeting date, unless you have revoked your proxy.

Registered stockholders can vote their shares of The Community Financial Corporation common stock by mailing a proxy card, via the Internet or by telephone. Specific instructions for Internet or telephone voting are set forth on the enclosed proxy or voting instruction card. The Internet and telephone voting procedures are designed to authenticate stockholders' identities, allow stockholders to provide their voting instructions and confirm that their instructions have been recorded properly. **The deadline for voting by telephone or via the Internet is 11:59 p.m., Eastern time, on May 19, 2020.**

Ownership of Shares; Attending the Meeting. You may own shares of the Company in one of the following ways:

- Directly in your name as the stockholder of record;
- Indirectly through a broker, bank or other holder of record in "street name;" or
- Indirectly in the Community Bank of the Chesapeake Employee Stock Ownership Plan.

If your shares are registered directly in your name, you are the holder of record of these shares and we are sending these proxy materials directly to you. As the holder of record, you have the right to give your proxy directly to us or to vote in person via the virtual annual meeting.

If you hold your shares in street name, your broker, bank or other holder of record is sending these proxy materials to you. As the beneficial owner, you have the right to direct your broker, bank or other holder of record how to vote by completing the voting instruction form that accompanies your proxy materials. Your broker, bank or other holder of record may allow you to provide voting instructions by telephone or via the Internet. Please see the voting instruction form provided by your broker, bank or other holder of record that accompanies this proxy statement.

If you participate in the Community Bank of the Chesapeake Employee Stock Ownership Plan, you will receive a voting instruction card that reflects all shares you may direct the plan trustees to vote on your behalf under the plan. Under the terms of the Employee Stock Ownership Plan, all allocated shares of Company stock held by the plan are voted by the trustees, as directed by plan participants. All unallocated shares of Company common stock held by the plan, and allocated shares for which no voting instructions are received, are voted by the trustees in the same

proportion as shares for which the trustees have received timely voting instructions, subject to the exercise of their fiduciary duties. **The deadline for returning your voting instructions to the Employee Stock Ownership Plan trustees is May 13, 2020.**

Quorum. We will have a quorum and will be able to conduct the business of the annual meeting if the holders of a majority of the outstanding shares of common stock entitled to vote are represented at the meeting. If you return valid proxy instructions or virtually attend the meeting, we will count your shares to determine whether there is a quorum, even if you abstain from voting. Broker non-votes (described below) also will be counted to determine the existence of a quorum.

Votes Required for Proposals. In voting on the election of directors, you may vote in favor of the nominees, withhold votes for all of the nominees, or withhold votes as to any of the nominees. There is no cumulative voting for the election of directors. Directors must be elected by a plurality of the votes cast at the annual meeting.

In voting on the ratification of the appointment of Dixon Hughes Goodman LLP as the Company's independent registered public accounting firm and on the non-binding resolution to approve the compensation of the named executive officers, you may vote in favor of the proposal, vote against the proposal or abstain from voting. All proposals will be decided by the affirmative vote of a majority of the shares cast at the annual meeting.

For all proposals, abstentions and broker non-votes will not be counted as votes cast and will have no effect on the outcome of the voting on the proposals.

Effect of Not Casting Your Vote. If you hold your shares in street name it is critical that you cast your vote if you want it to count in the election of directors (Item 1 of this proxy statement), or the approval of the non-binding advisory vote on executive compensation (Item 3 of this proxy statement). Current regulations restrict the ability of your bank or broker to vote your shares on these matters on a discretionary basis. Thus, if you hold your shares in street name and you do not instruct your bank or broker how to vote in the election of directors and the approval of the non-binding advisory vote on executive compensation no votes will be cast on your behalf. These are referred to as broker non-votes. Your bank or broker will, however, continue to have discretion to vote any shares for which you do not provide voting instructions on the ratification of the appointment of the Company's independent registered public accounting firm (Item 2 of this proxy statement). If you are a stockholder of record and you do not cast your vote, no votes will be cast on your behalf on any of the items of business at the annual meeting.

Revocation of Proxy. Stockholders who execute proxies retain the right to revoke them at any time. Unless revoked, the shares represented by such proxies will be voted at the annual meeting virtually and all adjournments thereof. Proxies may be revoked by written notice of revocation to the Secretary of the Company, by delivering a later-dated proxy or by voting in person at the virtual annual meeting. Attendance at the virtual annual meeting will not in and of itself constitute revocation of your proxy.

CORPORATE GOVERNANCE

Director Independence. The Company's Board of Directors currently consists of ten members, all of whom are independent under the listing requirements of The NASDAQ Stock Market, except for William J. Pasenelli, President and Chief Executive Officer of the Company, Chief Executive Officer of the Bank and Vice Chair of the Boards of Directors of the Company and Bank. In determining the independence of its directors, the Board considered transactions, relationships and arrangements between the Company and its directors that are not required to be disclosed in this proxy statement under the heading *"Relationships and Transactions with the Company and the Bank,"* including (i) legal services performed by the Jenkins Law Firm, LLC, of which Louis P. Jenkins, Jr. is a principal, and (ii) loans or lines of credit that the Bank has directly or indirectly made to each of the directors on the Board. Rebecca M. McDonald is the daughter of Michael L. Middleton, the current Chairman of the Board of the Company. Mr. Middleton submitted Ms. McDonald's name to the Governance Committee for consideration as a prospective director nominee candidate. Mr. Middleton will be retiring from the Board of Directors effective June 30, 2020. There was no understanding or arrangement that Ms. McDonald would be nominated to shareholders for election to the Board of Directors. The Governance Committee conducted due diligence on Ms. McDonald and reviewed her credentials and background consistent with the Governance Committee's Charter. In evaluating Ms. McDonald's candidacy, and in determining that she would be considered "independent" under the SEC's and Nasdaq's rules, the Nominating and Corporate Governance Committee and the Board of Directors also considered Ms. McDonald's familial relationship with Mr. Middleton, Mr. Middleton's current status as the Chairman of the Board and his beneficial ownership interest in the Company's common stock.

Board Leadership Structure. The Company currently separates the offices of President and Chief Executive Officer and Chairman of the Board. Doing so allows the President and Chief Executive Officer to better focus on his responsibilities of managing the day-to-day operations of the Company, enhancing stockholder value and expanding and strengthening the franchise while allowing the Chairman of the Board to lead the Board in its fundamental role of providing advice to and oversight of management. The Board also has created a Lead Director position to further enhance Board independence and oversight. Austin J. Slater, Jr. is currently the Lead Director of the Board of Directors. Among other things, the Lead Director (i) presides at meetings of the Board at which the Chairman of the Board is not present, including executive sessions of the independent directors, and (ii) may call meetings of the independent directors. As previously disclosed on October 31, 2019, the Chairman of the Board, Michael Middleton, will retire from the Board of Directors effective June 30, 2020. At that time, Director Slater will become Chairman of the Board.

The Board's Role in Risk Oversight. Risk is inherent with every business and how well a business manages risk can ultimately determine its success. We face a number of risks, including credit risk, interest rate risk, liquidity risk, operational risk, strategic risk and reputation risk. Management is responsible for the day-to-day management of risks the Company faces, while the Board, as a whole and through its committees, has responsibility for the oversight of risk management. In its risk oversight role, the Board of Directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. To do this, senior management attends the Board meetings and is available to discuss strategy and risks facing the Company and to address any questions or concerns raised by the Board on risk management and any other matters. The Board also provides strong oversight of the Company's management and affairs through its standing committees and, when necessary, special meetings of independent directors.

Committees of the Board of Directors. The following table identifies the members of the Board's Audit, Enterprise Risk Management, Governance and Compensation Committees as of March 23, 2020. All members of the Audit, Governance and Compensation Committees are independent in accordance with the listing requirements of The NASDAQ Stock Market. Each committee operates under a written charter, which is approved by the Board of Directors, that governs its composition, responsibilities and operation. Each committee reviews and reassesses the adequacy of its charter at least annually.

Director	Audit Committee	Enterprise Risk Management Committee	Governance Committee	Compensation Committee
Kimberly C. Briscoe-Tonic		X		
M. Arshed Javaid		X		
Louis P. Jenkins, Jr.		X	X*	X*
Michael L. Middleton		X		
William J. Pasenelli		X		
Mary Todd Peterson	X*	X		X
E. Lawrence Sanders, III	X	X		
Austin J. Slater, Jr.**	X	X*	X	X
Joseph V. Stone, Jr.	X	X	X	X
Kathryn Zabriskie			X	X
Number of Meetings in 2019	8	4	5	6

* Chairperson
** Lead Director

Audit Committee. The Audit Committee engages the Company's independent registered public accounting firm and meets with them in connection with their annual audit and reviews the Company's accounting and financial and regulatory reporting policies and practices. Other responsibilities of the Audit Committee include engagement of compliance and internal audit providers and the review with management of reports issued by such parties. The Board of Directors has determined that the Audit Committee does not have a member who is an "audit committee financial expert" as defined under the rules and regulations of the Securities and Exchange Commission. While the Board has not designated any individual Board member as an "audit committee financial expert," the Board believes the level of financial knowledge and experience of the current members of the Audit Committee, including the ability to read and understand financial statements, is cumulatively sufficient to discharge the Audit Committee's responsibilities. The Audit Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Enterprise Risk Management Committee. The Enterprise Risk Management Committee assists the Board in its oversight responsibilities by focusing specifically on the Company's enterprise risk management activities including the significant policies, procedures and practices employed to manage capital adequacy, market risk, earnings, credit risk, liquidity, compliance, regulatory, legal, reputation, and strategic operational risk and by providing recommendations to the Board and management on strategic guidance with respect to the assumption, management and mitigation of risk. The Enterprise Risk Management Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Governance Committee. The Governance Committee is responsible for promoting sound corporate governance policies that promote the best interests of the Company and its stockholders. The Committee's responsibilities include: identification of director candidates; director education; recommendations on the size and composition of the Board and the boards of any subsidiaries, review of any stockholder proposals; monitoring of regulatory and statutory compliance; review of committee charters; and evaluations of Board oversight and effectiveness. The Governance Committee also annually reviews and recommends, in conjunction with the Compensation Committee, the appropriate level of director compensation. The Governance Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About*

Community Bank" section of the Company's website (www.cbtc.com), and is available in print to any stockholder who requests a copy.

Compensation Committee. The Compensation Committee approves the compensation objectives for the Company and the Bank and establishes the compensation for the Chief Executive Officer and other executives. Our Chief Executive Officer, Bank President and Chief Operating Officer make recommendations to the Compensation Committee from time to time regarding the appropriate mix and level of compensation for other executives. The Compensation Committee reviews compensation for the Company's executive officers to ensure an appropriate balance between short-term pay and long-term incentives. In addition to reviewing competitive market values, the Compensation Committee also examines the total compensation mix, pay-for-performance relationship, and how all elements, in the aggregate, comprise the executive's total compensation package. Decisions by the Compensation Committee with respect to the compensation of executive officers are approved by the full Board of Directors. The Compensation Committee also annually reviews and recommends, in conjunction with the Governance Committee, the appropriate level of director compensation. The Compensation Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (www.cbtc.com), and is available in print to any stockholder who requests a copy.

Director Nomination Process. The Governance Committee selects nominees for election as directors. The Governance Committee seeks to create a Board that is strong in its collective knowledge and has a diversity of skills and experience in accounting and finance, management and leadership, vision and strategy, business operations, business judgment, industry knowledge and corporate governance. To accomplish this, the Governance Committee considers a candidate's knowledge of the banking business and involvement in community, business and civic affairs, and also considers whether the candidate would adequately represent the Company's market area. Any nominee for director must be highly qualified with regard to some or all of these attributes. In searching for qualified director candidates to fill vacancies on the Board, the Governance Committee solicits its current directors for the names of potential qualified candidates. The Governance Committee may also ask its directors to pursue their business contacts for the names of potentially qualified candidates. The Governance Committee would then consider the potential pool of director candidates, select the top candidates based on the candidates' qualifications and the Company's needs, and conduct a thorough investigation of each proposed candidate's background. If a stockholder has submitted a proposed nominee in accordance with the procedures specified below, the Governance Committee would consider the proposed nominee, along with any other proposed nominees recommended by directors, in the same manner in which the Governance Committee would evaluate nominees for director recommended by the Board of Directors.

Consideration of Recommendations by Stockholders. The Governance Committee will consider recommendations for directors submitted by stockholders. Stockholders who wish the Governance Committee to consider their recommendations for nominees for director should submit their recommendations in writing to the Governance Committee in care of the Corporate Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601. Each written recommendation must set forth (1) the name of the recommended candidate, (2) the number of shares of stock of the Company that are beneficially owned by the stockholder making the recommendation and by the recommended candidate, and (3) a detailed statement explaining why the stockholder believes the recommended candidate should be nominated for election as a director. In addition, the stockholder making such recommendation must promptly provide any other information reasonably requested by the Governance Committee. To be considered by the Governance Committee for nomination for election at an annual meeting of stockholders, the recommendation must be received by the January 1 preceding that annual meeting.

Board and Committee Meetings. During 2019, the Board of Directors of the Company held nine (9) meetings. No director attended fewer than 75% of the meetings of the Board of Directors and Board committees on which they served in 2019 except for Kimberly C. Briscoe-Tonic who was appointed to the Company's Board effective September 25, 2019.

Director Attendance at Annual Meeting of Stockholders. While the Company does not have a policy regarding Board member attendance at annual meetings of stockholders it encourages directors to attend the annual meeting of stockholders. All of the Company's directors attended the Company's 2019 annual meeting of stockholders.

Code of Ethics. The Community Financial Corporation maintains a Code of Ethics that is designed to ensure that the Company's directors and employees meet the highest standards of ethical conduct. The Code of Ethics, which applies to all employees and directors, addresses conflicts of interest, the treatment of confidential information, general employee conduct and compliance with applicable laws, rules and regulations. In addition, the Code of Ethics is designed to deter wrongdoing and promote honest and ethical conduct, the avoidance of conflicts of interest, full and accurate disclosure and compliance with all applicable laws, rules and regulations. Under the terms of the Code of Ethics, violations of the Code of Ethics are required to be reported to the Audit Committee of the Board of Directors. A copy of the Code of Ethics is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Management - Chief Officers. Our executive officers are elected by the Board of Directors and serve at the Board's discretion. Below is information regarding our executive officers who are not directors. Ages presented are as of December 31, 2019.

James M. Burke, age 51, joined the Bank in 2005. He serves as Executive Vice President of the Company and President of the Bank. Before his appointment as President of the Bank in 2016, he served as Executive Vice President and Chief Risk Officer. Before joining the Bank, Mr. Burke served as Executive Vice President and Senior Loan Officer of Mercantile Southern Maryland Bank. Mr. Burke has over 20 years of banking experience. Mr. Burke is the former Chairman of the Board of Directors of University of Maryland Charles Regional Medical Center, serves on the Board of Directors for the ARC of Southern Maryland, Trustee for St. Mary's Ryken High School, Trustee for Historic Sotterley Plantation and is active in other civic groups. Mr. Burke is a Maryland Bankers School graduate and holds a Bachelor of Arts from High Point University. He is also a graduate of the East Carolina Advanced School of Commercial Lending and attended the Harvard Business School Program on Negotiation.

Todd L. Capitani, age 53, joined the Bank in 2009. He serves as Executive Vice President, Chief Financial Officer of the Company and the Bank. Before joining the Bank, Mr. Capitani served as a Senior Finance Manager at Deloitte Consulting and as Chief Financial Officer at Ruesch International, Inc. Mr. Capitani has over 25 years of experience in corporate finance, controllership and external audit. Mr. Capitani is involved with several local charities, religious and community organizations. Mr. Capitani is a member of the American Institute of Certified Public Accountants and other civic groups. He serves on the Board of Directors for Annmarie Sculpture Garden & Arts Center. Mr. Capitani is a Certified Public Accountant and holds a Bachelor of Arts from the University of California at Santa Barbara. He also attended the Harvard Business School Program on Negotiation and the Yale School of Management Strategic Leadership Conference.

John A. Chappelle, age 34, joined the Bank in 2007. He serves as Executive Vice President and Chief Digital Officer of the Bank. Mr. Chappelle is responsible for the execution of digital banking strategies and oversees commercial services and consumer and residential lending. Mr. Chappelle has more than 10 years of banking experience. He serves on the Board of Directors of Bay Community Support Services and is Chair Elect of the Charles County Chamber of Commerce. He is a Maryland Bankers School graduate and holds a Master's in Business Administration from University of Maryland University College.

Brian Scot Ebron, age 51, joined the Bank in 2018. He serves as Executive Vice President, Chief Banking Officer for the Bank's Virginia market. Mr. Ebron is responsible for business development efforts in the Virginia market and oversees the Bank's branch network. Mr. Ebron has worked in banking for nearly 30 years and has prior executive level experience. He serves on the Boards of Directors of Sagepoint Foundation, Maryland Veterans Memorial Museum and Gwyneth's Gift Foundation. Mr. Ebron also serves on the College of Southern Maryland's Business Advisory Council. He holds a bachelor's degree in economics from University of North Carolina.

Christy M. Lombardi, age 43, joined the Bank in 1998. She serves as Executive Vice President, Chief Operating Officer of the Company and the Bank. Ms. Lombardi is responsible for corporate governance matters for the Company, and oversees operations, human resources, information technology and community shareholder relations. Ms. Lombardi has over 20 years of banking experience. She serves on the Board of Trustees of the College of Southern Maryland, on the Advisory Board of the Maryland Banker's Association Council of Professional Women in Banking and Finance and on the Southern Maryland Workforce Development Board. Ms. Lombardi served on the Board of Directors of the Calvert County Chamber of Commerce from 2012-2018. She is a Maryland Bankers School graduate and holds a Masters in Management from University of Maryland University College as well as a Master's in Business Administration. Ms. Lombardi also attended the Harvard Business School Program on Negotiation.

Lacey A. Pierce, age 34, joined the Bank in 2007. She serves as Executive Vice President, Chief Administrative Officer of the Bank. Ms. Pierce is responsible for administration matters and oversees lending administration, marketing and facilities. She has more than 10 years of banking experience. Ms. Pierce serves on the Board of Directors of The Arc of Southern Maryland and Farming 4 Hunger. She is a Maryland Banking School graduate and holds a bachelor's degree from Towson University.

Patrick D. Pierce, age 41, joined the Bank in 2003. He serves as Executive Vice President, Chief Banking Officer for the Bank's Maryland market. Mr. Pierce is responsible for business development efforts in the Maryland market and oversees Community Wealth Advisors, the Bank's wealth division. Mr. Pierce has nearly 20 years of experience in banking and financial services. He serves on the Board of Directors of the University of Maryland Charles Regional Medical Center and is a Board Member and Treasurer for the La Plata Business Association. Mr. Pierce is a Maryland Bankers School graduate and holds a bachelor's degree in business management from University of Maryland University College.

Talal Tay, age 42, joined the Bank in 2018. He serves as Executive Vice President, Chief Risk Officer of the Bank. Mr. Tay is responsible for enterprise risk and oversees compliance and credit administration. He has worked in the audit and risk areas of financial services for more than 15 years. Mr. Tay holds a bachelor's degree in business marketing from Florida State University. He holds a Certified Anti-Money Laundering Specialist designation as well as Internal Audit Practitioner designation from IIA.

DIRECTOR COMPENSATION

The following table provides the compensation received by the non-employee directors of the Company and the Bank during 2019.

Name	Fees Earned or Paid in Cash ($)	Non-qualified Deferred Compensation Earnings ($) (1)	Total ($)
Kimberly C. Briscoe-Tonic[(2)]	$ 22,125	$ —	$ 22,125
James F. Di Misa[(3)]	15,692	—	15,692
M. Arshed Javaid	37,825	5,317	43,142
Louis P. Jenkins, Jr.	50,000	—	50,000
Michael L. Middleton	55,000	7,139	62,139
John K. Parlett, Jr.[(4)]	34,925	—	34,925
Mary Todd Peterson	49,800	5,230	55,030
E. Lawrence Sanders, III	47,800	476	48,276
James R. Shepherd[(5)]	20,525	—	20,525
Austin J. Slater, Jr.	51,125	—	51,125
Joseph V. Stone, Jr.	54,775	10,543	65,318
Kathryn Zabriskie	44,725	876	45,601

(1) Represents the portion of non-qualified deferred compensation earnings under the Community Bank of the Chesapeake Retirement Plan for Directors that was above the Internal Revenue Service long-term rate. Under the plan, interest is credited at a rate equal to the Company's annualized return on equity or based on the gains or losses on the deemed investments.

(2) Ms. Kimberly C. Briscoe-Tonic was appointed to the Board of Directors of the Company effective September 25, 2019 and continues to serve as a director of the Bank. The fees reported in the table include fees received as a non-employee director of the Company from September 25, 2019 through December 31, 2019.

(3) Mr. James F. Di Misa retired as Executive Vice President and Chief Operating Officer of the Company and the Bank on March 31, 2019. The fees reported in the table represent the fees received as a non-employee director of the Bank from April 1, 2019 through December 31, 2019.

(4) Mr. John K. Parlett, Jr. resigned from the Boards of Directors of the Company and the Bank effective September 19, 2019.

(5) Mr. James R. Shepherd resigned from the Board of Directors of the Bank effective December 31, 2019.

Cash Retainer and Meeting Fees for Directors. The following tables set forth the applicable retainers and fees that will be paid to directors for their service on the Boards of Directors of the Company and the Bank for 2020:

***Board of Directors of the Company*:**	
Annual Retainer	$15,000
Fee per Board Meeting (Regular or Special)	$750 ($225 per telephone meeting)
Fee per Committee Meeting	$500 ($225 per telephone meeting)
Annual Retainer for the Chairman of the Board and Audit Committee Chair	$5,000
Annual Retainer for Governance, Compensation, and Enterprise Risk Management Committee Chairs	$2,500

***Board of Directors of the Bank*:**	
Annual Retainer	$10,000
Fee per Board Meeting (Regular or Special)	$650 ($225 per telephone meeting)
Fee per Committee Meeting	$425 ($225 per telephone meeting)
Annual Retainer for ALCO and Credit Risk Committee Chairs	$2,500

Employee directors of the Company receive only the annual retainer and Board meeting fees; they do not receive fees for committee meetings. Employee directors of the Bank do not receive annual retainers, board meeting fees or fees for committee meetings.

Directors' Retirement Plan. The Bank maintains a retirement plan for non-employee members of the Board of Directors of the Bank (the "Directors' Plan"). Under the Directors' Plan, each eligible director of the Bank will receive an annual retirement benefit for ten years following his or her termination of service on the Bank's Board in an amount equal to the product of his "Benefit Percentage", "Vested Percentage", and $3,500. A participant's "Benefit Percentage" is 0% for less than five years of service, 33 1/3% for five to nine years of service, 66 2/3% for 10 to 14 years of service, and 100% for 15 or more years of service. A participant's "Vested Percentage" is 33 1/3% for less than one year of service, 66 2/3% for one year of service, and 100% for two or more years of service. If a participant terminates service on the Board due to disability, the Bank will pay the participant each year for ten years an amount equal to the product of his or her Benefit Percentage and $3,500. If a participant dies before collecting either his or her retirement or disability benefit, the participant's surviving spouse or estate will receive a lump sum payment having a present value equal to five times the annual retirement benefit to which the participant was entitled, assuming the participant separated service on the date of death and was fully vested. If the participant dies after beginning to receive his or her retirement or disability benefits, the participant's surviving spouse or estate will receive a lump sum payment having a present value equal to the remaining benefits to which the participant was entitled from the date of death through the tenth annual payment thereafter. A participant will become fully vested in the event of a "change in control" (as defined in the Directors' Plan) or upon separation from service on the Board after attaining the age 72 or incurring a disability.

The Directors' Plan also provides non-employee directors the opportunity to defer all or any portion of the fees and/ or salary otherwise payable. Deferred amounts may be credited quarterly and adjusted annually with a rate of return equal to the consolidated return on equity of the Company for the calendar year, as determined under accounting principles generally accepted in the United States, and/or credited quarterly with earnings or losses based on the rate of return of mutual funds selected by the plan participants.

Consulting Agreement with Michael L. Middleton. On October 30, 2019, the Company announced that Michael L. Middleton informed the Board of Directors that he will retire on June 30, 2020 from his position as Chairman of the Boards of Directors of the Company and the Bank. Further, following notification of Mr. Middleton's retirement, the Compensation Committee of the Board of Directors of the Company terminated the consulting agreement between Mr. Middleton and the Bank effective December 31, 2019.

Consulting Agreement with James F. Di Misa. Community Bank of the Chesapeake maintains a 12 month Consulting Agreement with James F. Di Misa. Under the terms of the Consulting Agreement, Mr. Di Misa's consulting services include, but are not limited to, advising the EVP, Administrative Affairs Officer and Chief Operating Officer in matters relating to operations, marketing and facilities, advising the EVP, Banking Officers in matters relating to CWA and the retail banking network and advising the EVP, Digital Banking Officer on matters associated with Commercial Services, as well as any other matters Executive Management request. In consideration of the consulting services, Mr. Di Misa receives an annual consulting fee of $70,000 payable in equal monthly installments.

AUDIT RELATED MATTERS

Report of the Audit Committee. The Company's management is responsible for the Company's internal controls and financial reporting process. The Company's independent registered public accounting firm is responsible for performing an independent audit of the Company's consolidated financial statements and issuing an opinion on the conformity of those financial statements with accounting principles generally accepted in the United States. The Audit Committee oversees the Company's internal controls and financial reporting process on behalf of the Board of Directors.

The Audit Committee has met and held discussions with management and the independent registered public accounting firm. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States and the Audit Committee has reviewed and discussed the consolidated financial statements with management and the independent registered public accounting firm. The Audit Committee discussed with the independent registered public accounting firm matters required to be discussed by Statement on Auditing Standard No. 16, as amended (AICPA, *Professional Standards*, Vol. 1. AU Section 380) as adopted by the Public Company Accounting Oversight Board in Rule 3200T, including the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of the disclosures in the financial statements.

In addition, the Audit Committee has received the written disclosures and the letter from the independent registered public accounting firm required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered public accounting firm's communications with the Audit Committee concerning independence and has discussed with the independent registered public accounting firm the independent registered public accounting firm's independence from the Company and its management. In concluding that the registered public accounting firm is independent, the Audit Committee considered, among other factors, whether the non-audit services provided by the firm were compatible with its independence.

The Audit Committee discussed with the Company's independent registered public accounting firm the overall scope and plans for its audit. The Audit Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of its examination, its evaluation of the Company's internal controls, and the overall quality of the Company's financial reporting.

In performing all of these functions, the Audit Committee acts only in an oversight capacity. In its oversight role, the Audit Committee relies on the work and assurances of the Company's management, which has the primary responsibility for financial statements and reports, and of the independent registered public accounting firm that, in its report, expresses an opinion on the conformity of the Company's financial statements to accounting principles generally accepted in the United States. The Audit Committee's oversight does not provide it with an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or policies, or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's considerations and discussions with management and the independent registered public accounting firm do not assure that the Company's financial statements are presented in accordance with accounting principles generally accepted in the United States, that the audit of the Company's financial statements has been carried out in accordance with generally accepted auditing standards or that the Company's independent registered public accounting firm is independent.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS
OF THE COMMUNITY FINANCIAL CORPORATION

Mary Todd Peterson (Chair)
E. Lawrence Sanders, III
Austin J. Slater, Jr.
Joseph V. Stone, Jr.

Audit Fees. The following table sets forth fees billed to the Company by Dixon Hughes Goodman for the fiscal years ended December 31, 2019 and December 31, 2018:

	2019	2018
Audit Fees[1]	$ 209,108	$ 256,577
Audit Related Fees[2]	$ 29,184	$ 23,562
Tax Fees	$ —	$ —
All Other Fees	$ —	$ —

(1) Represents fees for review of Quarterly Reports on Form 10-Q and audit of financial statements.
(2) Represents fees for the audit of the 401(k) and ESOP plans.

Pre-Approval of Services by the Independent Registered Public Accounting Firm. The Audit Committee's charter provides that the Audit Committee will approve in advance any non-audit services permitted by the Securities Exchange Act, including tax services that its independent registered public accounting firm renders to the Company, unless such prior approval may be waived because of permitted exceptions under the Securities Exchange Act, including but not limited to a 5% *de minimis* exception. The Audit Committee may delegate to one or more members of the Audit Committee the authority to grant pre-approvals for auditing and allowable non-auditing services, which decision shall be presented to the full Audit Committee at its next scheduled meeting for ratification. During the fiscal year ended December 31, 2019, the Audit Committee approved 100% of all audit-related, tax and other fees.

PRINCIPAL HOLDERS OF VOTING SECURITIES

The following table sets forth, as of March 23, 2020, certain information as to those persons known by the Company to beneficially own more than 5% of the Company's outstanding shares of common stock and the shares of Company common stock beneficially owned by each director, each executive officer named in the summary compensation table and by all executive officers and directors of the Company as a group. All beneficial owners listed in the table have the same address as the Company, unless otherwise provided. Unless otherwise indicated, each of the named individuals has sole voting power and sole investment power with respect to the shares shown.

Name of Beneficial Owners	Number of Shares Beneficially Owned (1)(2)	Percent of Shares of Common Stock Outstanding (3)
Directors:		
Kimberly C. Briscoe-Tonic	379	*
M. Arshed Javaid	3,986	*
Louis P. Jenkins, Jr.	20,188	*
Michael L. Middleton	228,347(4)	3.86%
William J. Pasenelli	51,819	*
Mary Todd Peterson	8,234	*
E. Lawrence Sanders, III	27,119(5)	*
Austin J. Slater, Jr.	24,718	*
Joseph V. Stone, Jr.	33,652(6)	*
Kathryn Zabriskie	4,262	*
Named Executive Officers Who are Not Also Directors		
James M. Burke	21,453	*
Gregory C. Cockerham	124,518	2.11%
All Directors, Executive Officers and Nominees as a Group (20 persons)	625,603(7)	10.59%
5% Owner(s):		
Fourthstone LLC[8] Fourthstone Master Opportunity Fund Ltd Fourthstone GP LLC Fourthstone QP Opportunity Fund LP 13476 Clayton Road St Louis, MO 63131	354,717(8)	6.35%

*Less than 1% of the shares outstanding

(1) Includes shares allocated to the account of the individuals under the Community Bank of the Chesapeake Employee Stock Ownership Plan, with respect to which the individual has voting but not investment power as follows; Mr. Burke — 1,944 shares; Mr. Cockerham — 24,981 shares; and Mr. Pasenelli — 5,609 shares.

(2) Includes shares of unvested restricted stock, with respect to which the individual has voting but no investment power as follows: Ms. Briscoe-Tonic – 294 shares; Mr. Javaid – 294 shares; Mr. Middleton — 294 shares; Ms. Peterson – 294 shares; Mr. Sanders – 294 shares; Mr. Slater – 294 shares; Mr. Stone – 294 shares; Ms. Zabriskie – 294 shares; Mr. Pasenelli — 1,576 shares; and Mr. Burke — 1,102 shares.

(3) Based upon 5,910,064 shares of Company common stock outstanding as of March 23, 2020.

(4) Includes 64,351 shares beneficially owned by Mr. Middleton's wife.

(5) Includes 2,173 shares beneficially owned by the individual retirement account of Mr. Sanders's wife.

(6) Includes 2,000 shares beneficially owned by the individual retirement account of Mr. Stone's wife.

(7) Includes 10,603 shares beneficially owned by James F. Di Misa which 147 shares are unvested restricted stock which Mr.

Di Misa has voting power but no dispositive power. Mr. Di Misa is a director of Community Bank of the Chesapeake. Includes 11,895 shares beneficially owned by Todd Capitani which 1,059 shares are unvested restricted stock which Mr. Capitani has voting power but no dispositive power and 10,778 shares beneficially owned by Christy Lombardi which 904 shares are unvested restricted stock which Ms. Lombardi has voting power but no dispositive power. Mr. Capitani and Ms. Lombardi are executive officers of the Company.

Includes shares beneficially owned as follows: John Chappelle - 769; B. Scot Ebron - 18,691; and Talal Tay - 402. Of those shares beneficially owned, some of which are unvested restricted stock to which the individual has voting power but no dispositive power as follows: Mr. Chappelle - 177; Mr. Ebron - 1,755; and Mr. Tay - 370. Messrs. Chappelle, Ebron and Tay are executive officers of the Bank.

Includes shares beneficially owned by Patrick Pierce and Lacey Pierce of 9,475 and 9,065, respectively, of which 7,035 shares are owned jointly by Mr. and Mrs. Pierce. Mr. and Mrs. Pierce each have voting power but not dispositive power for 489 shares of unvested restricted stock. Mr. and Mrs. Pierce are executive officers of the Bank.

(8) Based on information contained in a Schedule 13G/A filed with the U.S. Securities and Exchange Commission on February 20, 2020.

ITEMS TO BE VOTED ON BY STOCKHOLDERS

Item 1 – Election of Directors

The Company's Board of Directors currently consists of 10 members. The Board is divided into three classes, each with terms of three years, one-third of whom are elected annually. The Board of Directors has nominated Kimberly Briscoe-Tonic, M. Arshed Javaid, Rebecca M. McDonald and Kathryn M. Zabriskie to serve for a three-year term or until their successors have been elected and qualified. Mr. Javaid, Ms. Briscoe-Tonic and Ms. Zabriskie are currently directors of the Company. Ms. McDonald has been nominated to serve a three-year term as a new member of the Board to the class of directors that expires in 2023.

It is intended that the persons named in the proxies solicited by the Board will vote for the election of the named nominees. If any nominee is unable to serve, the shares represented by all valid proxies will be voted for the election of such substitute nominee as the Board of Directors may recommend. At this time, the Board knows of no reason why any nominee might be unable to serve.

The Board of Directors recommends a vote "FOR" the election of each of the nominees.

Information regarding the nominees and the directors continuing in office is provided below. Unless otherwise stated, each individual has held his or her current occupation for the last five years. The age indicated in each biography is as of December 31, 2019. There are no family relationships among the directors or executive officers, except that Rebecca M. McDonald is the daughter of Michael L. Middleton, the current Chairman of the Board of the Company who will retire on June 30, 2020.

Board Nominees with Term Ending in 2023

Kimberly Briscoe-Tonic is a respected business leader in Charles and St. Mary's counties in Maryland. She, along with her husband, own and operate the Briscoe-Tonic Funeral Home, P.A. with locations in Waldorf and Mechanicsville, Maryland. Briscoe-Tonic Funeral Home was founded in 2008. Ms. Briscoe-Tonic earned an Associate of Arts degree in Mortuary Science and is a licensed mortician. She has served families through the Washington DC metropolitan area for over 30 years. Age 51. Director of the Bank since 2016 and Director of the Company since 2019.

Ms. Briscoe-Tonic provides the Board with management and strategic knowledge through her experience as founder and owner of a local business. Her experience as a business owner adds valuable expertise regarding local issues and provides first-hand understanding of the needs of business owners in the business environment in which the Bank operates.

M. Arshed Javaid is the President of Parraid, LLC founded in 2019 and wholly devoted to design, engineering, sales, and support of telemetry data systems and tactically oriented mission critical communications solutions.

Previously Mr. Javaid was the president of Smartronix, Inc., an information technology and engineering solutions provider. Mr. Javaid founded Smartronix, Inc. in 1995, and has extensive experience in business management and community relations. He served on the Historic Sotterley Inc. Board of Trustees for ten years 2008 – 2018 and was re-elected in January 2019 for a 5 year term. Age 65. Director of the Bank and the Company since 2013.

Mr. Javaid provides the Board with significant management, strategic and operational knowledge through his experience as founder and president of an information technology and engineering solutions provider that has evolved from a start-up company to a company with over 700 employees. Mr. Javaid's experience in the information technology industry, especially cyber security, provides the Board with valuable insight into the data security and reputational risk issues facing businesses.

Rebecca Middleton McDonald, CPA, is a partner at CohnReznick, LLP a national audit, tax and business advisory firm. She has 25 years of experience providing accounting advisory services and financial transformation support

to both private and public companies. Ms. McDonald specializes in a range of services, such as outsourced and project based accounting, SEC reporting, audit and IPO readiness, internal control and process improvement analysis, and due diligence support for mergers and acquisitions. Prior to joining CohnReznick, Ms. McDonald held various finance roles with a publicly traded company. Ms. McDonald is a member of the American Institute of Certified Public Accountants. She serves as the Treasurer on the Board of Trustees of Commonwealth Academy. Ms. McDonald holds a BS from Elon University. Age 46. If elected to the Board at the annual meeting, it is expected that Rebecca M. McDonald will be appointed to the Audit and Enterprise Risk Committees.

Ms. McDonald has extensive audit, public accounting, and executive level experience. Ms. McDonald's proficiencies provide the Board with a skill set critical to providing effective oversight of the Company and Bank.

Kathryn M. Zabriskie Kathryn M. Zabriskie is president of Business Training Works, Inc., an employee-development firm specializing in soft-skills training, leadership development, and customer-experience initiatives. Ms. Zabriskie started the company in 2000. Since that time, she and her team have worked with hundreds of organizations across industries, including several members of the Fortune 50. Ms. Zabriskie holds an MBA from the University of Texas at Austin and a BA from George Mason University. She has served on several philanthropic boards and civic organizations in the Bank's market. Age 48. Director of the Bank since 2013 and Director of the Company since February 8, 2017.

Ms. Zabriskie brings a depth and breadth of knowledge to the board related to best practices in employee development, human resources, facilitation, and organizational planning. Her experience working nationally, internationally, and across industries offers a broad perspective on issues related to training and development, corporate culture, managing and attracting talent, and planning for the future.

Directors Continuing in Office

Directors with Terms Ending in 2021:

William J. Pasenelli is President and Chief Executive Officer of The Community Financial Corporation and Vice Chairman and Chief Executive Officer of Community Bank of the Chesapeake. Mr. Pasenelli joined the Bank as Chief Financial Officer in 2000 and was named President of the Bank in 2010, President of The Community Financial Corporation in 2012, Chief Executive Officer in July 2014 and Vice Chairman and Chief Executive Office of Community Bank of the Chesapeake in July 2016. Before joining the Bank, Mr. Pasenelli had been Chief Financial Officer of Acacia Federal Savings Bank, Annandale, Virginia, since 1987. Mr. Pasenelli serves as the Vice Chairman of the Board of Directors for the Maryland Bankers Association. He also serves on the Board and as a member of the Finance Committee of the Germanna Community College Education Foundation. Mr. Pasenelli is a member of the American Institute of Certified Public Accountants and the Greater Washington Society of Certified Public Accountants and other civic groups. Mr. Pasenelli graduated Magna Cum Laude from Duke University with a Bachelor of Arts degree in Management Science. He is a graduate of the National School of Banking. Age 61. Director of the Bank and the Company since 2010.

In his 20 years at the Bank and Company, Mr. Pasenelli has helped to formulate the growth strategies which have led to the Bank's successful transformation from a $200 million asset size Bank to its current size and success. Mr. Pasenelli led the acquisition of County First Bank and several capital raising efforts that have fueled the Company's growth. He is a respected member of the Banking community in Maryland and Virginia. His strategic vision, demonstrated leadership and operational expertise make him well suited to guide our Company and Bank through difficult times.

E. Lawrence Sanders, III is President of Edward L. Sanders Insurance Agency, which provides multi-line insurance services to clients in Maryland since 1903. Mr. Sanders graduated from NC State University in 1978, obtained his Certified Insurance Counselor designation in 1979 and became a licensed Insurance Advisor in 1981. Mr. Sanders served on the board of directors of County First Bank for 28 years, and served as chairman of the board from 2013 to 2018. He is a current member and past President of the Charles County Rotary, past director for the Professional Insurance Agent's Association, past director and past President for the Civista Foundation and current director for the Charles County Rotary Foundation. Age 63. Director of the Bank and the Company since 2018.

Through his experience as owner of an insurance agency, Mr. Sanders has extensive financial and operational knowledge. His years of experience serving as a bank director provides the Board valuable insight regarding corporate governance, regulatory compliance, risk assessment practices and bank operations.

Austin J. Slater, Jr. is the President and Chief Executive Officer of the Southern Maryland Electric Cooperative, which is one of the ten largest electrical distribution cooperatives in the country. Mr. Slater formerly served on the Board of Directors of the Federal Reserve Bank of Richmond, Baltimore Branch, the Board of Directors as Vice Chairman of the University of Maryland Charles Regional Medical Center, and he has also served as Chairman of the Board of the Maryland Chamber of Commerce and Chairman of the Board of Trustees for the College of Southern Maryland, as well as numerous other industry and civic organizations. Mr. Slater holds a MBA in Finance from George Washington University and a BS in Accounting from Shepherd University. Age 66. Director of the Bank and the Company since 2003.

Mr. Slater has extensive management level experience in a large company setting outside of the financial services industry. Mr. Slater's financial acumen and operational experience allow him to understand the complexities of the Company and the Bank. His experience in a regulated industry has exposed Mr. Slater to many of the issues facing companies today, particularly regulated entities, making Mr. Slater a valued component of a well-rounded board.

Joseph V. Stone, Jr. owned and operated Joe Stone Insurance Agency, which provided multi-line insurance services to clients in Maryland and Virginia, from 1981 to 2016. He has served as a director for the Southern Maryland Electric Cooperative since 1996. Age 65. Director of the Bank and the Company since 2006.

Mr. Stone provides the Board with significant marketing and operational knowledge through his experience as owner of an insurance agency and various director positions with companies outside of the financial services industry. Mr. Stone also has considerable experience in the insurance industry, corporate governance and risk assessment practices necessary in banking operations.

Directors with Terms Ending in 2022:

Louis P. Jenkins, Jr. is the principal of Jenkins Law Firm, LLC, located in LaPlata, Maryland. Before entering private practice, Mr. Jenkins served as an Assistant State's Attorney in Charles County, Maryland from 1997 to 1999. In addition to his private practice, Mr. Jenkins serves as Court Auditor for the Circuit Court for Charles County, Maryland and attorney for the Charles County Board of Elections. From 2017-2019, Mr. Jenkins served as a member of the Board of Directors of the University of Maryland Medical System which consists of twelve hospitals located throughout the State of Maryland with annual revenue in excess of $3.67 Billion. Mr. Jenkins has also served as a board member of several other public service organizations including the University of Maryland Charles Regional Medical Center, Southern Maryland Chapter of the American Red Cross, Charles County Chamber of Commerce and the Charles County Bar Association. Age 48. Director of the Bank and the Company since 2000.

As an attorney, Mr. Jenkins provides the Board with substantial knowledge regarding issues facing the Company and the Bank. In addition, Mr. Jenkins brings a critical perspective to the lending and governance function of the Company and the Bank. Mr. Jenkins' experience in the public sector adds valuable expertise regarding local issues and provides first-hand understanding of the local political and business environment in which the Bank operates.

Michael L. Middleton is Chairman of the Board of Directors of the Company and the Bank and serves as a consultant to the Bank. On June 30, 2016, he retired as Executive Chairman of the Board of Directors of the Company and the Bank. As previously disclosed on October 31, 2019, Michael Middleton will retire from the Board of Directors effective June 30, 2020. At that time, Director Slater will become Chairman of the Board. Mr. Middleton joined the Bank in 1973 and served in various management positions until 1979 when he became President of the Bank, which he served as until 2010. He remained President of the Company until 2012 and Chief Executive Officer of the Company and the Bank until June 2014. Mr. Middleton is a lifetime member of the American Institute of Certified Public Accountants and holds a Masters of Business Administration. From 1996 to 2004, Mr. Middleton served on the Board of Directors of the Federal Home Loan Bank of Atlanta, serving as Chairman of the Board in 2004. Mr. Middleton served on the Board of Directors of the Federal Reserve Bank, Baltimore Branch, from 2004 to 2009. He completed his term as Chairman of the Maryland Bankers Association in June 2013 and is Trustee Emeritus and former Chairman of the Board for the College of Southern Maryland. Mr.

Middleton completed his term on the Federal Reserve's Community Depository Advisory Council in October 2015. He also serves on several philanthropic and civic boards. Age 72. Director of the Bank since 1979 and of the Company since 1989.

Mr. Middleton's extensive experience in the local banking industry and involvement in the communities in which the Bank serves affords the Board valuable insight regarding the business and operations of the Bank. In addition to Mr. Middleton's extensive background in finance and corporate management, Mr. Middleton also has significant expertise in large financial institution governance providing a unique and broad-based decision-making capability for the Company and the Bank. Mr. Middleton's knowledge of the Company's and the Bank's business and history, combined with his success and strategic vision, position him well to serve as our Chairman.

Mary Todd Peterson retired in May 2018 as the senior advisor to the Chairman and CEO of ProAssurance Corporation supporting key strategic initiatives. In February 2016, she retired as the President and Chief Executive Officer of Medmarc Insurance Group and as a Director of Medmarc Casualty Insurance Company and its subsidiary Noetic Specialty Insurance Company, both of which are subsidiaries of ProAssurance. Ms. Peterson had been associated with Medmarc since 2001 where she also held the positions of Chief Financial Officer and Chief Operating Officer. From 1993 to 2001, Ms. Peterson was a Partner with Johnson Lambert & Co., a certified public accounting firm. Ms. Peterson also held positions with Acacia Life Insurance Company, Oxford Development Corporation and Ernst & Whinney (now Ernst & Young). Prior to her retirement from Medmarc, Ms. Peterson served as a member of the Property Casualty Insurers Association of America ("PCI") Board of Governors, Chair of PCI's Investment Committee and a member of PCI's Executive and Finance Committees. Ms. Peterson is a member of the American Institute of Certified Public Accountants. Age 65. Director of the Bank and the Company since 2010.

Ms. Peterson has extensive executive-level experience in a mid-size company setting within the financial services industry combined with 18 years' experience in public accounting. Ms. Peterson's financial and operational expertise within the insurance industry, including proficiencies in corporate governance and risk assessment, provide the Board with a skill set critical to providing effective oversight of the Company and Bank.

Item 2 – Ratification of the Independent Registered Public Accounting Firm

Dixon Hughes Goodman, which was the Company's independent registered public accounting firm for 2019, has been retained by the Audit Committee of the Board of Directors to be the Company's independent registered public accounting firm for 2020, subject to ratification by the Company's stockholders. A representative of Dixon Hughes Goodman is expected to be present at the virtual annual meeting and will have the opportunity to make a statement if he or she desires to do so and will be available to respond to appropriate questions.

If the ratification of the appointment of the independent registered public accounting firm is not approved by a majority of the votes cast at the virtual annual meeting, the Audit Committee will consider other independent registered public accounting firms. In addition, if the ratification of the independent registered public accounting firm is approved by stockholders at the annual meeting, the Audit Committee may also consider other independent registered public accounting firms in the future if it determines that such consideration is in the best interests of the Company and its stockholders.

The Board of Directors recommends that stockholders vote "FOR" the ratification of the appointment of Dixon Hughes Goodman as the Company's independent registered public accounting firm.

Item 3 – Advisory Vote on Executive Compensation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") requires that we provide our stockholders with the opportunity to express their views, on a non-binding basis, on the compensation of our named executive officers as disclosed in this proxy statement. This vote, which is often referred to as the "say-on-pay" vote, provides stockholders with the opportunity to endorse or not endorse the following resolution:

“Resolved, that the stockholders approve the compensation of the named executive officers, as described in the tabular disclosure regarding named executive officer compensation and the accompanying narrative disclosure in this proxy statement.”

Because your vote is advisory, it will not be binding upon the Compensation Committee or the Board of Directors. However, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

The Board of Directors unanimously recommends a vote “FOR” approval of the compensation of the named executive officers.

EXECUTIVE COMPENSATION

The following overview is intended to provide stockholders with a description of the Company's executive compensation philosophy, components of its executive compensation program, and the factors considered by the Compensation Committee (or "Committee" in this section) for determining executive compensation for our named executive officers (or "NEO" in this section) in 2019.

Because of the June 2018 amendment to the definition of a "smaller reporting company" under rules promulgated by the Securities and Exchange Commission, we now qualify for, and have elected to comply with, the scaled disclosure requirements applicable to smaller reporting companies. Accordingly, this executive compensation overview is not intended to meet the "Compensation Discussion and Analysis" disclosure required of larger reporting companies.

Our 2019 named executive officers are our three most highly-compensated executive officers who were serving as an executive officer at the end of 2019. This executive compensation overview should be read in conjunction with the compensation tables and associated narrative that follows.

Named Executive Officer	Title
William J. Pasenelli	President and Chief Executive Officer (CEO)
James M. Burke	Executive Vice President and Bank President
Gregory C. Cockerham	Executive Vice President and Chief Lending Officer (CLO)

Our Compensation Philosophy

Our executive compensation program is structured to motivate and retain executive officers who are critical to our success. Our competitive salary, incentive opportunities and benefits program reflect a balanced and responsible pay approach while also considering the environment in which the Company operates. Our executive compensation program is designed to reward our named executive officers for delivering results and achieving sustainable growth. We seek to accomplish this goal in a way that rewards performance and is aligned with our shareholders' long-term interests. Our compensation philosophy is grounded on the following guiding principles:

Team-Based Approach. Each named executive officer is a member of the Company's executive team. The Company's executive compensation program is intended to promote and maintain stability within the executive team. As such, compensation levels amongst the NEOs are closely aligned and their incentive opportunities are linked to similar performance metrics.

Performance Expectations. The Company has clear performance expectations of its officers that are reinforced by its performance review and compensation programs. First, each executive officer must demonstrate exceptional personal performance in order to remain part of the executive team. Second, each executive officer must contribute to the Company's overall success, rather than focus solely on specific objectives within the officer's area of responsibility.

Ownership. We believe executives should have an ownership position in our Company. A portion of the annual incentive is paid in restricted stock. The Company has in place stock ownership guidelines for its executive officers (ranging between 1x – 2x base pay).

Principal Elements of Pay

The executive compensation program reflects our compensation philosophy and uses a full range of pay components to achieve our objectives. We believe that we can meet the objectives of our compensation philosophy by reaching a balance among the primary elements of base salary, short-term incentives and long-term incentives.

The target allocation of base salary and performance-based compensation (short-term cash incentives and equity awards) varies depending upon the role of a named executive officer in our organization and his or her individual performance and achievements in support of our strategic objectives.

Supplemental benefits: In addition to eligibility to participate in the Company's health and welfare programs and other broad-based programs on the same basis as other employees, the Company offers NEOs supplemental retirement and life insurance benefits commonly offered by peers within the industry.

Our Decision-Making Process

Role of the Compensation Committee. The Committee is responsible for overseeing and administering the Company's employee benefit plans and policies. The Committee determines all compensation for the named executive officers. Each year, the Committee conducts an evaluation of each executive officer to determine if any changes in the officer's compensation would be appropriate based on the considerations described above.

The Committee is composed of at least three directors who are determined to be "independent directors" as defined by NASDAQ Rule 5605(d) (2) (A). The members of the Committee are appointed annually by the Board of Directors. Four members of the Company's Board of Directors serve on the Committee, each of whom is an "independent director". The Chair of the Committee reports to the Company's Board regarding Committee actions.

Compensation Committee Interlocks and Insider Participation. No member of the Committee is a current or former officer or employee of the Company or any of its subsidiaries. There are no compensation committee interlocks with other entities with respect to any such member.

Role of Management. At the Committee's request, Mr. Pasenelli, our Chief Executive Officer, provides input regarding the performance and appropriate compensation of the other executive officers. The Committee considers Mr. Pasenelli's evaluation of the other executive officers because of his direct knowledge of each executive officer's performance and contributions. In accordance with NASDAQ rules, Mr. Pasenelli is not present when his compensation is being discussed or approved.

Role of the Compensation Consultant. For 2019 compensation decisions, the Committee retained the services of Pearl Meyer & Partners, LLC ("Pearl Meyer") to assist the Committee with its compensation governance responsibilities, including areas such as competitive assessment of our executive compensation programs, advice on incentive plan design, and education and guidance on regulatory matters and emerging trends related to executive compensation. The Committee assessed the independence of Pearl Meyer pursuant to SEC and NASDAQ rules and concluded that no conflict of interest exists that would prevent Pearl Meyer from serving as an independent consultant to the Committee.

Role of Compensation Benchmarking. The Committee reviews both compensation and performance at peer companies to inform its decision-making process so it can set total compensation opportunities that it believes are commensurate with the market and the Company's scope and performance. The Committee refers to executive compensation studies prepared by its independent consultants when it reviews and approves executive compensation. However, the Committee also considers other factors when setting compensation, including specific job responsibilities and scope, adjustments for individual skills and expertise, and internal pay equity.

2019 Executive Compensation Decisions

The Committee began its work on executive compensation for 2019 by assessing competitive market compensation using a number of data sources including publicly disclosed information on a selected peer group of publicly traded banking organizations similar in asset size, business model, and geographic region. Additionally, the Committee considered the results of the Company's say-on-pay vote when making compensation decisions for the NEOs. At the Company's 2019 annual meeting of stockholders, approximately 95.6% of the votes cast on the say-on-pay proposal were voted for the proposal, demonstrating a high level of support for the Committee's executive pay decisions.

2019 Business Highlights. When establishing and evaluating performance goals for the 2019 executive annual incentive opportunities, consideration was given to the following 2019 business results in light of the objectives set forth in the Company's strategic plan for 2019:

During 2019, the Company and its subsidiary, Community Bank of the Chesapeake, continued to successfully execute on its strategic longer-term objectives of increased profitability and shareholder value.

Below are a few highlights of our 2019 performance:

- During the year ended December 31, 2019, the Bank stabilized net interest margin, controlled expenses, organically grew loans and improved credit quality. The second half of 2019 was highlighted with a stable net interest margin due mainly to a slightly liability sensitive balance sheet and management's focus on improving the Bank's funding mix. Net interest margin declines were only four basis points from 3.33% in the second quarter of 2019 to 3.29% in the fourth quarter of 2019.
- Gross loans increased 8.0% or $107.3 million from $1,346.9 million at December 31, 2018 to $1,454.2 million at December 31, 2019. Overall loan growth for 2019 was as expected and based on management's evaluation of loan opportunities in light of marginal and total funding costs.
- Total deposits increased $82.2 million or 5.8% to $1,511.8 million at December 31, 2019, which included an increase in transaction accounts of $135.1 million and a decrease in time deposits of $52.9 million. Transaction deposit accounts increased to 73.9% of deposits at December 31, 2019 from 68.7% at December 31, 2018.
- On December 31, 2019, the Company issued a total of 312,747 shares of its common stock, par value $0.01 in a private placement offering. The Company received net proceeds of $10.6 million after deal expenses. On February 15, 2020, the Company used the proceeds and a cash dividend from the Bank to redeem the Company's outstanding $23.0 million of 6.25% fixed-to-floating rate subordinated notes. The redemption of the $23.0 million in subordinated notes in February 2020 will reduce interest expense by $1.4 million on an annualized basis and be accretive to earnings. The annualized positive impact on net interest margin is estimated to be between eight and nine basis points for 2020.
- Net income for the year ended December 31, 2019 was $15.3 million or $2.75 per diluted share compared to net income of $11.2 million or $2.02 per diluted share for the year ended December 31, 2018. The year ended December 31, 2018 included merger and acquisition costs net of tax of $2.7 million ($3.6 million pre-tax expense). Merger and acquisition costs did not impact earnings per share in 2019. Merger and acquisition costs resulted in a reduction to 2018 earnings per share of approximately $0.49.
- The Company's ROAA and ROACE were 0.88% and 9.32% in the year ended December 31, 2019 compared to 0.70% and 7.53% in the year ended December 31, 2018.
- The Company's efficiency ratio improved, decreasing from 69.42% for the year ended December 31, 2018 to 61.10% for the year ended December 31, 2019, primarily as a result of increased efficiencies from the County First Bank acquisition and updates to the Bank's technology platforms which have allowed the Company to slow the growth of expenses as the asset size of the Bank has increased. In addition, noninterest income increased as a percentage of average assets due to increases in fee income and service charge income.
- Liquidity was stable in 2019 as the increase in transaction deposits were partially offset by a reduction in time deposits. The decrease in wholesale funding increased available off-balance sheet lines of credit. The Company's net loan to deposit ratio has decreased from 103.1% at December 31, 2017 to 93.5% at December 31, 2018 and 95.6% at December 31, 2019.
- Classified assets as a percentage of assets improved in 2019, decreasing 49 basis points from 2.42% at December 31, 2018 to 1.93% at December 31, 2019.
- Non-accrual loans, OREO and TDRs to total assets decreased 56 basis points from 2.02% at December 31, 2018 to 1.46% at December 31, 2019.

Base Salaries. Competitive base salaries are critical in attracting and retaining our executives. We establish base salaries and assess market competitiveness by comparing our executives' qualifications, experience, and responsibilities as well as their individual performance and value with similar positions among our peers.

The following table reflects each active named executive officer's increase in base pay for 2019.

Executive	Title	2018 Salary	2019 Salary	% Increase
William J. Pasenelli	President and CEO	$ 440,000	$ 465,000	5.68%
James M. Burke	EVP and Bank President	$ 336,000	$ 360,000	7.14%
Gregory C. Cockerham	EVP, CLO	$ 320,000	$ 330,000	3.13%

The increases for Messrs. Pasenelli and Burke were intended to align their compensation more closely with market pay levels for their respective positions.

Annual Performance-Based Incentive Compensation. We maintain a short-term annual compensation plan which allows us to provide our active named executive officers with the opportunity to earn incentive compensation for achieving specific Company performance goals. The plan uses a balanced scorecard approach by establishing threshold, target and maximum incentive opportunities tied to performance factors aligned with the annual strategic plan approved by the Board. A portion of the incentives, once earned, is paid in restricted stock which vests ratably over three years beginning on the first anniversary of the grant date.

The total amount of each NEO's incentive award under the short-term incentive plan is determined by taking into account performance against a scorecard of financial performance metrics that tie to our annual business plan, along with the results of a holistic assessment of each executive. All of these components are part of a scorecard that is provided to each NEO and used by the Committee to determine annual short-term incentive awards. Under the terms of the short-term incentive plan, the Committee has discretionary authority to adjust for one-time non-recurring charges or other extenuating circumstances. The Committee did not exercise this authority for awards related to the 2019 plan year.

The performance factors used to determine annual bonus awards for our named executive officers under the Bank's Executive Incentive Compensation Plan in 2019 included ROAA, ROAE and efficiency ratio. The plans for the CEO and Bank President also included non-performing assets as a percentage of total assets and net charge-offs. These criteria were chosen because they reflect commonly recognized measures of overall company performance and are associated with shareholder value creation. The plan included threshold, target and maximum levels of performance for each performance factor and a corresponding payout, weighted as a percentage of salary, to each of the named executive officers based upon actual achievement. The 2019 target incentive opportunity was 35% of base salary for the CEO and 30% of base salary for the other NEOs. The incentive opportunity ranged from 50% of target at threshold performance to a maximum of 150% of target for superior performance (from 17.5% to 52.5% of base salary for the CEO and 15% to 45% for the other NEOs). As soon as practicable following year end, the Committee determines the amount to be awarded to each executive officer by comparing the Company's financial results to the established performance goals. For 2019, ROAA and ROAE aligned slightly below target performance, efficiency exceeded the annualized target goal and non-performing assets and net charge-offs achieved performance below threshold.

Following the Compensation Committee's review of the results of the components of each executive officer's annual incentive plan scorecard in February 2020, the Committee interpolated the results and awarded incentive payouts near target levels as noted below:

Executive	Target Incentive (% of Salary)	Target Incentive ($)	Amount Awarded (% of Salary)	Amount Awarded ($)
William J. Pasenelli	35.0%	$ 162,798	30.50%	$ 141,838
James M. Burke	30.0%	108,000	27.65%	99,522
Gregory C. Cockerham	30.0%	99,000	30.84%	101,772

Each named executive officer received 25% of the 2019 total incentive award in restricted stock, except for Mr. Cockerham who meets the minimum age and stock ownership requirements to receive a full cash payout. The

restricted stock awards were granted on February 20, 2020, and vest ratably over a three-year period, beginning on the first anniversary of the grant date.

Executive	Title	Total 2019 Annual Award	Amount Paid in Cash	Amount Paid in Restricted Stock
William J. Pasenelli	President and CEO	$ 141,838	$ 106,407	$ 35,431
James M. Burke	EVP and Bank President	99,522	74,650	24,872
Gregory C. Cockerham	EVP, CLO	101,772	101,772	—

Each named executive officer received of portion of the 2018 total incentive award in restricted stock as follows. The restricted stock awards were granted on February 14, 2019, and vest ratably over a three-year period, beginning on the first anniversary of the grant date.

Executive	Title	Number of Shares Issued	FMV of Restricted Stock on Grant Date
William J. Pasenelli	President and CEO	404	$ 12,120
James M. Burke	EVP and Bank President	264	7,920
Gregory C. Cockerham	EVP, CLO	0	—

Long-Term, Equity Based Compensation. The Committee believes that equity should represent a meaningful portion of executive compensation to align the interests of our executives and stockholders. Additionally, we believe that equity provides for a longer-term retention tool. These ownership and retention objectives are supported by paying a portion of incentives in restricted stock and through the use of time-based vesting for equity awards. The Committee makes an annual determination as to who will receive equity awards, the type of awards, vesting conditions, and level of the awards. All equity grants made to named executives have a minimum three year vesting period; however, in the event of death, disability or a change in control, participants will become fully vested in their awards. In addition, we require certain levels of stock ownership as described in the Other Compensation Guidelines, Practices and Policies section below.

Except for restricted stock awarded to our named executive officers under the annual incentive plan described above, our named executive officers received no other equity awards in 2019.

Other Compensation Guidelines, Practices and Policies

Stock Ownership Guidelines: Under the Company's stock ownership guidelines for executives, our CEO is expected to own shares of Company common stock that have a value equal to 2.0 times his base salary. The Bank President is expected to own shares with a value equal to 1.5 times his base salary and other named executives must own 1.0 times their salary. Until these target ownership levels are reached, an executive must retain 100% of his or her net shares from any vested awards (after taxes and any exercise price). All named executive officers met the minimum stock ownership requirements at the end of 2019. Because an executive officer must retain 100% of net shares acquired from equity awards until the specified target of ownership is met, there is no minimum time period required to achieve the target level of ownership.

The Company also maintains stock ownership guidelines for directors. Under these guidelines, Holding Company directors are required to own shares of Company common stock that have a value that is at least equal to a multiple of the Holding Company Board annual cash retainer for the immediate prior year. The cash retainer for 2019 was $15,000. The multiple is based on years of service on the Board. Directors with up to three years of service are required to own stock with a value equal to at least five times the annual cash retainer. Directors with between four and five years of service are required to own stock with a value equal to at least 10 times the annual cash retainer and the multiple for directors with more than five years of service is 15 times the annual cash retainer. All directors of the Bank are required to own shares of common stock of the Company having a value equal to at least three times the Bank Board annual cash retainer for the immediate prior year. The cash retainer for 2019 was $10,000. For

Bank and Company directors, shares must be acquired within the earlier of three years of first becoming a director or within three years of the initial adoption of the guidelines. All directors were in compliance with these guidelines at the end of 2019.

Responsible Equity Practices: The grant date for all equity awards is established when the grants and all key terms are approved by the Board or the Compensation Committee. Our 2015 Equity Compensation Plan includes prohibitions on the repricing of stock options without shareholder approval.

Prohibition on Hedging and Short Sales: The Company prohibits short sales and transactions in derivatives of Company securities, including hedging transactions, for all directors and officers of the Company.

Risk Considerations: In addition to our guiding principles, the Company engages in the following practices to ensure its executive compensation program is aligned with shareholders' interests and protects us against risk. We believe that the design and objectives of our executive compensation program provide an appropriate balance of incentives for executives and avoid inappropriate risks. The Committee considers, in establishing and reviewing the executive compensation program, whether the program encourages unnecessary or excessive risk taking and has concluded that it does not. In this regard, our executive compensation program includes, among other things, the following design features:

- Variable compensation based on a variety of performance goals
- Committee discretion to lower annual incentive award amounts
- Balanced mix of short-term and long-term incentives
- Stock ownership requirements
- Claw-back provisions

The Committee conducts an annual evaluation of all of the Company's compensation programs, policies and practices to ensure that compensation policies and incentive compensation programs in place are not reasonably likely to have a material adverse impact on the Company and do not encourage our employees to excessive risks.

Summary Compensation Table. The following table provides information concerning total compensation earned or paid for the last two completed fiscal years to the principal executive officer and the two most highly compensated executive officers of the Company who served in such capacity as of December 31, 2019. These three officers are referred to as the named executive officers in this proxy statement.

Name and Principal Position	**Year**	**Salary ($)**	**Stock Awards ($) (1)(2)**	**Non-equity Incentive Plan Compensation $(3)**	**Non-qualified Deferred Compensation Earnings ($) (4)**	**All Other Compensation ($) (5)**	**Total ($)**
William J. Pasenelli	2019	$465,000	$12,120	$ 106,407	$ 376,228	$ 46,439	$1,006,194
President and Chief Executive Officer	2018	440,000	27,736	68,730	320,521	53,480	910,467
James M. Burke	2019	$360,000	$ 7,920	$ 74,650	$ 62,466	$ 20,151	$ 525,187
Executive Vice President and President of Subsidiary	2018	336,000	20,514	45,000	59,796	27,247	488,557
Gregory C. Cockerham	2019	$330,000	$ —	$ 101,772	$ 41,280	$ 27,561	$ 500,613
Executive Vice President and Chief Lending Officer	2018	320,000	19,769	57,600	119,462	30,402	547,233

(1) Represents the aggregate grant date fair value of the granting of 404 and 264 shares of restricted stock awards to Messrs. Pasenelli and Burke respectively, computed in accordance with FASB ASC Topic 718 based on a per share price of $30.00, on the date of grant for awards under the 2018 annual incentive plan granted in 2019.

(2) Represents the aggregate grant date fair value of the granting of 745, 551 and 531 shares of restricted stock awards to Messrs. Pasenelli, Burke and Cockerham respectively, computed in accordance with FASB ASC Topic 718 based on a per share price of $37.23, on the date of grant for awards under the 2017 annual incentive plan granted in 2018.

(3) Represents incentive payments earned in 2019 under the Company's annual incentive plan.

(4) Represents the sum of above-market earnings under the Community Bank of the Chesapeake Executive Deferred Compensation Plan and the aggregate change in the present value of accumulated benefits under the Supplemental Executive Retirement Plans ("SERPs") and Salary Continuation Agreements ("SCAs") from the prior completed fiscal year to the current fiscal year. Includes above market earnings under the Bank's Executive Deferred Compensation Plan in the amounts of $8,309 for Mr. Cockerham. Includes an aggregate change in the present value of accumulated benefits under the SERPs and SCAs of $376,228, $62,466, and $32,971 for Messrs. Pasenelli, Burke and Cockerham, respectively.

(5) Details of the amounts reported in the "All Other Compensation" column for 2019 are provided in the table below.

Item	Pasenelli	Burke	Cockerham
Company Directors' fees	$ 17,475	$ —	$ —
Market value of allocations under the employee stock ownership plan	2,217	2,217	2,217
Employer contribution to 401(k) Plan	11,000	10,400	11,200
Imputed income under split-dollar life insurance arrangement	1,879	473	1,125
Automobile	5,231	6,032	5,083
Club dues	6,369	—	4,630
Dividends paid on unvested restricted stock	747	546	439
Group term life benefit	1,386	483	2,667
Wellness allowance	135	—	200

Employment Agreements. The Community Financial Corporation and Community Bank of the Chesapeake maintain employment agreements with each of its named executive officers. The term of the employment agreements with Messrs. Pasenelli, Burke and Cockerham are automatically extended by one day each day so that the term remains at three years, until either party gives notice to the other of its intent to stop the renewal of the term of the agreement or if the officer's employment with the Bank terminates, whether by resignation, discharge or otherwise. Among other things, the employment agreements provide for an annual salary, eligibility to participate in employee benefit plans and programs maintained by the Company and the Bank for the benefit of their employees, including discretionary bonuses, incentive compensation programs, medical, dental, pension, profit sharing, retirement and stock-based compensation plans and certain fringe benefits applicable to executive personnel.

Under the employment agreements if the executive's employment is terminated for cause, he will receive only his base salary or other compensation earned through the date of termination and any other compensation or vested benefits provided under applicable Bank plans or programs. All other obligations of the Bank terminate on the date of termination.

Further, under Messrs. Pasenelli and Burke's employment agreements, if their employment is terminated without cause (as defined in their employment agreements), the executive will receive a lump sum payment equal to three times his base salary and three times his most recent annual incentive compensation payment. Messrs. Pasenelli and Burke would also receive an amount equal to the monthly COBRA premium that the executive would be required to pay to continue the benefits in effect as of his termination date under the Bank's medical, dental and life insurance plans, multiplied by 36. Under the employment agreement for Mr. Cockerham, if his employment is terminated without cause (as defined in the his employment agreement), the executive would receive a lump sum payment equal to two times his base salary and two times his most recent annual incentive compensation payment. The executive would also receive an amount equal to the monthly COBRA premium that he would be required to pay to continue

the benefits in effect as of his termination date under the Bank's medical, dental and life insurance plans, multiplied by 36.

Upon voluntary termination of employment, our named executive officers would receive accrued and earned base salary and other compensation and benefits provided under the Bank's benefit plans and programs as of the date of termination.

The employment agreements also provide each executive with disability benefits. If an executive terminates employment after becoming disabled pursuant to the terms of the agreement, the executive will receive the compensation and benefits provided for under his employment agreement for (1) any period during the term of his agreement and before the establishment of the executive's disability; or (2) any period of disability before the executive's termination of employment due to disability.

Upon an executive's death, the employment agreements provide that the Company will pay the executives or their respective beneficiaries or estate any compensation due to the executive through the end of the month in which the executive's death occurred, plus any other compensation or benefits to be provided in accordance with the terms and provisions of the Bank's benefit plans and programs in which the executive participated as of the date of the executive's death.

Upon a change in control, Messrs. Pasenelli and Burke's employment agreements provide that if (1) the executive's employment is terminated without cause or without the executive's consent and for a reason other than cause in connection with or within 12 months after a change in control (as defined in the agreement); or (2) the executive voluntary terminates employment within 12 months following a change in control upon the occurrence of events described in the agreement, he will receive a lump sum payment equal to three times his annual base salary and three times his most recent annual incentive compensation payment, plus an amount equal to the monthly COBRA premium that he would be required to pay to continue the benefits in effect as of his termination date under the Bank's medical, dental and life insurance plans, multiplied by 36. Under Mr. Cockerham's employment agreement, he will receive a lump sum payment equal to two times his annual base salary and two times his most recent annual incentive compensation payment, plus an amount equal to the monthly COBRA premium that he would be required to pay to continue the benefits in effect as of his termination date under the Bank's medical, dental and life insurance plans, multiplied by 36.

Section 280G of the Internal Revenue Code provides that severance payments that equal or exceed three times an individual's base amount are deemed to be "excess parachute payments" if they are contingent upon a change in control. An individual's base amount is generally equal to an average of the individual's taxable compensation for the five taxable years preceding the year a change in control occurs. The employment agreements apply a "best net benefits" approach in the event that severance benefits under the agreement or otherwise result in "excess parachute payments" under Section 280G. Applying the "best net benefits" methodology, the Agreement provides for two separate calculations to address the application of Section 280G to payments that are contingent on a change in control. The first calculation establishes the after-tax benefit to the executive if the aggregate change in control-related payments are reduced below his Section 280G threshold, thereby avoiding the excise tax. The second calculation determines the after-tax benefit if the payments are made without reduction, and the executive's after-tax benefit reflects payment of the golden parachute excise tax by the executive. The calculation that yields the greatest after-tax benefit to the executive determines whether the executive's benefits are subject to reduction or whether the executive will receive all change in control-related benefits.

2015 Equity Compensation Plan. The Company maintains the 2015 Equity Compensation Plan, a stock-based incentive plan to attract and retain key personnel. The 2015 Equity Compensation Plan provides for the award of restricted stock, stock appreciation rights, stock units and stock options to members of the Board of Directors and key employees. See the Equity Awards Table below for information on the restricted stock awards granted to our named executive officers. Under the terms of the 2015 Equity Compensation Plan, all awards will fully vest upon an executive's death or disability. If an executive voluntarily terminates his employment or is terminated Without cause (as defined in the plan) all unvested shares of restricted stock are forfeited as of such termination date. In the event of a change in control, if an executive terminates his employment, other than for cause, during the 12-month

period following a change on control, unvested restricted stock awards will become fully vested and transferable to the executive.

Outstanding Equity Awards at Fiscal Year End. The following table provides information concerning unvested restricted stock awards for each of the named executive officers outstanding as of December 31, 2019.

	Restricted Stock Awards		
Name	**Grant Date**	**Number of Shares or Units of Stock That Have Not Vested (#)**	**Market Value of Shares or Units of Stock That Have Not Vested ($) (1)**
William J. Pasenelli	02/09/2017	209(2)	$ 7,434
	02/15/2018	497(3)	17,678
	02/14/2019	404(4)	14,370
James M. Burke	02/09/2017	145(2)	5,158
	02/15/2018	368(3)	13,090
	02/14/2019	264(4)	9,390
Gregory C. Cockerham	02/09/2017	145(2)	5,158
	02/15/2018	355(3)	12,627

(1) Based upon the Company's closing stock price of $35.57 per share at December 31, 2019.
(2) Shares vest in three equal annual installments beginning on February 9, 2018.
(3) Shares vest in three equal annual installments beginning on February 15, 2019.
(4) Shares vest in three equal annual installments beginning on February 14, 2020.

RETIREMENT AND INSURANCE BENEFITS

Our named executive officers have the opportunity to accumulate retirement benefits through participation in our 401(k) and Employee Stock Ownership Plans and to earn supplemental retirement benefits through Salary Continuation Agreements ("SCAs") and Supplemental Executive Retirement Plans ("SERPs") sponsored by the Bank. All of our named executive officers have SERPs and SCAs with the Bank.

Salary Continuation Agreements. The SCAs are non-qualified deferred compensation arrangements that provide our named executive officers with additional compensation at retirement or upon termination of employment due to death, disability or a change in control. Messrs. Pasenelli, Burke and Cockerham maintain SCAs with the Bank which provide the executives a total annual SCA benefit equal to $92,212, 101,000, and $77,035, respectively. These benefits are payable upon normal retirement at or after age 65 (normal retirement age). A reduced benefit is payable if the named executive officer retires before normal retirement age. The annual SCA benefits are payable on a monthly basis to the executives or their designated beneficiaries over a 15 year period. If an executive dies while in active service with the Bank, the executive's designated beneficiaries with an annual benefit, for a period of 15 years, of $92,212 for Mr. Pasenelli, $101,000 for Mr. Burke, and $77,035 for Mr. Cockerham, commencing with the month following the executive's death. If the executive dies after his employment has terminated, but before payments under the agreement have commenced, their designated beneficiaries will be entitled to the same payments beginning on the first day of the month after the executive's death. If the executive dies after the benefit payments have commenced, but before receiving all of the payments, the designated beneficiaries will be entitled to the remaining benefits that would have been paid to the executive if the executive had survived.

Under the SCAs if a named executive officer's employment is terminated for cause, he will not be entitled to any benefits under the terms of his SCAs.

The 2003 SCAs provide that in the event of a change in control followed by Mr. Pasenelli's or Mr. Cockerham's termination of employment within 12 months of the change in control (and before attainment of age 65) each executive will receive a change in control benefit in lieu of his normal SCA benefit. Mr. Pasenelli's annual change in control benefit under the 2003 SCA is equal to his accrued benefit as of separation from service following the change in control, assuming an additional 36 months of service for purposes of calculating the accrual. Mr. Cockerham's annual change in control benefit is equal to $72,235. Change in control SCA benefits will be made for a period of 15 years. Further, the 2003 SCAs provide that if the value of the benefits provided in connection with a change in control exceed an executive's 280G Limit, his payment will be reduced or revised so that the aggregate payments do not exceed his 280G Limit; however, the payments or benefits shall not be reduced if the net after tax benefit to the executive of receiving the total payments exceeds the net after tax benefit of receiving the reduced payments by at least $50,000. Under the 2006 SCAs, Messrs. Pasenelli and Burke are entitled to an additional change in control annual benefit ranging from $15,321 to $18,100 and $52,272 to $101,000, respectively (based on the date of termination) if his employment is terminated within 12 months subsequent to a change in control and before age 65.

In addition, the 2003 SCAs provide for disability benefits. Upon termination of employment as a result of disability, Messrs. Pasenelli and Cockerham are entitled to an annual benefit for a period of 15 years of $74,112 and $72,235, respectively, commencing with the month following the executive attaining age 65. The 2006 SCAs provide Messrs. Pasenelli and Burke with an annual disability benefit ranging from $17,586 to $18,100 and $71,344 to $101,000, respectively, depending on the date of termination, commencing with the month following the executive attaining age 65. The 2006 SCA entitles Mr. Cockerham to an annual disability benefit of $4,800, on the date of termination, commencing with the month following the executive attaining age 65.

Supplemental Executive Retirement Plans. The Bank maintains 2011 and 2014 supplemental executive retirement plans (the "SERPs"), with each of Messrs. Pasenelli, Burke, and Cockerham to provide the executives with additional compensation at retirement or upon termination of employment due to death, disability or a change in control. If an executive remains employed with the Bank until his normal retirement age of 65, he is entitled to receive an accrued retirement benefit payable annually for a period of 15 years. The annual benefits for Messrs.

Pasenelli, Burke and Cockerham (in the aggregate) are $124,974, $77,434, and $13,087, respectively. A reduced benefit is payable if the executive retires before normal retirement age or terminates service with the Bank for other reasons.

If an executive's employment is terminated for cause, the executive will not be entitled to any benefits under the SERPs.

In the event that Messrs. Pasenelli, Burke and Cockerham become disabled before termination of employment with the Bank or retirement, and prior to a Change in Control, the 2011 and 2014 SERP provide the executives with a disability benefit equal to the executive's accrued benefit under the SERPs as of the date of determination of disability. Payment of the disability benefit will commence on the first day of the month following the earlier of the executive's 65th birthday or death and is paid in 15 equal annual installments.

The amended 2011 and 2014 SERPs also provide that if an executive dies while actively employed by the Bank and before reaching his normal retirement age of 65, the SERPs provide for a death benefit equal to the executive's accrued benefit under the SERPs, payable to the executive's beneficiary in 15 equal annual installments. If the executive dies after the commencement of his SERP benefit payments, the executive's beneficiary is entitled to the unpaid balance of the payments for the balance of 15 annual installments.

In the event of a change in control prior to Messrs. Pasenelli, Burke and Cockerham (i) attaining age 65, (ii) his death, (iii) disability, (iv) retirement, or (v) Separation from Service (as defined in the SERP agreements), the SERP benefit will equal the accrued benefit calculated as of any subsequent separation from service following the change in control with 36 months of additional service for purposes of calculating the accrual. Payments will commence at the earliest of an executive's attainment of age 65 or death. However, if an executive experiences a Separation from Service within 24 months following a Change in Control, the executive is entitled to his full accrued retirement benefit, with payments to commence no later than the second month following his Separation from Service. Under the 2011 SERPs if the change in control benefit payment made to Messrs. Pasenelli, Burke and Cockerham would be treated as an "excess parachute payment" under Code Section 280G ("280G Limit"), the Bank will reduce such benefit payment to the extent necessary to avoid treating such benefit payment as an excess parachute payment; however, the payments or benefits shall not be reduced if the net after tax benefit to the executive of receiving the total payments exceeds the net after tax benefit of receiving the reduced benefits by at least $50,000.

Deferral Plan. The Bank also maintains an Executive Deferred Compensation Plan under which our named executive officers may defer all or any portion of their base salary. Deferred amounts may be credited annually with interest at a rate equal to the Company's consolidated return on equity for the calendar year or credited with earnings or losses based on the rate of return of mutual funds selected by the plan participants. The executive's account balance under this plan will be distributed to the executive following the executive's termination of service or on a specified date in either a lump sum or over a period of one to ten years, as elected by the executive.

Split Dollar Life Insurance Agreements. The Bank is a party to individual split dollar life insurance arrangements with Messrs. Pasenelli, Burke, and Cockerham. These arrangements provide each executive's beneficiary with pre- and post-retirement death benefits. The Bank has purchased life insurance policies on the lives covered by these agreements in amounts sufficient to provide payments to the beneficiaries, and the Bank pays the premiums due on the policies as an additional employment benefit. The economic benefit (the imputed income amount of this insurance) for the year 2019 to the named executives officers is included in the amounts for each of these executive officers set forth in the Summary Compensation Table under the column "All Other Compensation." Under these arrangements, Messrs. Pasenelli, Burke and Cockerham are entitled to a pre-retirement split dollar benefit amount equal to the lesser of $1,000,000, $500,000 and $500,000, respectively, or the net amount at risk insurance portion of the proceeds. These arrangements provide a post-retirement split dollar benefit to Messrs. Pasenelli, Burke and Cockerham equal to the lesser of $500,000, $100,000 and $600,000, respectively, or the net amount at risk insurance portion of the proceeds. The net amount at risk portion is the total proceeds less the cash value of the policy.

OTHER INFORMATION RELATING TO DIRECTORS AND EXECUTIVE OFFICERS

Section 16(a) Beneficial Ownership Reporting Compliance

General. Pursuant to federal securities laws, the Company's officers, directors and persons who own more than 10% of the Company's outstanding common stock are required to file electronic reports detailing their ownership and changes of ownership in Company common stock with the SEC through the SEC's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR").

Delinquent Section 16(a) Reports. Based solely on our review of the copies of the reports filed with the SEC's EDGAR system and any written representations from such persons that no additional reports of changes in beneficial ownership were required, the Company believes that during 2019, all of its officers, directors and all of its stockholders owning in excess of 10% of the outstanding common stock of the Company, have complied with the reporting requirements, except for Messrs. Burke, Capitani, Pasenelli and Ms. Lombardi, each of whom filed one Form 4, reporting one transaction, after its due date.

Policies and Procedures for Approval of Related Persons Transactions. We maintain a written policy and set of procedures for the review and approval or ratification of transactions involving related persons. Under the policy, related persons consist of directors, director nominees, executive officers, persons or entities known to us to be the beneficial owner of more than five percent of any outstanding class of the voting securities of the Company, or immediate family members or certain affiliated entities of any of the foregoing persons.

Transactions covered by the policy consist of any financial transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, in which:

- the aggregate amount involved will or may be expected to exceed $50,000 in any calendar year;
- the Company is, will or may be expected to be a participant; and
- any related person has or will have a direct or indirect material interest.

The policy excludes certain transactions, including:

- any compensation paid to an executive officer of the Company if the Governance Committee of the Board approved (or recommended that the Board approve) such compensation;
- any compensation paid to a director of the Company if the Board or an authorized committee of the Board approved such compensation; and
- any transaction with a related person involving consumer and investor financial products and services provided in the ordinary course of the Company's business and on substantially the same terms as those prevailing at the time for comparable services provided to unrelated third parties or to the Company's employees on a broad basis (and, in the case of loans, in compliance with the Sarbanes-Oxley Act of 2002).

Related person transactions will be approved or ratified by the Audit Committee. In determining whether to approve or ratify a related person transaction, the Audit Committee will consider all relevant factors, including:

- whether the terms of the proposed transaction are at least as favorable to the Company as those that might be achieved with an unaffiliated third party;
- the size of the transaction and the amount of consideration payable to the related person;
- the nature of the interest of the related person;
- whether the transaction may involve a conflict of interest; and
- whether the transaction involves the provision of goods and services to the Company that are available from unaffiliated third parties.

A member of the Audit Committee who has an interest in the transaction will abstain from voting on approval of the transaction, but may, if so requested by the chair of the Audit Committee, participate in some or all of the discussion.

Relationships and Transactions with the Company and the Bank. The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption from such prohibition for loans by the Bank to its executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured financial institutions must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons not related to the Bank and must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is therefore prohibited from making any new loans or extensions of credit to executive officers and directors at different rates or terms than those offered to the general public. Notwithstanding this rule, federal regulations permit the Bank to make loans to executive officers and directors at reduced interest rates if the loan is made under a benefit program generally available to all other employees and does not give preference to any executive officer or director over any other employee. The Bank does not currently have such a program in place. From time to time, the Bank makes loans and extensions of credit to its executive officers and directors, and members of their immediate families. The outstanding loans made to our directors and executive officers, and members of their immediate families, were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the Bank, and did not involve more than the normal risk of collectibility or present other unfavorable features. As of December 31, 2019**,** these loans were performing according to their original terms.

In accordance with banking regulations, the Board of Directors reviews all loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to such person and his or her related interests, exceed the greater of $25,000 or 5% of the Company’s capital and surplus (up to a maximum of $500,000), and such loan must be approved in advance by a majority of the disinterested members of the Board of Directors.

STOCKHOLDER PROPOSALS AND NOMINATIONS

To be eligible for inclusion in the Company's proxy materials for next year's annual meeting of stockholders, any stockholder proposal to take action at such meeting must be received at the Company's main office at 3035 Leonardtown Road, Waldorf, Maryland 20601 no later than December 7, 2020. If next year's annual meeting is held on a date more than 30 calendar days from May 20, 2021, a stockholder proposal must be received by a reasonable time before the Company begins to print and mail its proxy solicitation materials. Any stockholder proposals will be subject to the requirements of the proxy rules adopted by the Securities and Exchange Commission.

Stockholder proposals, other than those submitted above, and nominations must be submitted in writing, delivered or mailed by first class United States mail, postage pre-paid, to the Secretary of the Company not fewer than 30 days nor more than 60 days before any such meeting; provided, however, that if notice or public disclosure of the meeting is given fewer than 40 days before the meeting, such written notice shall be delivered or mailed to the Secretary of the Company not later than the close of the 10th day following the day on which notice of the meeting was mailed to stockholders.

BOARD POLICIES REGARDING COMMUNICATIONS WITH THE BOARD OF DIRECTORS

The Board of Directors maintains a process for stockholders to communicate with the Board of Directors. Stockholders wishing to communicate with the Board of Directors should send any communication to the Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601. Any communication must state the number of shares beneficially owned by the stockholder making the communication. The Secretary will forward such communication to the full Board of Directors or to any individual director or directors to whom the communication is addressed unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Secretary has the authority to discard the communication or take appropriate legal action regarding the communication.

MISCELLANEOUS

The Company will pay the cost of this proxy solicitation. The Company will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of the common stock. In addition to conducting solicitations by mail, directors, officers and regular employees of the Company may solicit proxies personally or by telephone without additional compensation.

The Company's 2019 Annual Report to Stockholders, including financial statements, accompanies this proxy statement. Such Annual Report is not to be treated as a part of the proxy solicitation material nor as having been incorporated herein by reference. **A copy of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019, as filed with the Securities and Exchange Commission, will be furnished without charge to stockholders as of March 23, 2020 upon written request to the Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601.**

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2019

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to ________

Commission File No. **001-36094**

THE COMMUNITY FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Maryland	**52-1652138**
(State of Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3035 Leonardtown Road, Waldorf, Maryland	**20601**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: **(301) 645-5601**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $.01 per share	TCFC	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	☐	Accelerated Filer	☒
Non-Accelerated Filer	☐	Smaller Reporting Company	☒
Emerging Growth Company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes ☐ No ☒

The aggregate market value of voting stock held by non-affiliates of the registrant was approximately $162.60 million based on the closing price $33.73 per share at which the common stock was sold on the last business day of the Company's most recently completed second fiscal quarter. For purposes of this calculation only, the shares held by directors, executive officers and the Company's Employee Stock Ownership Plan of the registrant are deemed to be shares held by affiliates.

The number of shares of Registrant's Common Stock outstanding as of March 2, 2020 was 5,901,291.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2020 Annual Meeting of Stockholders. (Part III)

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Report may not be based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements can generally be identified by the fact that they do not relate strictly to historical or current facts. They often include words like "is optimistic", "believe," "expect," "anticipate," "estimate" and "intend" or future or conditional verbs such as "will," "would," "should," "could" or "may." Statements in this report that are not strictly historical are forward-looking and are based upon current expectations that may differ materially from actual results. These forward-looking statements include, without limitation, those relating to the Company's and Community Bank of the Chesapeake's future growth and management's outlook or expectations for revenue, assets, asset quality, profitability, business prospects, net interest margin, non-interest revenue, allowance for loan losses, the level of credit losses from lending, liquidity levels, capital levels, or other future financial or business performance strategies or expectations, and any statements of the plans and objectives of management for future operations products or services, including the expected benefits from, and/or the execution of integration plans relating to the County First acquisition or any other acquisition that we undertake in the future; plans and cost savings regarding branch closings or consolidation; any statement of expectation or belief; projections related to certain financial metrics; and any statement of assumptions underlying the foregoing. These forward-looking statements express management's current expectations or forecasts of future events, results and conditions, and by their nature are subject to and involve risks and uncertainties that could cause actual results to differ materially from those anticipated by the statements made herein.

Factors that might cause actual results to differ materially from those made in such statements include, but are not limited to: the synergies and other expected financial benefits from any acquisition we might undertake in the future, may not be realized within the expected time frames; changes in The Community Financial Corporation or Community Bank of the Chesapeake's strategy; costs or difficulties related to merger integration matters might be greater than expected; availability of and costs associated with obtaining adequate and timely sources of liquidity; the ability to maintain credit quality; general economic trends; changes in interest rates; loss of deposits and loan demand to other financial institutions; substantial changes in financial markets; changes in real estate value and the real estate market; regulatory changes; the impact of impact of government shutdowns or sequestration; the possibility of unforeseen events affecting the industry generally; the uncertainties associated with newly developed or acquired operations; the outcome of litigation that may arise; market disruptions and other effects of terrorist activities; and the matters described in "Item 1A Risk Factors" in this Annual Report on Form 10-K for the Year Ended December 31, 2019, and in the Company's other Reports filed with the Securities and Exchange Commission (the "SEC").

The Company's forward-looking statements may also be subject to other risks and uncertainties, including those that it may discuss elsewhere in this Report or in its filings with the SEC, accessible on the SEC's Web site at www.sec.gov. The Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unforeseen events, except as required under the rules and regulations of the SEC.

You are cautioned not to place undue reliance on the forward-looking statements contained in this document in that actual results could differ materially from those indicated in such forward-looking statements, due to a variety of factors. Any forward-looking statement speaks only as of the date of this Report, and we undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date of this Report.

PART I

Item 1. Business

Business

Community Bank of the Chesapeake (the "Bank") is headquartered in Southern Maryland with 12 branches located in Maryland and Virginia. The Bank is a wholly owned subsidiary of The Community Financial Corporation (the "Company"). The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and Fredericksburg, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

The Company is a bank holding company organized in 1989 under the laws of the State of Maryland. It owns all the outstanding shares of capital stock of the Bank, a Maryland-chartered commercial bank. The Bank was organized in 1950 as Tri-County Building and Loan Association of Waldorf, a mutual savings and loan association, and in 1986 converted to a federal stock savings bank and adopted the name Tri-County Federal Savings Bank. In 1997, the Bank converted to a Maryland-chartered commercial bank and adopted the name Community Bank of Tri-County. Effective October 18, 2013, Community Bank changed its name to become Community Bank of the Chesapeake. The Company engages in no significant activity other than holding the stock of the Bank and operating the business of the Bank. Accordingly, the information set forth in this 10-K, including financial statements and related data, relates primarily to the Bank and its subsidiaries.

The Company's income is primarily earned from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits. One of the key measures of our success is our net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our clients.

Our customer focus is to serve small and medium sized commercial businesses with revenues between $5.0 million and $35.0 million as well as local municipal agencies and not-for-profits. Relationship teams provide customers with specific banker contacts and a support team to address product and service demands. The Bank believes that its ability to offer fast, flexible, local decision-making will continue to attract significant new business relationships. Our structure provides a consistent and superior level of professional service and excelling at customer service is a critical part of our culture. The Bank's marketing is directed towards increasing its balances of transactional deposit accounts. The Bank believes that increases in these account types will lessen the Bank's dependence on higher-cost funding, such as certificates of deposit and borrowings.

We also serve our customers through our website: www.cbtc.com. In addition to providing our customers with 24-hour access to their accounts, and information regarding our products and services, hours of service, and locations, the website provides information about the Company for the investment community. In addition, our filings with the SEC (including our annual report on Form 10-K; our quarterly reports on Form 10-Q; and our current reports on Form 8-K), and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available without charge, and are posted to the Investor Relations portion of our website. The website also provides information regarding our Board of Directors and management team, as well as Board Committee charters and our corporate governance policies. The content of our website is not incorporated by reference into this Annual Report.

The Bank is engaged in the commercial and retail banking business as authorized by the banking statutes of the States of Maryland and Virginia and applicable federal regulations, including the acceptance of deposits, and the origination of loans. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation ("FDIC"), the Bank's primary federal regulator.

Market Area

The Bank considers its principal lending and deposit market area to consist of the tri-county area in Southern Maryland and the greater Fredericksburg area in Virginia. As a result of the Bank's expansion into the greater Fredericksburg market in 2013, Stafford and Spotsylvania Counties have become part of the Bank's principal lending and deposit market area. Our market area is one of the fastest growing regions in the country and is home to a mix of federal facilities and industrial and high-tech businesses. The Bank's primary market areas boast a strong median household income, low unemployment and projected population growth better

than national averages**.** Based on information from the U.S. Bureau of Labor Statistics, unemployment rates in the Company's footprint have historically remained well below the national average.

The presence of several major federal facilities located within the Bank's footprint and in adjoining counties contribute to economic activity. Major federal facilities include the Patuxent River Naval Air Station in St. Mary's County, the Indian Head Division, Naval Surface Warfare Center in Charles County and the Naval Surface Warfare –Naval Support Facility in King George County. In addition, there are several major federal facilities located in adjoining markets including Andrews Air Force Base and Defense Intelligence Agency & Defense Intelligence Analysis Center in Prince Georges County, Maryland and the U.S. Marine Base Quantico, Drug Enforcement Administration Quantico facility and Federal Bureau of Investigation Quantico facility in Prince William County, Virginia. These facilities directly employ thousands of local employees and serve as an important contributor to the region's overall economic health. The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector.

The Bank expanded into the greater Fredericksburg, Virginia market in August 2013. According to the Fredericksburg Regional Alliance, Fredericksburg is the fastest growing market in the Commonwealth of Virginia.

Competition

The Bank faces strong competition for deposits and loans primarily from other banks and federal and state credit unions located in its market area. There are more than 20 FDIC-insured depository institutions as well as several large credit unions operating in the Bank's footprint including several large regional and national bank holding companies. The Bank also faces significant competition for deposits from mutual funds, brokerage firms, online Banks, and other financial service companies. The Bank competes for loans by providing competitive rates, flexible terms and personal service, including customer access to senior decision makers. It competes for deposits by offering depositors a variety of account types, convenient office locations and competitive rates. Other services offered include tax deferred retirement programs, brokerage services through an affiliation with Community Wealth Advisors, cash management services and safe deposit boxes. The Bank has used targeted direct mail, print and online advertising and community outreach to increase its market share of deposits, loans and other services in its market area. It provides ongoing training for its staff to provide high-quality service.

Economy

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including the Bank. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

The economy continued to grow in 2019 with annual GDP growth of 2.3%, led by consumer spending. Residential home spending and refinancing activity began to improve in the second half of 2019, as interest rates were cut multiple times by the Federal Reserve Open Market Committee ("FOMC"). Business investment declined in 2019 and could be an important economic indicator of an economic slowdown if it declines further in 2020. The fears of a negative impact on GDP from trade wars were sidelined in late 2019 and early 2020 with progress on a US-China trade deal and the passing of the United States-Mexico-Canada Agreement (USMCA). The continued progress with US-China trade relationship could have an impact on the 2020 economy. The United States reached its longest expansion in US history during the third quarter of 2019. Despite the length of the current recovery, many economists do not see a looming recession in 2020 but are cautious to predict continued economic expansion about 2021 and beyond.

In 2019, the Mid-Atlantic region in which the Company operates continued to experience solid regional economic performance. In the Bank's footprint residential housing demand was stable during 2019 with home prices up between 1.0% to 4.0% in the Bank's footprint.

The presence of federal government agencies, as well as significant government facilities, and the related private sector support for these entities, has led to faster economic growth in our market and lower unemployment compared to the nation as a whole. These facilities directly employ thousands of local employees and serve as an important player in the region's overall economic health. In addition, the Bank's proximity to Washington DC, Annapolis, Northern Virginia and Prince George County has provided the Bank with additional loan and deposit opportunities. These opportunities have positively impacted the Bank's organic growth.

The impact of government shutdowns or sequestration is more acutely felt in the Bank's footprint. In addition to the temporary economic impact to government employees, the Bank's business customers, which include government contractors that directly

support the federal government and small businesses that indirectly support the government and its employees, can be impacted with permanent losses of revenue. A prolonged shutdown or a lack of confidence in the federal government's ability to fund its operations could have an impact to spending and investments in the Company's footprint. The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector. Unemployment rates and household income in the Company's footprint have historically performed better than the national averages.

The FOMC rate cuts in 2019 helped limit the Company's net interest margin compression compared to peer institutions as the Bank's slight liability-sensitivity caused interest-bearing liabilities to reprice only slightly slower than interest-earning assets.

Lending Activities

General

The Bank offers a wide variety of real estate and commercial loans. The Bank's lending activities include commercial real estate loans, loans secured by residential rental property, construction loans, land acquisition and development loans, equipment financing, commercial and consumer loans. Most of the Bank's customers are residents of or businesses located in the Bank's market area. The Bank's primary targets for commercial loans consist of small and medium-sized businesses with revenues of $5.0 million to $35.0 million as well as not-for-profits in Southern Maryland, the Annapolis and Prince George's County areas of Maryland and the greater Fredericksburg area of Virginia. For a description of the risk characteristics of the Bank's loan portfolio segments refer to Note 3 of the Consolidated Financial Statements.

Commercial Real Estate (CRE) and Other Non-Residential Real Estate Loans

The permanent financing of commercial and other improved real estate projects, including office buildings, retail locations, churches, and other special purpose buildings, is the largest component of the Bank's loan portfolio. The CRE portfolio includes commercial construction that converts after the completion of construction to permanent financing.

Commercial real estate loans are secured by real property and the leases or businesses that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank's capital and participates with other lenders on larger projects. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price and have an initial contractual loan amortization period ranging from three to 20 years. Interest rates and payments on these loans typically adjust after an initial fixed-rate period, which is generally between three and ten years. Interest rates and payments on adjustable-rate loans are adjusted to a rate based on the United States Treasury Bill Index, LIBOR or other indices. The great majority of the Bank's commercial real estate loans are secured by real estate located in the Bank's primary market area.

Payments on loans secured by commercial real estate are often dependent on the successful operation of the business or management of the properties. Repayment of such loans may be subject to conditions in the real estate market or the economy. As a result of the greater emphasis that the Bank places on increasing its portfolio of commercial real estate loans, the Bank is increasingly exposed to the risks posed by this type of lending. To monitor cash flows on income properties, the Bank requires borrowers and loan guarantors to provide annual financial statements on commercial real estate loans. In reaching a decision on whether to make a commercial real estate loan, the Bank considers the net operating income of the property, the borrower's expertise, credit history and profitability, and the value of the underlying property, as well as the borrower's global cash flows. If a determination is made that there is a potential environmental hazard, the Bank will complete an Environmental Assessment Checklist. If this checklist or the appraisal indicates potential issues, a Phase 1 environmental survey will generally be required.

Residential First Mortgage Loans

Residential first mortgage loans are generally long-term loans, amortized on a monthly or bi-weekly basis, with principal and interest due each payment. These loans are secured by owner-occupied single-family homes. The initial contractual loan payment period for residential loans typically ranges from 10 to 30 years. Residential real estate loans typically remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty.

The Bank stopped originating owner-occupied residential first mortgages in 2015 and established third-party sources to originate its residential whole-loan portfolio. It has been the Bank's practice to buy residential first mortgages from other financial institutions. The third-party sources allow the Company to maintain a well-diversified residential portfolio while addressing the credit needs of the communities in its footprint. The Bank's practice has been to purchase individual residential first mortgage loans as well as the right to service the loans acquired. The Bank generally retains the right to service loans sold for a payment based upon a percentage (generally 0.25% of the outstanding loan balance).

Residential first mortgage loans with loan-to-value ratios in excess of 80% generally carry private mortgage insurance to lower the Bank's exposure to approximately 80% of the value of the property. The Bank had fewer than 10 loans with private mortgage insurance at December 31, 2019 and 2018. All improved real estate that serves as security for a loan made by the Bank must be insured. Insurance must be maintained through the entire term of the loan and in an amount not less than that amount necessary to pay the Bank's indebtedness.

Longer-term fixed-rate and adjustable-rate residential mortgage loans are subject to greater interest-rate risk due to term and annual and lifetime limitations on interest rate adjustments. Adjustable mortgages are generally adjustable on one-, three-, five-, and seven-year terms with limitations on upward adjustments per re-pricing period and an upward cap over the life of the loan. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower.

Residential Rentals

Residential rental mortgage loans are amortizing, with principal and interest due each month. These loans are non-owner occupied and secured by income-producing 1-4 family units and apartments. The Bank originates both fixed-rate and adjustable-rate residential rental first mortgages. Loans secured by residential rental properties are generally limited to 80% of the lower of the appraised value or sales price at origination and have initial contractual loan payments period ranging from three to 20 years. The primary securities on a residential rental loan are the property and the leases that produce income.

Loans secured by residential rental properties involve greater risks than 1-4 family residential mortgage loans. Although, there are similar risk characteristics shared with commercial real estate loans, the balances for the loans secured by residential rental properties are generally smaller. Because payments on loans secured by residential rental properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the rental real estate market or the economy than similar owner-occupied properties.

Construction and Land Development Loans

The Bank offers loans to home builders for the construction of one- to four-family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. Draws are made upon satisfactory completion of predefined stages of construction. The Bank will typically lend up to 80% of the lower of appraised value or the contract purchase price of the homes to be constructed. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals. Bank policy requires that zoning and permits must be in place prior to making development loans. The Bank typically lends up to the lower of 75% of the appraised value or cost. The Bank's ability to originate residential construction and development loans is heavily dependent on the continued demand for single-family housing in the Bank's market area.

The Bank's investment in these loans has declined in recent years. Construction and land development loans as a percentage of the Bank's portfolio have been decreasing since the 2008 financial crisis. If the demand for new houses being built from smaller builders in the Bank's market areas continues to decline, this portion of the loan portfolio may continue to decline. In addition, a decline in demand for new housing might adversely affect the ability of borrowers to repay these loans.

Construction and land development loans are inherently riskier than financing owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project's value might be insufficient to assure full repayment. Construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank has a portfolio of home equity and second mortgage loans. Home equity loans are generally lines of credit and have terms of up to 20 years, variable rates priced at the then current Wall Street Journal prime rate plus a margin, and require an 80% or 90% loan-to-value ratio (including any prior liens), depending on the specific loan program. Second mortgage loans are fixed or variable-rate loans that have original terms between five and 15 years. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage must be paid off prior to collection of the second mortgage.

Commercial Loans

The Bank offers its business customers a variety of commercial loan products including term loans, demand loans, and lines of credit. Loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history, the projected cash flows of the business, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower's ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable or other collateral. The availability of funds for the repayment of commercial loans may depend on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral would make full-recovery from the sale of collateral unlikely.

Consumer Loans

The Bank makes a variety of consumer loans including vehicle loans, home improvement loans, and lines of credit. Loans may be secured or unsecured. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

The Bank has an amortizing commercial loan portfolio consisting of commercial equipment loans. These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer's equipment or secured by real property, accounts receivable, or other collateral. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk than commercial real estate loans. The availability of funds for the repayment of commercial equipment loans may depend on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

Loan Originations, Purchases and Sales

The Bank solicits loan applications through marketing by commercial loan officers, its branch network, and referrals from customers. Loans are processed and approved according to Bank guidelines. Additionally, residential mortgages are purchased from third-party providers after reviewing loan documents, underwriting support, and completing other procedures, as necessary.

Loan processing functions are generally centralized except for small consumer loans. Depending on market conditions, residential mortgage loans may be classified with the intent to sell to third parties. The Company sold no residential mortgage loans for the years ended December 31, 2019, 2018 and 2017.

To comply with internal and regulatory limits on loans to one borrower, the Bank may sell portions of commercial, commercial real estate and commercial construction loans to other lenders. The Bank may also buy loans or portions of loans from other lenders to limit overall exposure. The Bank only purchases loans or portions of loans after reviewing loan documents, underwriting support, and completing other procedures, as necessary. Purchased participation loans are subject to the same regulatory and internal policy requirements as other loans in the Bank's portfolio as described below.

Loan Approvals, Procedures and Authority

Loan approval authority is established by Board policy. The Credit Risk Committee ("CRC") of the Board, consisting of three or more directors, assists the Board in its oversight responsibilities. The Committee reviews the Bank's credit risk management, including the significant policies, procedures and practices employed to manage credit risk, and provides recommendations to the Board and strategic guidance to management on the assumption, management and mitigation of credit risk.

All loans and loan relationships that exceed the Bank's in-house lending limit are required to be approved by at least three (3) members of the Bank's CRC. In addition, the Board of Directors or the CRC approve all loans required to be approved by regulation, such as Regulation O loans or commercial loans to employees. The in-house lending guideline is approved by the Board on an annual basis or as needed if more frequently and is less than the Bank's legal lending limit.

The Officer's Loan Committee (OLC) consists of the following members of the Bank's executive management; the Chief Executive Officer ("CEO"), President, Business Officers of the Virginia and Maryland markets and the Senior Credit Officer ("SCO"). The OLC must have three (3) aforementioned members of Executive Management approve all loans that meet the OLC threshold. Loans that fall below the OLC threshold are approved by the appropriate level of line and credit (dual approved authority).

Loans to One Borrower

Under Maryland law, the maximum amount that the Bank is permitted to lend to any one borrower and his or her related interests may generally not exceed 10% of the Bank's unimpaired capital and surplus, which is defined to include the Bank's capital, surplus, retained earnings and 100% of its reserve for possible loan losses. Under this authority, the Bank would have been permitted to lend up to $19.4 million to any one borrower at December 31, 2019. By interpretive ruling of the Maryland Commissioner, Maryland banks have the option of lending up to the amount that would be permissible for a national bank, which is generally 15% of unimpaired capital and surplus (defined to include a bank's total capital for regulatory capital purposes plus any loan loss allowances not included in regulatory capital). Under this formula, the Bank would have been permitted to lend up to $30.0 million to any one borrower at December 31, 2019. At December 31, 2019, the largest amount outstanding and committed to any one borrower and borrower's related interests was $27.0 million.

Loan Commitments

The Bank does not normally negotiate standby commitments for the construction and purchase of real estate. It has been the Bank's experience that few commitments expire unfunded. Refer to Note 18 *"Commitments and Contingencies"* in the consolidated financial statements for more information.

Maturity of Loan Portfolio

See Management's Discussion and Analysis ("MD&A") for information regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity as of December 31, 2019.

Asset Classification

Federal regulations require use of an internal asset classification system to report on asset quality. We use an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets as "substandard," "doubtful" or "loss" assets. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of these categories but possess weaknesses are required to be designated "special mention."

When an insured institution classifies assets as "substandard" or "doubtful," it is required that a specific valuation allowance for loan losses be established in an amount deemed prudent by management. When an insured institution classifies assets as "loss," it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount. For additional information regarding the Company's credit quality indicators and risk grading scale refer to Notes 1 and 3 of the Consolidated Financial Statements and the discussion in the MD&A.

Delinquencies

The Bank's collection procedures provide that when a loan is 15 days delinquent, the borrower is contacted, and payment is requested. If the delinquency continues, efforts will be made to contact the delinquent borrower and obtain payment. If these efforts prove unsuccessful, the Bank will pursue appropriate legal action including repossession of the collateral. In certain instances, the Bank will attempt to modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize

borrower's financial affairs. For an analysis of past due loans as of December 31, 2019 and 2018, respectively, refer to Note 3 in the Consolidated Financial Statements.

Impaired Loans and Allowance for Loan Losses

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The Bank individually evaluates substandard classified loans to determine whether a loan is impaired. Classified doubtful and loss loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructures ("TDRs") are generally considered impaired. For additional information regarding the Company's impairment methodology as well as the allowance for loans losses refer to Notes 1 and 3 of the Consolidated Financial Statements and the discussion in the MD&A under Critical Accounting Policies and Asset Quality.

Non-performing Assets

The Bank's non-performing assets include other real estate owned, non-accrual loans and TDRs. Both non-accrual and TDR loans include loans that are paid current and are performing in accordance with the term of their original or modified contract terms. For a detailed discussion on asset quality see the MD&A.

Investment Activities

The Bank maintains a portfolio of investment securities to provide liquidity as well as a source of earnings. The Bank's investment securities portfolio consists primarily of asset-backed mortgage-backed ("MBS") and collateralized mortgage obligations ("CMOs") and other securities issued by U.S. government agencies and government-sponsored enterprises ("GSEs"), including FNMA and FHLMC. The Bank also has smaller holdings of privately issued mortgage-backed securities, U.S. Treasury obligations, municipal bonds and other equity and debt securities. The Bank is required to maintain investments in the Federal Home Loan Bank based upon levels of borrowings.

The Bank's investment policy provides that securities that will be held for indefinite periods of time, including securities that will be used as part of the Bank's asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors are classified as AFS and accounted for at fair value. In December 2019, the Company reclassified the HTM investment portfolio to the AFS investment portfolio. The Bank's primary reasons for the reclassification were to better manage interest rate risks and provide additional on-balance sheet liquidity. Management believes that the reclassification and active oversight of the investment portfolio allows the Bank to take appropriate actions to defend interest-rate sensitivity in both rates up or down environments, and over time should lead to improved earnings of the Bank in a safe and sound manner. Management determined that it no longer had the positive intent to hold its investment in securities classified as HTM until maturity and does not intend to hold HTM securities in the future. The Company's HTM portfolio was primarily asset-backed securities issued by GSEs and U.S. Agencies. There were no HTM investments securities at December 31, 2019. Certain of the Company's asset-backed securities are issued by private issuers (defined as an issuer that is not a government or a government-sponsored entity). The Company had no investments in any private issuer's securities that aggregate to more than 10% of the Company's equity. For a discussion of investments see the MD&A and Notes 1 and 2 in the Consolidated Financial Statements.

Deposits and Other Sources of Funds

General

The funds needed by the Bank to make loans are primarily generated by deposit accounts solicited from its market area. The Company uses brokered deposits and borrowings to supplement funding when loan growth exceeds core deposit growth and for asset-liability management purposes. Reciprocal deposits are used to maximize FDIC insurance available to our customers. During 2018, revisions to the Federal Deposit Insurance Act determined that reciprocal deposits are core deposits and are not considered brokered deposits unless they exceed 20% of a bank's liabilities or $5.0 billion.

Deposits

The Bank's deposit products include savings, money market, demand deposit, IRA, SEP, and time deposit accounts. Variations in service charges, terms and interest rates are used to target specific markets. Products and services for deposit customers include safe deposit boxes, night depositories, cash vaults, automated clearinghouse transactions, wire transfers, ATMs, online and telephone banking, retail and business mobile banking, remote deposit capture, FDIC insured reciprocal deposits, merchant card services, credit monitoring, investment services, positive pay, payroll services, account reconciliation, bill pay, credit cards and lockbox. The Bank is a member of ACCEL, Master Card, Cirrus, Allpoint and Star ATM networks as well as the Bazing online membership discount program. As of December 31, 2019, the Bank operated 15 automated teller machines which includes three stand-alone locations.

The FDIC's examination policies require that the Company monitor all customer deposit concentrations at or above 2% of total deposits. For a discussion of deposits, see the MD&A and Notes 1 and 7 in the Consolidated Financial Statements.

Borrowings

Deposits are the primary source of funds for the Bank's lending and investment activities and for its general business purposes. The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and commercial banks. Long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. For a discussion of borrowing, see the MD&A and Notes 1, 8, 9 and 10 in the Consolidated Financial Statements.

Subsidiary Activities

The Company has two direct subsidiaries other than the Bank. In July 2004, Tri-County Capital Trust I was established as a statutory trust under Delaware law as a wholly owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust I issued $7.0 million of trust preferred securities on July 22, 2004. In June 2005, Tri-County Capital Trust II was also established as a statutory trust under Delaware law as a wholly owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust II issued $5.0 million of trust preferred securities on June 15, 2005. For more information regarding these entities, see Note 9 in the Consolidated Financial Statements.

The Bank has one direct subsidiary, Community Mortgage Corporation of Tri-County, that is currently inactive. This corporation was formed in April 1997 as a wholly owned subsidiary of the Bank to offer mortgage banking, brokerage, and other services to the public.

Employees

The Bank has 194 full time equivalent employees as of December 31, 2019. Bank employees are not represented by any collective bargaining agreements. We believe that relations with our employees are good. The Company has no employees and reimburses the Bank for estimated expenses, including an allocation of salaries and benefits.

Supervision and Regulation

Regulation of the Company

General

As a bank holding company, the Company is subject to comprehensive regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the regulations of the Federal Reserve Board. The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders, and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The following discussion summarizes certain of the regulations applicable to the Company but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Acquisition of Control

A bank holding company, with certain exceptions, must obtain Federal Reserve Board approval before (1) acquiring ownership or control of another bank or bank holding company if it would own or control more than 5% of the voting shares of such bank or bank holding company (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging with another bank holding company. In evaluating such application, the Federal Reserve Board considers factors such as the financial condition and managerial resources of the companies involved, the convenience and needs of the communities to be served and competitive factors. Federal law provides that no person may acquire "control" of a bank holding company or insured bank without the approval of the appropriate federal regulator. Control is defined to mean direct or indirect ownership, control of 25% or more of any class of voting stock, control of the election of a majority of the bank's directors or a determination by the Federal Reserve Board that the acquirer has or would have the power to exercise a controlling influence over the management or policies of the institution.

The Maryland Financial Institutions Code additionally prohibits any person from acquiring more than 10% of the outstanding shares of any class of securities of a bank or bank holding company or electing a majority of the directors or directing the management or policies of any such entity, without the prior approval of the Commissioner. The Commissioner may deny approval of the acquisition if the Commissioner determines it to be anti-competitive or to threaten the safety or soundness of a banking institution.

Permissible Activities

A bank holding company is limited in its activities to banking, managing or controlling banks, or providing services for its subsidiaries. Other permitted non-bank activities have been identified as closely related to banking. Bank holding companies that are "well capitalized" and "well managed" and whose financial institution subsidiaries have satisfactory Community Reinvestment Act records can elect to become "financial holding companies," which are permitted to engage in a broader range of financial activities than are permitted to bank holding companies. The Company has not opted to become a financial holding company.

The Federal Reserve Board has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

Dividend

The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a prospective rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. Under the prompt corrective action regulations adopted by the Federal Reserve Board, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized." See "Regulation of the Bank – Capital Adequacy."

Sources of Strength

The Dodd-Frank Act codified the source of strength doctrine requiring bank holding companies to serve as a source of strength for their depository subsidiaries, by providing capital, liquidity and other support in times of financial stress.

Stock Repurchases

The Company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption. This requirement does not apply to bank holding companies that are "well capitalized," "well-managed" and are not the subject of any unresolved supervisory issues.

Capital Requirement

Bank holding companies are required to maintain on a consolidated basis, specified minimum ratios of capital to total assets and capital to risk-weighted assets. These requirements, which generally apply to bank holding companies with consolidated assets of $1 billion or more, such as the Company, are substantially similar to those applicable to the Bank. See "– Regulation of the Bank – Capital Adequacy." The Dodd-Frank Act required the Federal Reserve Board to adopt consolidated capital requirements for holding companies that are equally as stringent as those applicable to the depository institution subsidiaries. That means that certain instruments that had previously been includable in Tier 1 capital for bank holding companies, such as trust preferred securities, will no longer be eligible for inclusion. The revised capital requirements are subject to certain grandfathering and transition rules. The Company is currently considered a grandfathered institution under these rules.

Regulation of the Bank

General

The Bank is a Maryland commercial bank and its deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC"). The Bank currently is subject to supervision, examination and regulation by the Commissioner of Financial Regulation of the State of Maryland (the "Commissioner") and the FDIC.

The Dodd-Frank Act established the Consumer Financial Protection Bureau ("CFPB") as an independent bureau of the Federal Reserve System. The CFPB assumed responsibility for implementing federal consumer financial protection and fair lending laws and regulations, a function formerly handled by federal bank regulatory agencies. However, institutions of less than $10 billion, such as the Bank, will continue to be examined for compliance with consumer protection or fair lending laws and regulations by, and be subject to enforcement authority of their primary federal regulators.

The following discussion summarizes regulations applicable to the Bank but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Capital Adequacy

On July 9, 2013, the federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act (the "Basel III Capital Rules").

On January 1, 2015, the Company and Bank became subject to the Basel III Capital Rules with full compliance with all of the final rules' requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The Basel III Capital Rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio ("Min. Ratio") of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer ("CCB") is also established above the regulatory minimum capital requirements. This capital conservation buffer began being phased-in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its

final level of 2.5% on January 1, 2019. Eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, total capital, and risk-weighted assets.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take "prompt corrective action" with respect to institutions that do not meet minimum capital requirements. For such purposes, the law establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

As a result of the Basel III Capital Rules (discussed further above), effective January 1, 2015, an institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a common equity Tier 1 risk-based capital ratio of 6.5% or greater, and a leverage capital ratio of 5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. An institution is deemed to be "adequately capitalized" if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, a common equity Tier 1 risk-based capital ratio of 4.5% or greater and generally a leverage capital ratio of 4% or greater. An institution is deemed to be "undercapitalized" if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a common equity Tier 1 risk-based capital ratio of less than 4.5% or generally a leverage capital ratio of less than 4%. An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a common equity Tier 1 risk-based capital ratio of less than 3% or a leverage capital ratio of less than 3%. An institution is deemed to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%.

"Undercapitalized" institutions are subject to growth, capital distribution (including dividend), and other limitations, and are required to submit a capital restoration plan. An institution's compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the bank's total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an undercapitalized institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." Significantly undercapitalized institutions are subject to one or more additional restrictions including, but not limited to, a regulatory order requiring them to sell sufficient voting stock to become adequately capitalized; requirements to reduce total assets, cease receipt of deposits from correspondent banks, or dismiss directors or officers; and restrictions on interest rates paid on deposits, compensation of executive officers, and capital distributions by the parent holding company.

Beginning 60 days after becoming "critically undercapitalized," critically undercapitalized institutions also may not make any payment of principal or interest on certain subordinated debt, extend credit for a highly leveraged transaction, or enter into any material transaction outside the ordinary course of business. In addition, subject to a narrow exception, the appointment of a receiver is required for a critically undercapitalized institution within 270 days after it obtains such status.

Branching

Maryland law provides that, with the approval of the Commissioner, Maryland banks may establish branches within Maryland and may establish branches in other states by any means permitted by the laws of such state or by federal law. The FDIC may approve interstate branching by merger in any state that did not opt out and *de novo* in states that specifically allow for such branching.

Dividend Limitations

Maryland banks may only pay cash dividends from undivided profits or, with the prior approval of the Commissioner, their surplus in excess of 100% of required capital stock. Maryland banks may not declare a stock dividend unless their surplus, after the increase in capital stock, is equal to at least 20% of the outstanding capital stock as increased. If the surplus of the bank, after the increase in capital stock, is less than 100% of its capital stock as increased, the commercial bank must annually transfer to surplus at least 10% of its net earnings until the surplus is 100% of its capital stock as increased.

Insurance of Deposit Accounts

The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. The deposit insurance per account owner is currently $250,000.

Under the Federal Deposit Insurance Corporation's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned. The initial base assessment rate ranges from three to 30 basis points. The rate schedules will automatically adjust in the future when the Deposit

Insurance Fund reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation or its prudential banking regulator. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Pursuant to the FDIC's examination policies, the Bank is required to actively monitor large deposit relationships and concentration risks. This includes monitoring deposit concentrations and maintaining fund management policies and strategies that take into account potentially volatile concentrations and significant deposits that mature simultaneously. The FDIC defines a large depositor as a customer or entity that owns or controls 2% or more of the Bank's total deposits. Examiners are charged with considering the overall relationship between customers and the institution when assessing the volatility of large deposits, and key considerations include potential cash flow fluctuations, pledging requirements, affiliated relationships, and the narrow interest spreads that may be associated with large deposits.

Reserve Requirements

Under federal regulations, the Bank is required to maintain non-interest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations required that reserves be maintained against aggregate transaction accounts as follows for 2019: (i) a 3% reserve ratio was assessed on net transaction accounts up to and including $124.2 million; and (ii) a 10% reserve ratio was applied above $124.2 million. The first $16.3 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually and, for 2020, a 3% ratio for up to $127.5 million and an exemption of $16.9 million. At December 31, 2019, the Bank met applicable reserve requirements.

Transactions with Affiliates

A state nonmember bank, such as the Bank, is limited in the amount of "covered transactions" with any affiliate. Covered transactions must also be on terms substantially the same, or at least as favorable, to the Bank or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions. Certain covered transactions, such as loans to affiliates, must meet collateral requirements. At December 31, 2019, we had no transactions with affiliates.

Loans to directors, executive officers and principal stockholders of a state nonmember bank must be made on substantially the same terms as those prevailing for comparable transactions with persons who are not executive officers, directors, principal stockholders or employees of the bank. Loans to any executive officer, director and principal stockholder together with all other outstanding loans to such person and affiliated interests generally may not exceed 15% of the Bank's unimpaired capital and surplus and all loans to such persons may not exceed the institution's unimpaired capital and unimpaired surplus. Loans to directors, executive officers and principal stockholders, and their respective affiliates, in excess of the greater of $25,000 or 5% of capital and surplus, or any loans cumulatively aggregating $500,000 or more, must be approved in advance by a majority of the board of directors of the Bank with any "interested" director not participating in the voting. State nonmember banks are prohibited from paying the overdrafts of any of their executive officers or directors unless payment is made pursuant to a written, pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or transfer of funds from another account at the Bank. In addition, loans to executive officers may not be made on terms more favorable than those afforded other borrowers and are restricted as to type, amount and terms of credit.

Enforcement

The Commissioner has extensive enforcement authority over Maryland banks. This includes the ability to issue cease and desist orders and civil money penalties and to remove directors or officers. The Commissioner may also take possession of a Maryland bank whose capital is impaired and seek to have a receiver appointed by a court.

The FDIC has primary federal enforcement responsibility over state banks under its jurisdiction, including the authority to bring enforcement action against all "institution-related parties," including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an institution. Formal enforcement action may range from the issuance of capital directive or a cease and desist order for the removal of officers and/or directors, receivership, conservatorship or termination of deposit insurance. Civil money penalties cover a wide range of violations and actions and range up to $25,000 per day or even up to $1 million per day (in the most egregious cases). Criminal penalties for most financial institution crimes include fines of up to $1 million and imprisonment for up to 30 years.

Other Regulations

The Bank's operations are also subject to federal laws applicable to credit transactions, including the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one- to four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Bank Secrecy Act of 1970, requiring financial institutions to assist U.S. government agencies to detect and prevent money laundering;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of the Bank also are subject to laws such as the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check.
- Gramm-Leach-Bliley Act privacy statute which requires each depository institution to disclose its privacy policy, identify parties with whom certain nonpublic customer information is shared and provide customers with certain rights to "opt out" of disclosure to certain third parties;
- Title III of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (referred to as the "USA PATRIOT Act"), which significantly expands the responsibilities of financial institutions in preventing the use of the United States financial system to fund terrorist activities. Among other things, the USA PATRIOT Act and the related regulations requires banks operating in the United States to develop anti-money laundering compliance programs, due diligence policies and controls to facilitate the detection and reporting of money laundering;
- The Fair and Accurate Reporting Act of 2003, as an amendment to the Fair Credit Reporting Act, as noted previously, which includes provisions to help reduce identity theft by providing procedures for the identification, detection, and response to patterns, practices, or specific activities—known as "red flags"; and
- Truth in Savings Act, which establishes the requirement for clear and uniform disclosure of terms and conditions regarding deposit interest and fees to help promote economic stability, competition between depository institutions, and allow the consumer to make informed decisions.

Item 1A. Risk Factors

Risks

An investment in shares of our common stock involves various risks. Our business, financial condition and results of operations could be harmed by any of the following risks or by other risks that have not been identified or that we may believe are immaterial or unlikely. The value or market price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Credit Risks

Our increased emphasis on commercial lending may expose us to increased lending risks.

At December 31, 2019 and 2018, our loan portfolio included $964.8 million, or 66.3%, and $878.0 million, or 65.2%, respectively, of commercial real estate loans, $123.6 million, or 8.5%, and $124.3 million, or 9.2%, respectively, of residential rental loans, $63.1 million, or 4.3% and $71.7 million, or 5.3%, respectively of commercial business loans and $63.6 million, or 4.4% and $50.2 million, or 3.7%, respectively, of commercial equipment loans. We intend to maintain our emphasis on these types of loans. These types of loans generally expose a lender to greater risk of non-payment and loss and require a commensurately higher loan loss allowance than owner-occupied one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances compared to one- to four-family residential mortgage loans. Commercial business and equipment loans expose us to additional risks since they typically are made on the basis of the borrower's ability to make repayments from the cash flows of the borrower's business and are secured by non-real estate collateral that may depreciate over time. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. At December 31, 2019 and 2018, $16.6 million, or 92.8% and $17.8 million, or 92.1%, respectively, of our non-accrual loans of $17.9 million and $19.3 million, respectively, consisted of commercial loans.

Imposition of limits by the bank regulators on commercial real estate lending activities could curtail the Company's growth and adversely affect its earnings.

In 2006, the federal banking regulators issued joint guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices," referred to herein as the CRE Guidance. Although the CRE Guidance did not establish specific lending limits, it provides that a bank's commercial real estate lending exposure could receive increased supervisory inquiry where total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans, represent 300% or more of an institution's total risk-based capital, and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more during the preceding 36 months. Additionally, in December 2015, the federal banking regulators released a new statement on prudent risk management for commercial real estate lending, referred to herein as the 2015 Statement. In the 2015 Statement, the federal banking regulators, among other things, indicate the intent to continue "to pay special attention" to commercial real estate lending activities and concentrations going forward. Taking into account this guidance, if the FDIC, the Bank's primary federal regulator, were to impose restrictions on the amount of commercial real estate loans the Bank can hold in its portfolio, for reasons noted above or otherwise, the Company's earnings could be adversely affected. At December 31, 2019, the Bank's total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans represented 319.98% of the Bank's total risk-based capital. Management has established a CRE lending framework to monitor specific exposures and limits by types within the CRE portfolio and takes appropriate actions, as necessary.

We may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future. Further, our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

For the years ended December 31, 2019 and 2018, we recorded a provision for loan losses of $2.1 million and $1.4 million, respectively. We also recorded net loan charge-offs of $2.2 million and $944,000 for the years ended December 31, 2019 and 2018, respectively. Our non-accrual loans, OREO and accruing TDRs aggregated $26.3 million, or 1.46% of total assets and $34.1 million, or 2.02% of total assets, respectively, at December 31, 2019 and 2018. Additionally, loans that were classified as special mention and substandard were $26.9 million and $32.2 million, respectively, at December 31, 2019 and 2018. We had no loans classified as doubtful or loss at December 31, 2019 and 2018. If the economy and/or the real estate market weakens, more of our classified loans may become non-performing and we may be required to take additional provisions to increase our allowance for loan losses for these assets as the value of the collateral may be insufficient to pay any remaining net loan balance, which would have a negative effect on our results of operations. We maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. We believe that our allowance for loan losses is maintained at a level adequate to absorb

probable losses inherent in our loan portfolio as of the corresponding balance sheet date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results.

In evaluating the adequacy of our allowance for loan losses, we consider numerous factors, including our historical charge-off experience, growth of our loan portfolio, changes in the composition of our loan portfolio and the volume of delinquent, non-accrual and classified loans, TDRs and foreclosed real estate. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Finally, we also consider other qualitative factors, including general and economic business conditions, anticipated duration of the current business cycle, current general market collateral valuations, and trends apparent in any of the factors we take into account. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses may vary from our current estimates.

Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs. Any such additional provisions for loan losses or charge-offs, as required by our regulators, could have a material adverse effect on our financial condition and results of operations.

If we do not effectively manage our credit risk, we may experience increased levels of non-performing loans, charge-offs and delinquencies, which would require additional increases in our provision for loan losses.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of non-payment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. Our credit risk approval and monitoring procedures may not reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, fails to improve, or even if it does improve, our borrowers may experience difficulties in repaying their loans, and the level of non-performing loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses, which would cause our net income and return on equity to decrease.

Non-performing and classified assets could take significant time to resolve and adversely affect our results of operations and financial condition and could result in further losses in the future.

At December 31, 2019 and 2018, our non-accrual loans totaled $17.9 million, or 1.23% of our loan portfolio and $19.3 million, or 1.43% of our loan portfolio, respectively. At December 31, 2019 and 2018, our non-accrual loans, OREO and accruing TDRs totaled $26.3 million, or 1.46% of total assets and $34.1 million, or 2.02% of total assets, respectively. Our non-performing assets adversely affect our net income in various ways. We do not accrue interest income on non-accrual loans or foreclosed properties, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its fair market value less estimated selling costs, which may result in a loss. These non-performing loans and foreclosed properties also increase our risk profile and the amount of capital our regulators believe is appropriate to maintain in light of such risks. The resolution of non-performing assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in non-performing loans and non-performing assets, our net interest income will be negatively impacted, and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

At December 31, 2019 and 2018 our total classified assets were $34.6 million and $40.8 million, respectively. While we continue to accrue interest income on classified loans that are performing, classified loans and other classified assets may negatively impact profitability by requiring additional management attention and regular monitoring. Increased monitoring of these assets by management may impact our management's ability to focus on opportunistic growth, potentially adversely impacting future profitability.

Our residential mortgage loans and home equity loans expose us to a risk of loss due to declining real estate values.

At December 31, 2019 and 2018, $167.7 million, or 11.5%, of our total loan portfolio, and $156.7 million, or 11.6%, of our total loan portfolio, respectively, consisted of owner-occupied one- to four-family residential mortgage loans. At December 31, 2019 and 2018, $36.1 million, or 2.5%, of our total loan portfolio and $35.6 million, or 2.6%, of our total loan portfolio, respectively, consisted of home equity loans and lines of credit. Declines in the housing market could result in declines in real estate values in our market area. A decline in real estate values could cause some of our mortgage and home equity loans to be inadequately

collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

Our asset valuation may include methodologies, estimations and assumptions that are subject to differing interpretations and could result in changes to asset valuations that may materially adversely affect our results of operations or financial condition.

We must use estimates, assumptions, and judgments when financial assets and liabilities are measured and reported at fair value. Assets and liabilities carried at fair value inherently result in a higher degree of financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices and/or other observable inputs provided by independent third-party sources, when available. When such third-party information is not available, we estimate fair value primarily by using cash flows and other financial modeling techniques utilizing assumptions such as credit quality, liquidity, interest rates and other relevant inputs. Changes in underlying factors, assumptions, or estimates in any of these areas could materially impact our future financial condition and results of operations.

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value some of our assets if trading becomes less frequent and market data becomes less observable. There may be asset classes that were in active markets with significant observable data that become illiquid due to the financial environment. In such cases, asset valuation may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation.

If the value of real estate in our market area were to decline, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

Declines in local economic conditions could adversely affect the value of the real estate collateral securing our loans. A decline in property values would diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

We may be adversely affected by economic conditions in our market area, which is significantly dependent on federal government and military employment and programs.

Our marketplace is primarily in the counties of Charles, Calvert, St. Mary’s and Anne Arundel, Maryland and neighboring communities, and the Fredericksburg area of Virginia. Many, if not most, of our customers live and/or work in those counties or in the greater Washington, DC metropolitan area. Because our services are concentrated in this market, we are affected by the general economic conditions in the greater Washington, DC area. Changes in the economy may influence the growth rate of our loans and deposits, the quality of the loan portfolio and loan and deposit pricing. A significant decline in economic conditions caused by inflation, recession, unemployment or other factors beyond our control could decrease the demand for banking products and services generally and/or impair the ability of existing borrowers to repay their loans, which could negatively affect our financial condition and performance.

A significant portion of the population in our market area is affiliated with or employed by the federal government or at military facilities located in the area which contribute to the local economy. As a result, a reduction in federal government or military employment or programs could have a negative impact on local economic conditions and real estate collateral values and could also negatively affect the Company’s profitability.

Liquidity Risk

Our deposit concentrations may subject us to additional liquidity and pricing risk.

Significant variations in deposit concentrations and pricing could have a material adverse effect on our business, financial condition and results of operations. We manage portfolio diversification through our asset/liability committee process. We occasionally accept larger deposit customers, and our typical deposit customers might occasionally carry larger balances. The aggregate amount of our top 25 deposit relationships have grown from $347.4 million, or 20.6%, of our total assets at December 31, 2018 to $503.3 million, or 28.0% of our total assets at December 31, 2019. The FDIC’s examination policies require that the Company monitor all customer deposit concentrations at or above 2% of total deposits. At December 31, 2019, the Bank had two local municipal customer deposit relationships that exceeded 2% of total deposits, totaling $297.1 million which represented 19.6% of total deposits of $1,511.8 million. At December 31, 2018, there was one municipal customer

deposit relationship that exceeded 2% of total deposits, totaling $158.8 million which represented 11.1% of total deposits of $1,429.6 million.

The Bank's asset and liability management process closely monitors municipal deposit concentrations. However, unanticipated significant changes in these large balances could affect our liquidity risk and pricing risk. While we reduced our reliance on wholesale funding during the year ended December 31, 2019, the withdrawal of more municipal deposits than we anticipate could have an adverse impact on our profitability as this source of funding, if not replaced by similarly priced deposit funding, would need to be replaced with wholesale funding, the sale of interest-earning assets, or a combination of the two. The replacement of municipal deposit funding with wholesale funding could cause our overall cost of funds to increase, which would reduce our net interest income and results of operations. A decline in interest-earning assets would also lower our net interest income and results of operations.

The Company is a bank holding company and its sources of funds necessary to meet its obligations are limited.

The Company is a bank holding company, and its operations are primarily conducted by the Bank, which is subject to significant federal and state regulation. Cash available to pay dividends to our common and preferred stockholders, pay our obligations and meet our debt service requirements is derived from dividends received from the Bank. Future dividend payments by the Bank to us will require generation of future earnings by the Bank and are subject to certain regulatory guidelines. If the Bank is unable to pay dividends to us, we may not have the resources or cash flow to pay or meet all of our obligations.

Operational Risk

Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 could have a material adverse effect on our business and stock price.

As a public company, we are required to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”). Internal control over financial reporting is complex and may be revised over time to adapt to changes in our business, or changes in applicable accounting rules. Sarbanes-Oxley requires our management to evaluate the Company’s disclosure controls and procedures and its internal control over financial reporting and requires our auditors to issue a report on our internal control over financial reporting. We are required to disclose, in our annual report on Form 10-K, the existence of any “material weaknesses” in our internal controls. We cannot assure that we will not identify one or more material weaknesses as of the end of any given quarter or year, nor can we predict the effect on our stock price of disclosure of a material weakness. If we are not able to maintain or document effective internal control over financial reporting, our independent registered public accounting firm will not be able to certify as to the effectiveness of our internal control over financial reporting. Matters impacting our internal control over financial reporting may cause us to be unable to report our financial information on a timely basis or may cause us to restate previously issued financial information, and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, or violations of applicable stock exchange listing rules. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial statements is also likely to suffer if we or our independent registered public accounting firm reports a material weakness in the effectiveness of our internal control over financial reporting. This could materially adversely affect us by, for example, leading to a decline in our stock price and impairing our ability to raise capital. Sarbanes-Oxley also limits the types of non-audit services our outside auditors may provide to us in order to preserve their independence from us. If our auditors were found not to be “independent” of us under SEC rules, we could be required to engage new auditors and re-file financial statements and audit reports with the SEC. In that case, we could be out of compliance with SEC rules until new financial statements and audit reports were filed, limiting our ability to raise capital and resulting in other adverse consequences.

Our internal control systems are inherently limited.

Our systems of internal controls, disclosure controls and corporate governance policies and procedures are inherently limited. The inherent limitations of our system of internal controls include the use of judgment in decision-making that can be faulty; breakdowns can occur because of human error or mistakes; and controls can be circumvented by individual acts or by collusion of two or more people. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and may not be detected, which may have an adverse effect on our business, results of operations or financial condition. Additionally, any plans of remediation for any identified limitations may be ineffective in improving our internal controls.

We rely on other companies to provide key components of our business infrastructure.

Third party vendors provide key components of our business infrastructure such as core data processing systems, internet, mobile applications, connections, network access and fund distribution. While we have selected these third-party vendors carefully, we cannot control their actions. Any problems caused by these third parties, including those which result from their failure to provide services for any reason or their poor performance of services, could adversely affect our ability to deliver products and services to its customers and otherwise to conduct its business. Replacing these third-party vendors could also entail significant delay and expense.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have a material adverse effect on us.

Our business is dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

In addition, we provide our customers with the ability to bank remotely, including over the Internet, mobile applications and the telephone. The secure transmission of confidential information over the Internet and other remote channels is a critical element of remote banking. Despite instituted safeguards and monitoring, our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, physical and cyber security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could materially and adversely affect us.

We are subject to a variety of operational risks, environmental, legal and compliance risks, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer, telecommunications systems, cyber security breaches and other disruptive problems caused by the Internet or other users. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions of other entities, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers and can expose us to litigation and regulatory action. Actual or alleged conduct by the Bank can also result in negative public opinion about our other businesses.

If personal, non-public, confidential or proprietary information of customers in our possession were to be misappropriated, mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, erroneously providing such information to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or the interception or inappropriate acquisition of such information by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in our diminished ability to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage

and regulatory intervention, which could adversely affect our business, financial condition or results of operations, perhaps materially.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including our proprietary business information and that of our customers, suppliers and business partners; and personally identifiable information of our customers and employees. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. We, our customers, and other financial institutions with which we interact, are subject to ongoing, continuous attempts to penetrate key systems by individual hackers, organized criminals, and in some cases, state-sponsored organizations. Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the internet, mobile applications, and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. Despite our security measures and monitoring, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such unauthorized access, disclosure or other loss of information could result in significant costs to us, which may include fines and penalties, potential liabilities from governmental or third party investigations, proceedings or litigation, legal, forensic and consulting fees and expenses, costs and diversion of management attention required for investigation and remediation actions, and the negative impact on our reputation and loss of confidence of our customers and others, any of which could have a material adverse impact on our business, revenues, financial condition and competitive position. As cyber threats continue to evolve, we may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses.

If our information technology is unable to keep pace with industry developments, our business and results of operations may be adversely affected.

Financial products and services have become increasingly technology driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

Exiting or entering new lines of business or new products and services may subject us to additional risk.

From time to time, we may exit an existing line of business or implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts. When exiting a line of business or product we may have difficulty replacing the revenue stream and may have to take certain actions to make up for the line of business or product. For example, we recently discontinued the origination of residential mortgage loans and instead now purchase residential mortgage loans for our loan portfolio from other sources. If those sources are not available or the cost for such purchases increases our results of operations may be adversely affected. We also may face increased credit risk with respect to purchased loans relative to the credit risks we faced in connection with the origination of loans. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved, and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and/or new products or services could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

Interest Rate Risk

Changes in interest rates could reduce our net interest income and earnings.

Our largest component of earnings is net interest income, which could be negatively affected by changes in interest rates. Changing interest rates impact customer actions and may limit the options available to the Company to maximize earnings or increase the costs to minimize risk. We do not have control over market interest rates and the Company's focus to mitigate potential earnings risk centers on controlling the composition of our assets and liabilities.

Our net interest income is the interest we earn on loans and investments less the interest we pay on our deposits and borrowings. Our net interest margin is net interest income divided by average interest-earning assets. Changes in interest rates could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to increase or decrease. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches up. Changes in the slope of the "yield curve"— or the spread between short-term and long-term interest rates—could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets. Our procedures for managing exposure to falling net interest income involve modeling possible scenarios of interest rate increases and decreases to interest-earning assets and interest-bearing liabilities.

Changes in interest rates also can affect: (1) our ability to originate loans; (2) the value of our interest-earning assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay their loans, particularly adjustable or variable rate loans.

The Company may be required to transition from the use of the LIBOR interest rate index in the future.

The Company has certain loans, investment securities and debt obligations whose interest rate is indexed to the London InterBank Offered Rate (LIBOR). The United Kingdom's Financial Conduct Authority, which is responsible for regulating LIBOR, has announced that the publication of LIBOR is not guaranteed beyond 2021 and it appears highly likely that LIBOR will be discontinued or modified by 2021. At this time, no consensus exists as to what reference rate or rates or benchmarks may become acceptable alternatives to LIBOR, although the Alternative Reference Rates Committee (a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York) has identified the Secured Overnight Financing Rate, or SOFR, as the recommend alternative to LIBOR. Uncertainty as to the adoption, market acceptance or availability of SOFR or other alternative reference rates, may adversely affect the value of LIBOR-based loans and securities in the Company's portfolio and may impact the availability and cost of hedging instruments and borrowings. The language in the Company's LIBOR-based contracts and financial instruments has developed over time and may have various events that trigger when a successor index to LIBOR would be selected. If a trigger is satisfied, contracts and financial instruments may give the Company or the calculation agent, as applicable, discretion over the selection of the substitute index for the calculation of interest rates. The implementation of a substitute index for the calculation of interest rates under the Company's loan agreements may result in the Company incurring significant expenses in effecting the transition and may result in disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute index, any of which could have an adverse effect on the Company's results of operations. The Company continues to develop and implement plans to mitigate the risks associated with the expected discontinuation of LIBOR. In particular, the Company has implemented or is in the process of implementing fallback language for LIBOR-linked loans.

Strategic and Other Risks

Our financial condition and results of operations could be negatively affected if we fail to timely and effectively execute our strategic plan or manage the growth called for in our strategic plan. We have grown through our January 1, 2018 acquisition of County First Bank and may continue to grow through other acquisitions. To be successful as a larger institution, we must successfully integrate the operations and retain the customers of acquired institutions, attract and retain the management required to successfully manage larger operations, and control costs.

Among other things, our strategic plan currently calls for reducing the amount of our non-performing assets, growing assets through commercial lending and generating transaction deposit accounts to reduce our funding costs and improve our net interest margin. Our ability to increase profitability in accordance with this plan will depend on a variety of factors including the identification of desirable business opportunities, competitive responses from financial institutions in our market area and our ability to manage liquidity and funding sources. While we believe we have the management resources and internal systems in place to successfully manage our strategic plan, opportunities may not be available and that the strategic plan may not be successful or effectively managed.

In implementing our strategic plan, we may expand into additional communities or attempt to strengthen our position in our current markets through opportunistic acquisitions of whole banks or branch locations. On January 1, 2018, we acquired County First Bank. Future results of operations will be impacted by our ability to successfully integrate the operations of County First Bank and any other acquired institutions and retain the customers of those institutions. If we are unable to successfully manage the integration of the separate cultures, customer bases and operating systems of the acquired institutions, and any other institutions

that may be acquired in the future, our results of operations could be negatively impacted. To the extent that we undertake additional acquisitions, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations during the integration period, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. In addition, if we undertake substantial growth, we may need to increase non-interest expenses through additional personnel, occupancy expense and data processing costs, among others. In order to successfully manage growth, we may need to adopt and effectively implement policies, procedures and controls to maintain credit quality, control costs and oversee operations. No assurance can be given that we will be successful in this strategy. Other effects of engaging in such growth strategies may include potential diversion of our management's time and attention and general disruption to our business. We may not be able to adequately, timely and profitably achieve the intended benefits or our growth strategies or manage anticipated growth.

Finally, substantial growth may stress regulatory capital levels, and may require us to raise additional capital. No assurance can be given that we will be able to raise any required capital, or that it will be able to raise capital on terms that are beneficial to stockholders.

Strong competition within our market area could hurt our profits and slow growth.

We face intense competition both in making loans and attracting deposits. Our competition for loans and deposits includes banks, savings institutions, mortgage banking companies, credit unions and non-banking financial institutions. We compete with regional and national financial institutions that have a substantial presence in our market area, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than us. Furthermore, tax-exempt credit unions operate in our market area and aggressively price their products and services to a large portion of the market. This competition may make it more difficult for us to originate new loans and may force us to offer higher deposit rates than we currently offer. Price competition for loans and deposits might result in lower interest rates earned on our loans and higher interest rates paid on our deposits, which would reduce net interest income. Our profitability depends upon our continued ability to compete successfully in our market area.

Risks Related to the Company's Financial Statements

Changes in accounting standards or interpretation of new or existing standards may affect how the Company reports its financial condition and results of operations.

From time to time the Financial Accounting Standards Board ("FASB") and the SEC change accounting regulations and reporting standards that govern the preparation of the Company's financial statements. In addition, the FASB, SEC, bank regulators and the outside independent auditors may revise their previous interpretations regarding existing accounting regulations and the application of these accounting standards. These changes can be difficult to predict and can materially impact how to record and report the Company's financial condition and results of operations. In some cases, there could be a requirement to apply a new or revised accounting standard retroactively, resulting in the restatement of prior period financial statements.

The implementation of a new accounting standard could require the Company to increase its allowance for loan losses and may have a material adverse effect on its financial condition and results of operations.

FASB has adopted a new accounting standard that will be effective for the Company's first fiscal year after December 15, 2022 unless the Company chooses early adoption. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and provide for the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which the Company expects could require it to increase its allowance for loan losses and will likely increase the data the Company would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in the allowance for loan losses, or expenses incurred to determine the appropriate level of the allowance for loan losses, may have a material adverse effect on the Company's financial condition and results of operations.

We may be adversely affected by changes in U.S. tax laws and regulations.

Changes in tax laws contained in the Tax Cuts and Jobs Act, which was enacted in December 2017, include a number of provisions that could continue to have an impact on the banking industry, borrowers and the market for single family residential and multi-family residential real estate. Included in this legislation was a reduction of the corporate income tax rate from 35% to 21%. In addition, other changes included: lower limits on the deductibility of mortgage interest on single family residential mortgages; the elimination of interest deductions for home equity loans; a limitation on deductibility of business interest expense; and a limitation on the deductibility of property taxes and state and local income taxes. Such changes in the tax laws may have an adverse effect on the market for, and valuation of, single family residential properties and multifamily residential properties, and on the demand for such loans in the future. In addition, these changes may have a disproportionate effect on taxpayers in states with high

residential home prices and high state and local taxes. If home ownership or multifamily residential property ownership becomes less attractive, demand for mortgage loans would decrease. The value of the properties securing loans in the Company's portfolio may be adversely impacted as a result of the changing economics of home ownership and multifamily residential ownership, which could require an increase in the Company's provision for expected credit losses. Additionally, certain borrowers could become less able to service their debts as a result of higher tax obligations. These changes could have a material adverse effect on the Company's business, financial condition and results of operations.

Impairment in the carrying value of goodwill and other intangible assets could negatively impact the Company's financial condition and results of operations.

At December 31, 2019, goodwill and other intangible assets totaled $13.0 million. Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. The estimated fair values of the acquired assets and assumed liabilities may be subject to refinement as additional information relative to closing date fair values becomes available and may result in adjustments to goodwill within the first 12 months following the closing date of the acquisition. Goodwill is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. A significant decline in expected future cash flows, a material change in interest rates, a significant adverse change in the business climate, slower growth rates or a significant or sustained decline in the price of the Company's common stock may necessitate taking charges in the future related to the impairment of goodwill and other intangible assets. The amount of any impairment charge could be significant and could have a material adverse impact on the Company's financial condition and results of operations.

The Company's accounting estimates, and risk management processes rely on analytical and forecasting models.

The processes that the Company uses to estimate its expected credit losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on its financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models that the Company uses for interest rate risk and asset-liability management are inadequate, the Company may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models that the Company uses for determining its expected credit losses are inadequate, the allowance for credit losses may not be sufficient to support future charge-offs. If the models that the Company uses to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Company could realize upon sale or settlement of such financial instruments. Any such failure in the Company's analytical or forecasting models could have a material adverse effect on its business, financial condition and results of operations.

Legal and Compliance Risk

Our enterprise risk management framework may not be effective in mitigating the risks to which we are subject, based upon the size, scope, and complexity of the Company.

As a financial institution, we are subject to a number of risks, including interest rate, credit, liquidity, legal/compliance, market, strategic, operational, and reputational. Our enterprise risk management ("ERM") framework is designed to minimize the risks to which we are subject, as well as any losses stemming from such risks. Although we seek to identify, measure, monitor, report, and control our exposure to such risks, and employ a broad and diverse set of risk monitoring and mitigation techniques in the process, those techniques are inherently limited because they cannot anticipate the existence or development of risks that are currently unknown and unanticipated.

For example, economic and market conditions, heightened legislative and regulatory scrutiny of the financial services industry, and increases in the overall complexity of our operations, among other developments, have resulted in the creation of a variety of risks that were previously unknown and unanticipated, highlighting the intrinsic limitations of our risk monitoring and mitigation techniques. As a result, the further development of previously unknown or unanticipated risks may result in our incurring losses in the future that could adversely impact our financial condition and results of operations. Furthermore, an ineffective ERM framework, as well as other risk factors, could result in a material increase in our FDIC insurance premiums.

We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.

The Company and the Bank are subject to extensive regulation, supervision and examination as noted in the "*Supervision and Regulation"* section of this report. The regulation and supervision by the Maryland Commissioner, the Federal Reserve and the FDIC are not intended to protect the interests of investors in The Community Financial Corporation common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including changes in the ownership or control

of banks and bank holding companies, maintenance of adequate capital and sound financial condition, permissible types, amounts and terms of loans and investments, permissible nonbanking activities, the level of reserves against deposits and restrictions on dividend payments. These and other restrictions limit the manner in which the Company may conduct business and obtain financing. The laws, rules, regulations, and supervisory guidance and policies applicable to the Company and the Bank are subject to regular modification and change. Such changes may, among other things, increase the cost of doing business, limit the types of financial services and products the Company may offer, or affect the competitive balance between banks and other financial institutions. Failure to comply with laws, regulations, or policies could result in sanctions by regulatory agencies, civil money penalties, and/or reputational damage, which could have a material adverse effect on the Company's business, financial condition, or results of operations. The burdens imposed by federal and state regulations put banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies, and leasing companies.

We are periodically subject to examination and scrutiny by a number of banking agencies and, depending upon the findings and determinations of these agencies, we may be required to make adjustments to our business that could adversely affect us.

Federal and state banking agencies periodically conduct examinations of our business, including compliance with applicable laws and regulations. If, as a result of an examination, a federal banking agency was to determine that the financial condition, capital resources, asset quality, asset concentration, earnings prospects, management, liquidity, sensitivity to market risk or other aspects of any of our operations has become unsatisfactory, or that we or our management is in violation of any law or regulation, it could take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to change the asset composition of our portfolio or balance sheet, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance. If we become subject to such regulatory actions, our business, results of operations and reputation may be negatively impacted.

Negative developments in the financial industry, the domestic and international credit markets, and the economy in general pose significant challenges for our industry and us and could adversely affect our business, financial condition and results of operations.

Negative developments that began in the latter half of 2007 and that have continued since then in the global credit and securitization markets have resulted in unprecedented volatility and disruption in the financial markets, a general economic downturn and a tepid economic recovery, both nationally and in our primary markets. As a result, commercial as well as consumer loan portfolio performances deteriorated at many institutions and have not fully recovered, and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. As a result, we may face the following risks:

- Economic conditions that negatively affect housing prices and the job market may cause the credit quality of our loan portfolios to deteriorate;
- Market developments that affect consumer confidence may cause adverse changes in payment patterns by our customers, causing increases in delinquencies and default rates on loans and other credit facilities;
- The processes that we use to estimate our allowance for loan losses and reserves may no longer be reliable because they rely on judgments, such as forecasts of economic conditions, that may no longer be capable of accurate estimation;
- The value of our securities portfolio may decline; and
- We face increased regulation of our industry, and the costs of compliance with such regulation may increase.

These conditions or similar ones may continue to persist or worsen, causing us to experience continuing or increased adverse effects on our business, financial condition, results of operations and the price of our common stock.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. In recent years, various significant economic and monetary stimulus measures were implemented by the U.S. Congress and the Federal Reserve pursued a highly accommodative monetary policy aimed at keeping interest rates at historically low levels. U.S. economic activity has significantly improved, but there can be no assurance that this progress will continue or will not reverse.

An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Provisions of our articles of incorporation, bylaws and Maryland law, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Provisions in our articles of incorporation and bylaws and Maryland corporate law could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to our board of directors and for proposing matters that shareholders may act on at shareholder meetings. In addition, we are subject to Maryland laws, including one that prohibits us from engaging in a business combination with any interested shareholder for a period of five years from the date the person became an interested shareholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors other than the candidates nominated by our Board.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “PATRIOT Act”) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

The Company is subject to numerous laws designed to protect consumers, including the Community Reinvestment Act (“CRA”) and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The CRA requires the Federal Reserve to assess the Bank’s performance in meeting the credit needs of the communities it serves, including low and moderate-income neighborhoods. If the Federal Reserve determines that the Bank needs to improve its performance or is in substantial non-compliance with CRA requirements, various adverse regulatory consequences may ensue. In addition, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The CFPB, the U.S. Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. The CFPB was created under the Dodd-Frank Act to centralize responsibility for consumer financial protection with broad rulemaking authority to administer and carry out the purposes and objectives of federal consumer financial laws with respect to all financial institutions that offer financial products and services to consumers. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider, identifying and prohibiting acts or practices that are “unfair, deceptive, or abusive” in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The ongoing broad rulemaking powers of the CFPB have potential to have a significant impact on the operations of financial institutions offering consumer financial products or services.

A successful regulatory challenge to an institution’s performance under the CRA, fair lending laws or regulations, or consumer lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines.

Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on the Company's business, financial condition and results of operations.

Market Risk

The market price and liquidity of our common stock could be adversely affected if the economy were to weaken or the capital markets were to experience volatility.

The market price of our common stock could be subject to significant fluctuations due to changes in sentiment in the market regarding our operations or business prospects. Among other factors, these risks may be affected by:

- Operating results that vary from the expectations of our management or of securities analysts and investors;
- Developments in our business or in the financial services sector generally;
- Regulatory or legislative changes affecting our industry generally or our business and operations;
- Operating and securities price performance of companies that investors consider to be comparable to us;
- Changes in estimates or recommendations by securities analysts or rating agencies;
- Announcements of strategic developments, acquisitions, dispositions, financings, and other material events by us or our competitors;
- Changes or volatility in global financial markets and economies, general market conditions, interest or foreign exchange rates, stock, commodity, credit, or asset valuations; and
- Significant fluctuations in the capital markets.

Economic or market turmoil could occur in the near or long term, which could negatively affect our business, our financial condition, and our results of operations, as well as volatility in the price and trading volume of our common stock.

We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.

On December 31, 2019, the Company entered into subscription agreements with various purchasers under which it issued a total of 312,747 shares of its common stock in a private placement offering. In order to maintain our capital at desired or regulatory-required levels, or to fund future growth, our board of directors may decide from time to time to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of our common stock. The sale of these shares may significantly dilute your ownership interest as a shareholder. New investors in the future may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

Reputational Risk

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be adversely affected.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our headquarters are located in Waldorf, MD. As of December 31, 2019, the Bank operates 12 full services branches. See Note 5, "Premises and Equipment" in the Notes to the Consolidated Financial Statements for additional information.

The net book value of premises, which included land, building and improvements, totaled $20.2 million and $20.8 million, respectively, at December 31, 2019 and 2018.

Branch Location	Address	Description	Owned or Leased
Bryans Road	8010 Matthews Road Bryans Road, MD 20616	Full service branch with drive-thru	Owned
Charlotte Hall	30165 Three Notch Rd Charlotte Hall, MD 20622	Full service branch with drive-thru	Land Leased Building Owned
Dunkirk	10321 Southern Maryland Blvd Dunkirk, MD 20754	Full service branch with drive-thru	Leased
Fredericksburg	10 Chatham Heights Road, Suite 104 Fredericksburg, VA 22405	Loan office and operations center	Leased
Fredericksburg - Downtown	425 William Street Fredericksburg, VA 22401	Full service branch with drive-thru	Owned
La Plata	101 Drury Dr La Plata, MD 20646	Full service branch with drive-thru	Owned
La Plata - Downtown	202 Centennial St La Plata, MD 20646	Full service branch with drive-thru and loan office	Owned
Leonardtown	25395 Point Lookout Rd Leonardtown, MD 20650	Full service branch with drive-thru and loan office	Owned
Lexington Park	22730 Three Notch Rd California, MD 20619	Full service branch with drive-thru	Owned
Lusby	11725 Rousby Hall Road Lusby, MD 20657	Full service branch with drive-thru	Land Leased Building Owned
Prince Frederick	200 Market Square Dr Prince Frederick, MD 20678	Full service branch with drive-thru	Land Leased Building Owned
Prince Frederick	995 N Prince Frederick Blvd, Suite 105 Prince Frederick, MD 20678	Loan office	Leased
St. Patrick's	20 St Patricks Dr Waldorf, MD 20603	Full service branch with drive-thru	Land Leased Building Owned
Waldorf (Main Office)	3035 Leonardtown Rd Waldorf, MD 20601	Full service branch with drive-thru and operations center	Owned

Item 3. Legal Proceedings

Neither the Company, the Bank, nor any subsidiary is engaged in any legal proceedings of a material nature at the present time. From time to time, the Bank is a party to legal proceedings in the ordinary course of business.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

The following table sets forth high and low bid quotations reported for the Company's common stock for each quarter during 2019 and 2018 and the dividends declared per share for common stock. These quotes reflect inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

Quarter Ended	High	Low	Dividend Per Share
December 31, 2019	$ 36.23	$ 30.83	$ 0.125
September 30, 2019	33.80	30.20	0.125
June 30, 2019	34.15	28.12	0.125
March 31, 2019	30.35	27.30	0.125
December 31, 2018	34.08	26.47	0.10
September 30, 2018	37.09	32.83	0.10
June 30, 2018	37.75	35.12	0.10
March 31, 2018	39.07	35.77	0.10

Holders

The common stock of the Company is traded on the NASDAQ Stock Exchange (Symbol: TCFC). The number of stockholders of record of the Company at March 2, 2020 was 769**.**

Dividends

During 2019, the Company declared and paid four quarters of dividends at $0.125 per share. The Board of Directors considers on a quarterly basis the feasibility of paying a cash dividend to its stockholders. Under the Company's general practice, dividends, if declared during the quarter, are paid prior to the end of the subsequent quarter. In December 2019, the Company's Board of Directors approved a dividend of $0.125 per share, payable during the first quarter of 2020 to shareholders of record as of January 20, 2020.

The Company's ability to pay dividends is governed by the policies and regulations of the Federal Reserve Board (the "FRB"), which prohibits the payment of dividends under certain circumstances dependent on the Company's financial condition and capital adequacy. The Company's ability to pay dividends is also dependent on the receipt of dividends from the Bank.

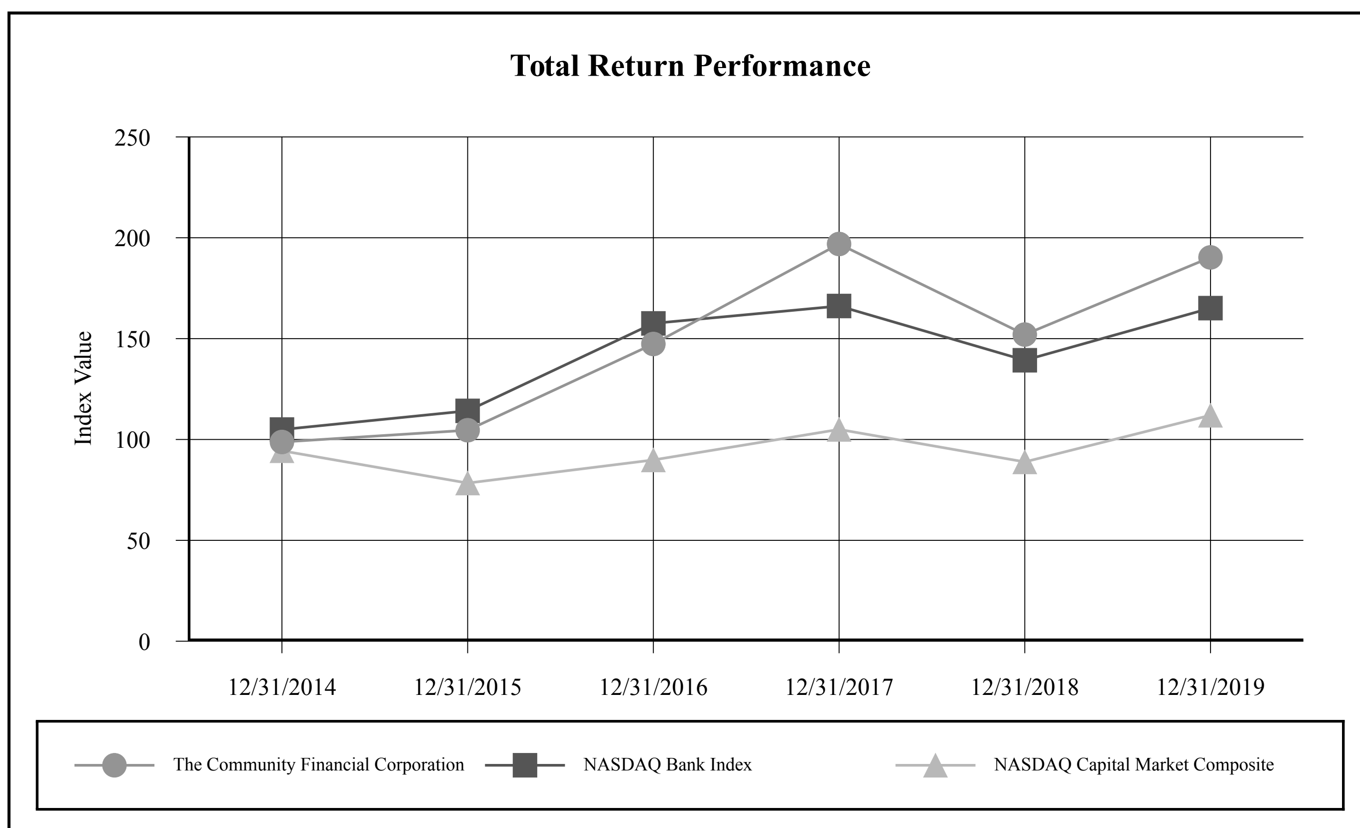
Federal regulations impose limitations on the payment of dividends and other capital distributions by the Bank. The Bank's ability to pay dividends is governed by the Maryland Financial Institutions Code and the regulations of the Federal Deposit Insurance Corporation ("FDIC"). Under the Maryland Financial Institutions Code, a Maryland bank (1) may only pay dividends from undivided profits or, with prior regulatory approval, its surplus in excess of 100% of required capital stock and, (2) may not declare dividends on its common stock until its surplus funds equals the amount of required capital stock, or if the surplus fund does not equal the amount of capital stock, in an amount in excess of 90% of net earnings.

Without the approval of the FDIC, a Federal Reserve nonmember bank may not declare or pay a dividend if the total of all dividends declared during the year exceeds its net income during the current calendar year and retained net income for the prior two years. The Bank is further prohibited from making a capital distribution if it would not be adequately capitalized thereafter. In addition, the Bank may not make a capital distribution that would reduce its net worth below the amount required to maintain the liquidation account established for the benefit of its depositors at the time of its conversion to stock form.

Stock Performance Graph

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the NASDAQ Capital Market Composite), and a narrower index of the NASDAQ Bank Index. Cumulative total return on the stock or the index equals the total increase in value since December 31, 2014, assuming reinvestment of all dividends paid into the stock or the index.

The graph and table were prepared assuming that $100 was invested on December 31, 2014, in the common stock and the securities included in the indexes.



Source: **Bloomberg**	Year Ended					
Index	**12/31/2014**	**12/31/2015**	**12/31/2016**	**12/31/2017**	**12/31/2018**	**12/31/2019**
The Community Financial Corporation	98.76	104.59	147.34	196.91	152.01	190.27
NASDAQ Bank Index	104.92	114.20	157.56	166.16	139.28	165.11
NASDAQ Capital Market Composite	94.40	78.39	89.85	104.99	88.89	112.00

Recent Sales of Unregistered Securities

Not applicable.

Purchases of Equity Securities by the Issuer

On May 4, 2015, the Board of Directors approved a repurchase plan (“2015 repurchase plan"). The 2015 repurchase plan authorizes the repurchase of up to 250,000 shares of outstanding common stock. The 2015 repurchase plan will continue until it is completed or terminated by the Company’s Board of Directors. During the quarter ended December 31, 2015, the 2015 repurchase plan began with the termination of the 2008 repurchase program. As of December 31, 2019, 186,078 shares were available to be repurchased under the 2015 repurchase program. The following schedule shows the repurchases during the three months ended December 31, 2019.

Period	**(a) Total Number of Shares Purchased**	**(b) Average Price Paid per Share**	**(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	**(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs**
October 1-31, 2019	—	$ —	—	186,078
November 1-30, 2019	—	—	—	186,078
December 1-31, 2019	—	—	—	186,078
Total	—	$ —	—	186,078

Item 6. Selected Financial Data

SUMMARY OF SELECTED FINANCIAL DATA

The following table shows selected historical consolidated financial data for the Company as of and for each of the five years ended December 31, 2019, which has been derived from our audited consolidated financial statements. You should read this table together with our consolidated financial statements and related notes included in this Annual 10-K report.

(dollars in thousands, except per share amounts)	At or for the Years Ended December 31,				
	2019	2018	2017	2016	2015
FINANCIAL CONDITION DATA					
Total assets	$ 1,797,536	$ 1,689,227	$ 1,405,961	$ 1,334,257	$ 1,143,332
Loans receivable, net	1,445,109	1,337,129	1,140,615	1,079,519	909,200
Investment securities	213,065	220,884	167,531	162,280	144,536
Goodwill	10,835	10,835	—	—	—
Core deposit intangible	2,118	2,806	—	—	—
Deposits	1,511,837	1,429,629	1,106,237	1,038,825	906,899
Borrowings	45,370	55,436	142,998	144,559	91,617
Junior subordinated debentures	12,000	12,000	12,000	12,000	12,000
Subordinated notes - 6.25%	23,000	23,000	23,000	23,000	23,000
Stockholders' equity—preferred	—	—	—	—	—
Stockholders' equity—common	181,494	154,482	109,957	104,426	99,783
OPERATING DATA					
Interest and dividend income	$ 72,453	$ 65,173	$ 53,570	$ 48,047	$ 43,873
Interest expenses	18,919	14,286	10,182	8,142	7,345
Net interest income (NII)	53,534	50,887	43,388	39,905	36,528
Provision for loan losses	2,130	1,405	1,010	2,359	1,433
NII after provision for loan losses	51,404	49,482	42,378	37,546	35,095
Noninterest income	5,766	4,068	4,041	3,796	3,299
Noninterest expenses	36,233	38,149	30,054	29,595	28,418
Income before income taxes	20,937	15,401	16,365	11,747	9,976
Income taxes	5,665	4,173	9,157	4,416	3,633
Net income	15,272	11,228	7,208	7,331	6,343
Preferred stock dividends declared	—	—	—	—	23
Income available to common shares	$ 15,272	$ 11,228	$ 7,208	$ 7,331	$ 6,320

(dollars in thousands, except per share amounts)	At or for the Years Ended December 31, 2019	2018	2017	2016	2015
COMMON SHARE DATA					
Basic earnings per common share	$ 2.75	$ 2.02	$ 1.56	$ 1.59	$ 1.36
Diluted earnings per common share	2.75	2.02	1.56	1.59	1.35
Dividends declared per common share	0.50	0.40	0.40	0.40	0.40
Book value per common share	30.76	27.70	23.65	22.54	21.48
Tangible book value per common share (1)	28.57	25.25	—	—	—
Common shares outstanding at end of period	5,900,249	5,577,559	4,649,658	4,633,868	4,645,429
Basic weighted average common shares	5,560,588	5,550,510	4,627,776	4,599,502	4,676,748
Diluted weighted average common shares	5,560,588	5,550,510	4,629,228	4,599,502	4,676,748
OTHER DATA					
Full-time equivalent employees	194	189	165	162	171
Full-service offices	12	12	11	12	12
Loan Production Offices	4	5	5	5	5
CAPITAL RATIOS					
Tier 1 capital to average assets (Leverage)	10.08%	9.50%	8.79%	9.02%	10.01%
Tier 1 common capital to risk-weighted assets	11.11	10.36	9.51	9.54	10.16
Tier 1 capital to risk-weighted assets	11.91	11.23	10.53	10.62	11.38
Total risk-based capital to risk-weighted assets	14.16	13.68	13.40	13.60	14.58
Common equity to assets	10.10	9.15	7.82	7.83	8.73
Tangible common equity to tangible assets [1]	9.44	8.41	—	—	—

(dollars in thousands, except per share amounts)	At or for the Years Ended December 31, 2019	2018	2017	2016	2015
KEY OPERATING RATIOS					
Return on average assets	0.88%	0.70%	0.52%	0.60%	0.58%
Return on average total equity	9.32	7.53	6.55	7.09	6.21
Return on average common equity	9.32	7.53	6.55	7.09	6.33
Average total equity to average total assets	9.40	9.30	7.99	8.41	9.35
Interest rate spread	3.06	3.22	3.24	3.35	3.48
Net interest margin	3.31	3.43	3.37	3.48	3.60
Efficiency ratio [2]	61.10	69.42	63.37	67.72	71.35
Common dividend payout ratio	18.18	19.80	25.64	25.16	29.41
Non-interest expense to average assets	2.08	2.38	2.18	2.41	2.60
Net operating expense to average assets [3]	1.75	2.13	1.89	2.10	2.30
Avg. int-earning assets to avg. int-bearing liabilities	121.62	121.31	116.95	117.56	117.71

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(1) The Company had no intangible assets between 2015-2017. The acquisition of County First Bank in January 2018 added intangible assets for goodwill and core deposits.

(2) Efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.

(3) Net operating expense is the sum of non-interest expense offset by non-interest income.

Use of Non-GAAP Financial Measures

Statements included in management's discussion and analysis include non-GAAP financial measures and should be read along with the accompanying tables, which provide a reconciliation of non-GAAP financial measures to GAAP financial measures. The Company's management uses these non-GAAP financial measures and believes that non-GAAP financial measures provide additional useful information that allows readers to evaluate the ongoing performance of the Company. Non-GAAP financial measures should not be considered as an alternative to any measure of performance or financial condition as promulgated under GAAP, and investors should consider the Company's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company. Non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the results or financial condition as reported under GAAP. See Non-GAAP reconciliation schedules that immediately follow:

THE COMMUNITY FINANCIAL CORPORATION
RECONCILIATION OF NON-GAAP MEASURES

Reconciliation of US GAAP total assets, common equity, common equity to assets and book value to Non-GAAP tangible assets, tangible common equity, tangible common equity to tangible assets and tangible book value.

The Company's management discussion and analysis contains financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. This financial information includes certain performance measures, which exclude intangible assets. These non-GAAP measures are included because the Company believes they may provide useful supplemental information for evaluating the underlying performance trends of the Company.

(dollars in thousands, except per share amounts)	December 31, 2019	December 31, 2018
Total assets	$ 1,797,536	$ 1,689,227
Less: intangible assets		
Goodwill	10,835	10,835
Core deposit intangible	2,118	2,806
Total intangible assets	12,953	13,641
Tangible assets	$ 1,784,583	$ 1,675,586
Total common equity	$ 181,494	$ 154,482
Less: intangible assets	12,953	13,641
Tangible common equity	$ 168,541	$ 140,841
Common shares outstanding at end of period	5,900,249	5,577,559
GAAP common equity to assets	10.10%	9.15%
Non-GAAP tangible common equity to tangible assets	9.44%	8.41%
GAAP common book value per share	$ 30.76	$ 27.70
Non-GAAP tangible common book value per share	$ 28.57	$ 25.25

THE COMMUNITY FINANCIAL CORPORATION
RECONCILIATION OF GAAP AND NON-GAAP MEASURES

Reconciliation of US GAAP Net Income, Earnings Per Share (EPS), Return on Average Assets (ROAA) and Return on Average Common Equity (ROACE) to Non-GAAP Operating Net Income, EPS, ROAA and ROACE

The Company's management discussion and analysis contains financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. This financial information includes certain operating performance measures, which exclude merger and acquisition costs and the additional income tax expense from the revaluation of deferred tax assets as a result of the reduction in the corporate income tax rate under the enacted Tax Cuts and Jobs Act of 2017, that are not considered part of recurring operations. These expenses are excluded to derive "operating net income", "operating earnings per share", "operating return on average assets", and "operating return on average common equity". These non-GAAP measures are included because the Company believes they may provide useful supplemental information for evaluating the underlying performance trends of the Company.

	Years Ended December 31,		
(dollars in thousands, except per share amounts)	2019	2018	2017
Net income (as reported)	$ 15,272	$ 11,228	$ 7,208
Impact of Tax Cuts and Jobs Act	—	—	2,740
Merger and acquisition costs (net of tax)	—	2,693	724
Non-GAAP operating net income	$ 15,272	$ 13,921	$ 10,672
Income before income taxes (as reported)	$ 15,272	$ 15,401	$ 16,365
Merger and acquisition costs ("M&A")	—	3,625	829
Adjusted pretax income	15,272	19,026	17,194
Adjusted income tax expense	—	5,105	6,522
Non-GAAP operating net income	$ 15,272	$ 13,921	$ 10,672
GAAP diluted earnings per share ("EPS")	$ 2.75	$ 2.02	$ 1.56
Non-GAAP operating diluted EPS before M&A	$ 2.75	$ 2.51	$ 2.31
GAAP return on average assets ("ROAA')	0.88%	0.70%	0.52%
Non-GAAP operating ROAA before M&A	0.88%	0.87%	0.78%
GAAP return on average common equity ("ROACE")	9.32%	7.53%	6.55%
Non-GAAP operating ROACE before M&A	9.32%	9.34%	9.70%
Net income (as reported)	$ 15,272	$ 11,228	$ 7,208
Weighted average common shares outstanding	5,560,588	5,550,510	4,629,228
Average assets	$ 1,743,448	$ 1,603,393	$ 1,376,983
Average equity	163,936	149,128	109,979

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties and could potentially result in materially different results under different assumptions and conditions. The Company considers its determination of the allowance for loan losses, the valuation of foreclosed real estate (OREO) and the valuation of deferred tax assets to be critical accounting policies.

The Company's Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and the general practices of the United States banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements. Accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When these sources are not available, management makes estimates based upon what it considers to be the best available information.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that exist in the loan portfolio. The allowance is based on two principles of accounting: (1) FASB ASC Topic 450 "Contingencies," which requires that losses be accrued when they are probable of occurring and are estimable and (2) FASB ASC 310 "Receivables," which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, is determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows and values observable in the secondary markets.

The allowance for loan losses balance is an estimate based upon management's evaluation of the loan portfolio. The allowance includes a specific and a general component. The specific component consists of management's evaluation of impaired loans. Impairment is measured on a loan-by-loan basis using one of three acceptable methods: 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. Management assesses the ability of the borrower to repay the loan based upon all information available. Loans are examined to determine a specific allowance based upon the borrower's payment history, economic conditions specific to the loan or borrower and other factors that would impact the borrower's ability to repay the loan on its contractual basis. Depending on the assessment of the borrower's ability to pay and the type, condition and value of collateral, management will establish an allowance amount specific to the loan.

Management uses a risk scale to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are risk rated. Residential first mortgages, home equity and second mortgages and consumer loans are monitored on an ongoing basis based on borrower payment history. Consumer loans and residential real estate loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned or higher risk rating due to a delinquent payment history.

The Company's commercial loan portfolio is periodically reviewed by regulators and independent consultants engaged by management.

In establishing the general component of the allowance, management analyzes non-impaired loans in the portfolio including changes in the amount and type of loans. This analysis reviews trends by portfolio segment in charge-offs, delinquency, classified loans, loan concentrations and the rate of portfolio segment growth. Qualitative factors also include an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends. Based upon this analysis a loss factor is applied to each loan category and the Bank adjusts the loan loss allowance by increasing or decreasing the provision for loan losses.

Management has significant discretion in making the judgments inherent in the determination of the allowance for loan losses, including the valuation of collateral, assessing a borrower's prospects of repayment and in establishing loss factors on the general component of the allowance. Changes in loss factors have a direct impact on the amount of the provision and on net income. Errors in management's assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio and may result in additional provisions.

For additional information regarding the allowance for loan losses, refer to Notes 1 and 3 of the Consolidated Financial Statements and the discussion in this MD&A.

Other Real Estate Owned ("OREO")

The Company maintains a valuation allowance on its other real estate owned. As with the allowance for loan losses, the valuation allowance on OREO is based on FASB ASC 450 "Contingencies," as well as the accounting guidance on impairment of long-lived assets. These statements require the Company to establish a valuation allowance when it has determined that the carrying amount of a foreclosed asset exceeds its fair value. Fair value of a foreclosed asset is measured by the cash flows expected to be realized from its subsequent disposition. These cash flows include the costs of selling or otherwise disposing of the asset.

In estimating the fair value of OREO, management must make significant assumptions regarding the timing and amount of cash flows. For example, in cases where the real estate acquired is undeveloped land, management must gather the best available evidence regarding the market value of the property, including appraisals, cost estimates of development and broker opinions. Due to the highly subjective nature of this evidence, as well as the limited market, long time periods involved and substantial risks, cash flow estimates are highly subjective and subject to change. Errors regarding any aspect of the costs or proceeds of developing, selling or otherwise disposing of foreclosed real estate could result in the allowance being inadequate to reduce carrying costs to fair value and may require an additional provision for valuation allowances.

For additional information regarding OREO, refer to Notes 1 and 6 of the Consolidated Financial Statements.

Deferred Tax Assets

The Company accounts for income taxes in accordance with FASB ASC 740, "Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FASB ASC 740 requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

Management periodically evaluates the ability of the Company to realize the value of its deferred tax assets. If management were to determine that it would not be more likely than not that the Company would realize the full amount of the deferred tax assets, it would establish a valuation allowance to reduce the carrying value of the deferred tax asset to the amount it believes would be realized. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax-planning strategies that could be implemented to realize the net deferred tax assets.

Failure to achieve forecasted taxable income might affect the ultimate realization of the net deferred tax assets. Factors that may affect the Company's ability to achieve sufficient forecasted taxable income include, but are not limited to, the following: increased competition, a decline in net interest margin, a loss of market share, decreased demand for financial services and national and regional economic conditions.

The Company's provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of management judgment and are based on the best information available at the time. The Company operates within federal and state taxing jurisdictions and is subject to audit in these jurisdictions.

For additional information regarding income taxes and deferred tax assets, refer to Notes 1 and 14 of the Consolidated Financial Statements.

COMPARISON OF RESULTS OF OPERATIONS

A comparison of the results of operations for the years ended December 31, 2019, December 31, 2018 and December 31, 2017 is presented below.

Summary Financial Results

Years ended December 31, 2019 and December 31, 2018

During the year ended December 31, 2019, the Bank stabilized net interest margin, controlled expenses, organically grew loans and improved credit quality. The second half of 2019 was highlighted with a stable net interest margin due mainly to a slightly liability sensitive balance sheet and management's focus on improving the Bank's funding mix. Net interest margin declines were only four basis points from 3.33% in the second quarter of 2019 to 3.29% in the fourth quarter of 2019.

The Company successfully integrated the 2018 County First acquisition into its existing franchise. In 2019, the Company returned to trend organic loan growth between 6%-8%. We believe current market disruptions caused by industry consolidation will provide opportunities for continued organic growth in 2020.

Net income for the year ended December 31, 2019 was $15.3 million or $2.75 per diluted share compared to net income of $11.2 million or $2.02 per diluted share for the year ended December 31, 2018. The year ended December 31, 2018 included merger and acquisition costs net of tax of $2.7 million ($3.6 million pre-tax expense). Merger and acquisition costs did not impact earnings per share in 2019. Merger and acquisition costs resulted in a reduction to 2018 earnings per share of approximately $0.49. The Company’s ROAA and ROACE were 0.88% and 9.32% in the year ended December 31, 2019 compared to 0.70% and 7.53% in the year ended December 31, 2018.

Increased earnings in 2019 were the result of improving the funding composition of the Bank’s interest-bearing liabilities, controlling operating costs, and organic loan growth partially offset by decreasing margin. The $4.0 million increase to net income in 2019 compared to 2018 included increased net interest income and noninterest income of $2.6 million and $1.7 million, respectively, and a decrease in noninterest expense of $1.9 million. These additions to net income were partially offset by an increased loan loss provision of $725,000 for the comparable periods. The improvements to pre-tax income resulted in increased income tax expense of $1.5 million for 2019 compared to 2018.

Income before taxes (pretax net income) increased $5.5 million or 35.9% to $20.9 million for the year ended December 31, 2019 compared to $15.4 million for the year ended December 31, 2018. The Company’s pretax returns on average assets and common stockholders’ equity for 2019 were 1.20% and 12.77%, respectively, compared to 0.96% and 10.33%, respectively, for 2018.

The Company’s efficiency ratio decreased from 69.42% for the year ended December 31, 2018 to 61.10% for the year ended December 31, 2019, primarily as a result of increased efficiencies from the County First acquisition and updates to the Bank's technology platforms which have allowed the Company to slow the growth of expenses as the asset size of the Bank has increased. In addition, noninterest income increased as a percentage of average assets due to increases in fee income and service charge income. Management believes it is important to continue the focus on creating additional operating leverage in the present low interest rate environment.

The following were balance sheet financial highlights for 2019:

- On December 31, 2019, the Company issued a total of 312,747 shares of its common stock, par value $0.01 in a private placement offering. The Company received net proceeds of $10.6 million after deal expenses. On February 15, 2020, the Company used the proceeds and a cash dividend from the Bank to redeem the Company’s outstanding $23.0 million of 6.25% fixed-to-floating rate subordinated notes. The redemption of the $23.0 million in subordinated notes in February 2020 will reduce interest expense by $1.4 million on an annualized basis and be accretive to earnings. The annualized positive impact on net interest margin is estimated to be between eight and nine basis points.
- In the fourth quarter of 2019, the Company reclassified all HTM investments as AFS. The Company no longer intends to hold HTM investments. Management’s decision should improve interest rate risk management opportunities and increase available on-balance sheet liquidity. In addition, at the Bank’s current asset size, regulatory capital ratios will not be impacted as accumulated other comprehensive income (“AOCI”) is excluded.

- Gross loans increased 8.0% or $107.3 million from $1,346.9 million at December 31, 2018 to $1,454.2 million at December 31, 2019. Overall loan growth for 2019 was as expected and based on management's evaluation of loan opportunities in light of marginal and total funding costs.

- Total deposits increased $82.2 million or 5.8% to $1,511.8 million at December 31, 2019, which included an increase in transaction accounts of $135.1 million and a decrease in time deposits of $52.9 million. Transaction deposit accounts increased to 73.9% of deposits at December 31, 2019 from 68.7% at December 31, 2018.

- Wholesale funding includes brokered deposits and Federal Home Loan Bank ("FHLB") advances. Wholesale funding decreased $62.2 million or 57.3% to $46.4 million at December 31, 2019 from $108.5 million at December 31, 2018 primarily due to the Bank's increased liquidity from deposit growth. As a percentage of assets, wholesale funding decreased to 2.58% at December 31, 2019 from 6.43% at December 31, 2018.

- Liquidity was stable in 2019 as the increase in transaction deposits were partially offset by a reduction in time deposits. The decrease in wholesale funding increased available off-balance sheet lines of credit. The Company's net loan to deposit ratio has decreased from 103.1% at December 31, 2017 to 93.5% at December 31, 2018 and 95.6% at December 31, 2019. The Company used available on-balance sheet liquidity during 2018 and 2019 to fund loans, increase investments and pay down wholesale funding. Increased liquidity provides more opportunities to lower our funding costs over time.

- Classified assets as a percentage of assets improved in 2019, decreasing 49 basis points from 2.42% at December 31, 2018 to 1.93% at December 31, 2019.

- Non-accrual loans, OREO and TDRs to total assets decreased 56 basis points from 2.02% at December 31, 2018 to 1.46% at December 31, 2019.

Years ended December 31, 2018 and December 31, 2017

Net income for the year ended December 31, 2018 was $11.2 million or $2.02 per diluted share compared to net income of $7.2 million or $1.56 per diluted share for the year ended December 31, 2017. The annual results included merger and acquisition costs net of tax of $2.7 million and $724,000 for the comparative periods. Additionally, the year ended December 31, 2017 results included $2.7 million in additional income tax expense from the revaluation of deferred tax assets because of the reduction in the corporate income tax rates under the Tax Cuts and Jobs Act of 2017. The impact of merger and acquisition costs for the comparative years and the adjustments to deferred tax assets in 2017 resulted in a reduction to earnings per share of $0.49 for the year ended December 31, 2018 and $0.75 for the year ended December 31, 2017. The Company's ROAA and ROACE were 0.70% and 7.53% in the year ended December 31, 2018 compared to 0.52% and 6.55% in the year ended December 31, 2017.

Net income for 2018 compared to 2017 increased due to additional net interest income from a larger balance sheet, a lower 2018 effective tax rate as well as the impact in 2017 of the $2.7 million in additional income tax expense from the revaluation of deferred tax assets partially offset by higher noninterest expenses and loan loss provisions. Earnings improved beginning in the second half of 2018 with the improved funding composition of the Bank's interest-bearing liabilities from the acquisition of County First as well as organic deposit growth; controlled operating costs; and, moderate organic loan growth. A normalized expense run rate and the anticipated cost savings from the acquisition began to be realized during the second half of 2018.

Income before taxes (pretax net income) decreased $964,000 or 5.9% to $15.4 million for the year ended December 31, 2018 compared to $16.4 million for the year ended December 31, 2017. The Company's pretax returns on average assets and common stockholders' equity for 2017 were 0.96% and 10.33%, respectively, compared to 1.19% and 14.88%, respectively, for 2017. The decrease in pretax income included increases in noninterest expense of $8.1 million and the provision for loan losses of $395,000 partially offset increases in net interest income of $7.5 million.

In 2018, pretax net income was lower than 2017 due to merger and acquisition costs as well as duplicative expenses related to integrating County First operation. The Company's profitability increased in the second half of 2018 with efficiencies realized from the successful execution of the County First acquisition. Earnings per share increased $0.75 from $0.64 for the six months ended June 30, 2018 to $1.39 for the six months ended December 31, 2018. ROAA and ROACE increased from 0.45% and 4.84% for the six months ended June 30, 2018 to 0.94% and 10.15% for the six months ended December 31, 2018.

The Company's efficiency ratio increased from 63.37% for the year ended December 31, 2017 to 69.42%, primarily as a result of merger expenses and duplicative costs related to the County First Bank acquisition in the first six months of 2018. The efficiency ratio improved in the second half of 2018 from 78.64% for the six months ended June 30, 2018 to 60.36% for the six months ended December 31, 2018. The Company has pursued a strategy of increasing operating leverage over the last several years. This occurs when the Company increases its assets, and by extension its net interest income, while limiting increases in noninterest expense. In order for this to be effective, the Company must simultaneously pursue the following; increase the asset size while maintaining asset quality, increase funding at an economically viable cost, and control noninterest expense growth.

The first half of 2018 included $3.6 million in merger-related costs, which included termination costs of County First's core processing contract as well as investment banking fees, legal fees and the costs of employee agreements and severance for terminations. The total merger-related costs were not significant in the third and fourth quarters of 2018. In addition, the Company continued to carry a small amount of additional noninterest expense in the second half of 2018 related to duplicate vendors and processes that were discontinued. The increase in noninterest expense was partially offset by an increase in net interest income realized from the integrated operations of County First and from a lower effective tax rate.

The following were balance sheet financial highlights for 2018:

- Gross loans increased 17.1% or $196.9 million from $1,150.0 million at December 31, 2017 to $1,346.9 million at December 31, 2018, due to the County First acquisition and $90.0 million or 7.8% growth in the Company's legacy portfolios.
- Transaction accounts increased $328.0 million, or 50.1% to $982.6 million at December 31, 2018 from $654.6 million at December 31, 2018. Transaction deposit accounts increased to 68.7% of deposits at December 31, 2018 from 59.2% of deposits at December 31, 2017. The County First transaction accounted for approximately $168 million of the $328 million increase in transaction deposits.
- Total deposits increased $323.4 million to $1,429.6 million in 2018, which included an increase in transaction accounts of $328.0 million and a decrease in time deposits of $4.6 million.
- Wholesale funding decreased $153.4 million or 59% to $108.5 million at December 31, 2018 from $261.9 million at December 31, 2017. Wholesale funding decreased in 2018, primarily due to the Bank's increased liquidity from deposit acquisition. Wholesale funding as a percentage of assets decreased to 6.43% at December 31, 2018 from 18.63% at December 31, 2017.
- Liquidity improved with the increase in transaction deposits and decrease in wholesale funding. The Company's net loan to deposit ratio has decreased from 103.1% at December 31, 2017 to 93.5% at December 31, 2018. The Company used available on-balance sheet liquidity during 2018 to fund loans, increase investments and pay down wholesale funding.
- Classified assets as a percentage of assets improved in 2018, decreased 116 basis points from 3.58% at December 31, 2017 to 2.42% at December 31, 2018.
- Non-accrual loans, OREO and TDRs to total assets increased 31 basis points to 2.02% at December 31, 2018 from 1.71% at December 31, 2017.

Net Interest Income

The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.

Average Balances and Yields for the years ended December 31, 2019, December 31, 2018 and 2017:

The following tables set forth average balances, average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect thereof was not material. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances and have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense. There was $864,000 and $742,000 of accretion interest during the years ended December 31, 2019 and 2018, respectively.

	For the Years Ended December 31,								
	2019			2018			2017		
(dollars in thousands)	Average Balance	Interest	Avg. Yield/Cost	Average Balance	Interest	Avg. Yield/Cost	Average Balance	Interest	Avg. Yield/Cost
Assets									
Commercial real estate	912,954	43,016	4.71%	833,355	38,417	4.61%	699,349	30,897	4.42%
Residential first mortgages	159,702	5,840	3.66%	162,505	6,004	3.69%	176,186	6,636	3.77%
Residential rentals	121,912	6,186	5.07%	126,491	6,215	4.91%	106,000	4,897	4.62%
Construction and land development	32,590	1,897	5.82%	28,489	1,583	5.56%	33,798	1,677	4.96%
Home equity and second mortgages	36,330	2,066	5.69%	37,862	1992	5.26%	21,515	943	4.38%
Commercial and equipment loans	118,399	6,538	5.52%	103,537	5,490	5.30%	86,871	4,524	5.21%
Consumer loans	920	59	6.41%	798	54	6.77%	477	37	7.76%
Allowance for loan losses	(11,170)	—	—%	(10,745)	—	—%	(10,374)	—	—%
Loan portfolio	1,371,637	65,602	4.78%	1,282,292	59,755	4.66%	1,113,822	49,611	4.45%
Taxable investment securities	227,693	6,576	2.89%	190,998	5,153	2.70%	171,465	3,906	2.28%
Interest-bearing deposits in other banks	8,719	112	1.28%	6,741	182	2.70%	3,395	49	1.44%
Federal funds sold	7,577	163	2.15%	3,621	83	2.29%	167	4	2.40%
Interest-Earning Assets ("IEAs")	1,615,626	72,453	4.48%	1,483,652	65,173	4.39%	1,288,849	53,570	4.16%
Cash and cash equivalents	23,044			23,579			15,012		
Goodwill	10,835			10,439			—		
Core deposit intangible	2,479			3,209			—		
Other assets	91,464			82,514			73,122		
Total Assets	**1,743,448**			**1,603,393**			**1,376,983**		

Average Balances and Yields for the years ended December 31, 2019, December 31, 2018 and 2017: (Continued)

	For the Years Ended December 31,								
	2019			2018			2017		
(dollars in thousands)	Average Balance	Interest	Avg. Yield/Cost	Average Balance	Interest	Avg. Yield/Cost	Average Balance	Interest	Avg. Yield/Cost
Liabilities and Stockholders' Equity									
Noninterest-bearing demand deposits	226,964	—	—%	217,897	—	—%	154,225	—	—%
Interest-bearing deposits									
Savings	70,130	70	0.10%	73,268	62	0.08%	53,560	27	0.05%
Interest-bearing demand and money market accounts	710,709	6,771	0.95%	584,341	4,020	0.69%	419,817	1,481	0.35%
Certificates of deposit	448,924	8,537	1.90%	452,494	6,600	1.46%	443,181	4,438	1.00%
Total interest-bearing deposits	1,229,763	15,378	1.25%	1,110,103	10,682	0.96%	916,558	5,946	0.65%
Total Deposits	1,456,727	15,378	1.06%	1,328,000	10,682	0.80%	1,070,783	5,946	0.56%
Long-term debt	32,702	743	2.27%	35,684	853	2.39%	58,704	1,313	2.24%
Short-term borrowings	30,965	774	2.50%	42,286	767	1.81%	91,797	1057	1.15%
Subordinated Notes	23,000	1,438	6.25%	23,000	1,438	6.25%	23,000	1,438	6.25%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	586	4.88%	12,000	546	4.55%	12,000	428	3.57%
Total Debt	98,667	3,541	3.59%	112,970	3,604	3.19%	185,501	4,236	2.28%
Interest-Bearing Liabilities ("IBLs")	1,328,430	18,919	1.42%	1,223,073	14,286	1.17%	1,102,059	10,182	0.92%
Total funds	1,555,394	18,919	1.22%	1,440,970	14,286	0.99%	1,256,284	10,182	0.81%
Other liabilities	24,118			13,295			10,720		
Stockholders' equity	163,936			149,128			109,979		
Total Liabilities and Stockholders' Equity	**1,743,448**			**1,603,393**			**1,376,983**		
Net interest income		53,534			50,887			43,388	
Interest rate spread			3.06%			3.22%			3.24%
Net yield on interest-earning assets			3.31%			3.43%			3.37%
Avg. loans to avg. deposits			94.16%			96.56%			104.02%
Avg. transaction deposits to total avg. deposits **			69.18%			65.93%			58.61%
Ratio of average IEAs to average IBLs			121.62%			121.31%			116.95%

** Transaction deposits exclude time deposits.

The tables below summarize changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

Years Ended December 31, 2019 and December 31, 2018

(dollars in thousands)	Volume	Due to Rate	Total
Interest income:			
Loan portfolio	$ 4,273	$ 1,574	$ 5,847
Investment securities, federal funds sold and interest-bearing deposits	1,197	236	1,433
Total interest-earning assets	$ 5,470	$ 1,810	$ 7,280
Interest-bearing liabilities:			
Savings	(3)	11	8
Interest-bearing demand and money market accounts	1,204	1,547	2,751
Certificates of deposit	(68)	2,005	1,937
Long-term debt	(68)	(42)	(110)
Short-term borrowings	(283)	290	7
Subordinated notes	—	—	—
Guaranteed preferred beneficial interest in junior subordinated debentures	—	40	40
Total interest-bearing liabilities	$ 782	$ 3,851	$ 4,633
Net change in net interest income	$ 4,688	$ (2,041)	$ 2,647

Years Ended December 31, 2018 and December 31, 2017

(dollars in thousands)	Volume	Due to Rate	Total
Interest income:			
Loan portfolio	$ 7,851	$ 2,293	$ 10,144
Investment securities, federal funds sold and interest-bearing deposits	709	750	1,459
Total interest-earning assets	$ 8,560	$ 3,043	$ 11,603
Interest-bearing liabilities:			
Savings	17	18	35
Interest-bearing demand and money market accounts	1,132	1,407	2,539
Certificates of deposit	136	2,026	2,162
Long-term debt	(550)	90	(460)
Short-term borrowings	(898)	608	(290)
Subordinated notes	—	—	—
Guaranteed preferred beneficial interest in junior subordinated debentures	—	118	118
Total interest-bearing liabilities	$ (163)	$ 4,267	$ 4,104
Net change in net interest income	$ 8,723	$ (1,224)	$ 7,499

Years ended December 31, 2019 and 2018

Net interest income totaled $53.5 million for the year ended December 31, 2019, which represents a $2.6 million, or 5.2% increase from $50.9 million for the year ended December 31, 2018. Net interest income increased during 2019 compared to the prior year as the positive impacts of average interest-earning asset growth and increased loans and investment yields outpaced the negative impacts of increasing funding costs and growth in the average balances of interest-bearing liabilities. Although there was some net interest margin compression in 2019, margin compression slowed in the second half of 2019.

Average total earning assets increased $132.0 million, or 8.9%, for the year ended December 31, 2019 to $1,615.6 million compared to $1,483.7 million for the year ended December 31, 2018. The increase in average total earning assets for the year ended December 31, 2019 compared to fiscal year 2018, resulted primarily from a $89.3 million, or 7.0% increase in average loans as a result of organic growth and a $42.6 million, or 21.2%, increase in average investments. Interest income increased $7.3 million for the year ended December 31, 2019 compared to the same period of 2018. The increase in interest income resulted from larger average balances of interest-earning assets contributing $5.5 million and higher interest yields accounting for $1.8 million.

Average total interest-bearing liabilities increased $105.4 million, or 8.6%, for the year ended December 31, 2019 to $1,328.4 million compared to $1,223.1 million for the year ended December 31, 2018. During the same timeframe, average noninterest-bearing demand deposits increased $9.1 million, or 4.2%, to $227.0 million compared to $217.9 million. Interest expense increased $4.6 million for the year ended December 31, 2019 compared to the same period of 2018. Interest expense increased $3.9 million due to higher interest rates and $782,000 from both increased average balances and a change in the composition of funding. For the comparative periods, average short-term borrowings and long-term debt decreased $14.3 million and was replaced with increases to average transaction accounts, which include savings, demand and money market, and noninterest-bearing accounts. During the year ended December 31, 2019, average transaction accounts increased $132.3 million or 15.1% to $1,007.8 million from $875.5 million for the year ended December 31, 2018. During the same timeframe average time deposits decreased $3.6 million or 0.8%, to $448.9 million for the year ended December 31, 2019.

The increase in transaction accounts due to organic transaction deposit growth during 2019 helped control the increase in deposit costs, minimized deposit betas and positively impacted net interest margin. Wholesale funding decreased from $108.5 million or 6.4% of assets at December 31, 2018 to $46.4 million or 2.6% of assets at December 31, 2019. The pay down of wholesale funding also positively impacted margins. Brokered deposits and FHLB advances were paid down and replaced with retail deposits. Retail deposits, which include all deposits except brokered deposits, increased $134.3 million or 9.8% from $1,376.5 million at December 31, 2018 to $1,510.8 million at December 31, 2019.

Net interest margin of 3.31% for the year ended December 31, 2019, was 12 basis points lower than the 3.43% for the year ended December 31, 2018. Margin compression slowed during the second half of 2019. The Bank's liability-sensitivity was positively impacted by FOMC rate cuts. In addition, the continued improvement in the Bank's funding mix, replacing wholesale funding and time deposits in favor of transaction accounts helped stabilize margins. Net interest margin decreased six basis points from 3.35% for the three months ended December 31, 2018 to 3.29% for the three months ended December 31, 2019. There was a small decrease in net interest margin of four basis points from 3.33% in the third quarter of 2019 to 3.29% for the three months ended December 31, 2019.

Interest earning asset yields increased nine basis points from 4.39% for the year ended December 31, 2018 to 4.48% for the year ended December 31, 2019. Interest income in 2019 and 2018 was impacted from $864,000 and $742,000, respectively, of interest income accretion. If the impacts of accretion interest were excluded, net interest margin for the years ended December 31, 2019 and 2018 would have reduced five basis points for the comparable periods to 3.26% and 3.38%, respectively. The Company's cost of funds increased 23 basis points from 0.99% for the year ended December 31, 2018 to 1.22% for the year ended December 31, 2019. Funding costs increased at a slower rate as the percentage of funding coming from transaction accounts increased from 60.8% for the year ended December 31, 2018 to 64.8% for the year ended December 31, 2019.

Wholesale and time-based funding rates are typically more sensitive to changing interest rates than transactional deposits. Compared to the year ended December 31, 2018, average interest rates on certificates of deposits in 2019 increased by 44 basis points in the year ended December 31, 2019 to 1.90%. During the comparable periods, interest-bearing transactional deposits increased by 26 basis points from 0.62% for the year ended December 31, 2018 to 0.88% for the year ended December 31, 2019. The increase in average interest rates on CDs and on interest bearing transactional accounts was primarily due to increases in the federal funds target rate. The Company's increases in transaction deposits during the last twenty-four months have eased downward pressure on net interest margin. The ability to increase transaction deposits faster than wholesale and time-deposit funding mitigated net interest margin compression during 2019.

Interest rates decreased in 2019 despite most economists third quarter 2018 forecasts predicting three to four rate hikes by the end of 2019. The opposite occurred in 2019 and as rates decreased the rate curve flattened and even inverted for a period of time. The FOMC increased the Fed Funds rate to 2.50% in December 2018 and instead of additional rate increases decreased rates three times during 2019 between July 31, 2019 and October 30, 2019 to the current rate of 1.75%. The below table illustrates how the Company's average rates responded during the five quarters ending December 31, 2019 and provides a summary of the Company's stable margins throughout 2019:

	Three Months Ended				
	December 31, 2019	**September 30, 2019**	**June 30, 2019**	**March 31, 2019**	**December 31, 2018**
Interest rate spread	3.05%	3.07%	3.06%	3.05%	3.11%
Net interest margin	3.29%	3.33%	3.33%	3.31%	3.35%
Loan Yields	4.70%	4.80%	4.83%	4.80%	4.72%
Cost of funds	1.14%	1.21%	1.27%	1.25%	1.14%
Cost of deposits	1.00%	1.05%	1.10%	1.07%	0.99%

Years ended December 31, 2018 and 2017

Net interest income totaled $50.9 million for the year ended December 31, 2018, which represents a $7.5 million, or 17.3%, increase from $43.4 million for the year ended December 31, 2017. Net interest income increased during 2018 compared to the prior year as the positive impacts of average interest-earning asset growth and increased loans and investment yields outpaced the negative impacts of increasing funding costs and growth in the average balances of interest-bearing liabilities. The Company has controlled the rising cost of funding over the last 24 months with cumulative deposit and funding betas[1] between December 31, 2016-2018 of less than 30%.

Average total earning assets increased $194.9 million, or 15.1%, for the year ended December 31, 2018 to $1,483.7 million compared to $1,288.8 million for the year ended December 31, 2017. The increase in average total earning assets for the year ended December 31, 2018 from the comparable period in 2017, resulted primarily from a $168.5 million, or 15.1%, increase in average loans as a result of organic growth and the acquisition of County First and a $26.3 million, or 15.1%, increase in average investments. Interest income increased $11.6 million for the year ended December 31, 2018 compared to the same period of 2017. The increase in interest income resulted from larger average balances of interest-earning assets contributing $8.6 million and higher interest yields accounting for $3.0 million.

Average total interest-bearing liabilities increased $121.0 million, or 11.0%, for the year ended December 31, 2018 to $1,223.1 million compared to $1,102.1 million for the year ended December 31, 2017. During the same timeframe, average noninterest-bearing demand deposits increased $63.7 million, or 41.3%, to $217.9 million compared to $154.2 million. Interest expense increased $4.1 million for the year ended December 31, 2018 compared to the same period of 2017. The increase in interest expense resulted from higher interest rates accounting for $4.3 million. Funding costs from a change in the composition of funding liabilities resulted in a small decrease of $163,000 to interest expense. For the comparative periods, average short-term borrowings and long-term debt decreased $72.5 million and was replaced with increases to average transaction accounts, which include savings, demand and money market, and noninterest-bearing accounts. During the year ended December 31, 2018, average transaction accounts increased $247.9 million or 39.5% to $875.5 million from $627.6 million for the year ended December 31, 2017. During the same timeframe average time deposits increased slightly, $9.3 million or 2.1%, to $452.5 million for the year ended December 31, 2018.

The increase in transaction accounts with the acquisition of County First, as well as organic transaction deposit growth during 2018 helped control the increase in deposit costs, minimized deposit betas and positively impacted net interest margin. The pay down of wholesale funding also positively impacted margins. Brokered deposits and FHLB advances were paid down $153.4 million in 2018 and replaced with retail deposits. Retail deposits, which include all deposits except brokered deposits, increased $389.3 million or 39.4% from $987.2 million at December 31, 2017 to $1,376.5 million at December 31, 2018.

Reciprocal deposits are included in retail transaction deposits and are used to maximize FDIC insurance available to our customers. Reciprocal deposits increased $142.0 million or 152.9% to $234.9 million at December 31, 2018 compared to $92.9 million at December 31, 2017. During 2018, the increase in reciprocal deposits were at lower funding costs than wholesale funding and in-market time deposits.

Net interest margin of 3.43% for the year ended December 31, 2018, was six basis points higher than the 3.37% for the year ended December 31, 2017. The stability of the Bank's margin was primarily due to the acquisition of lower cost County First transaction deposits as well as the acquisition of additional transaction deposits which changed the overall funding mix of the Bank's interest-bearing liabilities.

Interest earning asset yields increased 23 basis points from 4.16% for the year ended December 31, 2017 to 4.39% for the year ended December 31, 2018. Interest income in 2018 was impacted from $742,000 of interest income accretion due to the recognition of the acquired performing fair value mark related to County First as well as the addition of higher yielding loans from the County First acquisition. If the impacts of accretion interest were excluded, net interest margin for 2018 would have reduced five basis points to 3.38%. The Company's cost of funds increased 18 basis points from 0.81% for the year ended December 31, 2017 to 0.99% for the year ended December 31, 2018. Funding costs were positively impacted as the percentage of funding coming from noninterest-bearing deposits increased from 12.1% for the year ended December 31, 2017 to 15.2% for the year ended December 31, 2018.

Wholesale and time-based funding rates are typically more sensitive to rising interest rates than transactional deposits. Compared to the year ended December 31, 2017, average interest rates on certificates of deposits in 2018 increased by 46 basis points in the year ended December 31, 2018 to 1.46%. During the same comparable periods, interest-bearing transactional deposits increased by 30 basis points from 0.32% for the year ended December 31, 2017 to 0.62% for the year ended December 31, 2018. The increase in average interest rates on CDs and on interest bearing transactional accounts was primarily due to increases in the federal funds target rate. The Company's increases in transaction deposits during the last twelve months have decreased downward pressure on net interest margin. The ability to increase transaction deposits faster than wholesale funding mitigated net interest margin compression in the rising rate environment of 2018.

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

	Years Ended December 31,		
(dollars in thousands)	**2019**	**2018**	**2017**
Provision for loan losses	$ 2,130	$ 1,405	$ 1,010

The provision for loan losses increased $725,000 to $2.1 million for the year ended December 31, 2019 compared to $1.4 million for the year ended December 31, 2018. Net charge-offs increased $1.2 million from $944,000 or 0.07% of average loans for the year ended December 31, 2018 to $2.2 million or 0.16% of average loans for the year ended December 31, 2019. The increase in the loan loss provision during 2019 was mostly attributable to growth in the loan portfolios in 2019. The total increase in the provision would have been greater if not for improvements in historical loss rates and a reduction in specific loan loss allocations. The non-acquired loan portfolio increased $137.1 million or 11.1% for the year ended December 31, 2019 compared to $90.0 million or 7.8% for the year ended December 31, 2018. Improvements to historical charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as delinquency and classified assets, were partially offset by increases in other qualitative factors, such as concentration to capital factors and portfolio growth.

The provision for loan losses decreased $395,000 to $1.4 million for the year ended December 31, 2018 compared to $1.0 million for the year ended December 31, 2017. Net charge-offs increased $589,000 from $355,000 or 0.03% of average loans for the year ended December 31, 2017 to $944,000 or 0.07% of average loans for the year ended December 31, 2018. Moderate organic loan growth of 7.8%, charge-offs of 0.07% of average loans and continued improvement in charge-off factors and certain qualitative factors kept the provisioning in line with the year ended December 31, 2017.

See further discussion of the provision under the Asset Quality section in the Comparison of Financial Condition section of MD&A.

Noninterest Income

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Years Ended December 31, 2019	2018	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 335	$ 183	$ 152	83.1 %
Gain on sale of assets	—	1	(1)	(100.0)%
Net gains on sale of investment securities	226	—	226	n/a
Unrealized gain (loss) on equity securities	134	(81)	215	(265.4)%
Loss on premises and equipment held for sale	(1)	—	(1)	n/a
Income from bank owned life insurance	885	902	(17)	(1.9)%
Service charges	3,308	3,063	245	8.0 %
Referral fee income	879	—	879	n/a
Total Noninterest Income	$ 5,766	$ 4,068	$ 1,698	41.7 %

Noninterest income increased from 0.25% of average assets in 2018 to 0.33% of average assets in 2019. Noninterest income at $5.8 million in 2019 increased $1.7 million compared to 2018. The largest increase was due to an increase in interest rate protection referral fee income of $879,000 from a new product the Bank offered in 2019. During 2019, the Bank began referring customers to a third-party financial institution that offers interest rate protection for the length of a loan. The Company expects similar fee revenues in 2020 based on customer demand and the current interest rate environment.

During the year ended December 31, 2019, the Company recognized net gains of $226,000 on the sale of 20 AFS securities with aggregate carrying values of $31.6 million. There were no sales of securities during the year ended December 31, 2018. The importance of managing interest-rate risks has been heightened during the last two years due to the Bank's improved on-balance sheet liquidity and increased interest rate volatility from up and down rates and a flattened yield curve. Management believes that more active oversight of the investment portfolio will allows the Bank to take appropriate actions to defend interest-rate sensitivity in both rates up or down environments, and over time should lead to improved earnings of the Bank in a safe and sound manner.

Increased service charges of $245,000 were due to a larger customer base and the growth in organic deposits. In addition, the Bank revamped its retail deposit account product offerings in 2019 and focused on adding more consumer checking accounts during the second half of 2019. The Bank worked with its commercial customers to encourage their employees to Bank with us.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Years Ended December 31, 2018	2017	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 183	$ 157	$ 26	16.6 %
Gain on sale of assets	1	47	(46)	(97.9)%
Net gains on sale of investment securities	—	175	(175)	(100.0)%
Unrealized losses on equity securities	(81)	—	(81)	n/a
Income from bank owned life insurance	902	773	129	16.7 %
Service charges	3,063	2,595	468	18.0 %
Gain on sale of loans held for sale	—	294	(294)	(100.0)%
Total Noninterest Income	$ 4,068	$ 4,041	$ 27	0.7 %

Noninterest income was essentially flat at $4.1 million for the comparable periods. The small increase of $27,000 for the comparable periods included increased service charge and miscellaneous income of $494,000 due to a larger customer base with the acquisition of County First and the growth in organic deposits. In addition, Bank Owned Life Insurance acquired in the County First transaction of approximately $6.3 million increased non-interest income by $129,000 compared to the prior year comparable period. These increases to noninterest income were partially offset by decreases of $515,000 for gains on assets sold, loan sales and investment sales recognized in 2017. There were no investment or loan sales in 2018. In addition, unrealized losses on equity securities of $81,000 were recognized in 2018 to comply with a new accounting standard effective in the first quarter of 2018 that requires recognition of changes in the fair value flow through the Company's statement of income.

During the year ended December 31, 2017 the Company recognized net gains on the sale of securities of $175,000. The Company sold three AFS securities with aggregate carrying values of $3.7 million and nine HTM securities with aggregate carrying values of $4.8 million, recognizing gains of $9,000 and $166,000, respectively. The sale of HTM securities was permitted under ASC 320 "Investments - Debt and Equity Securities." ASC 320 permits the sale of HTM securities for certain changes in circumstances.

Noninterest Expense

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	2019	2018	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 20,445	$ 19,548	$ 897	4.6 %
OREO valuation allowance and expenses	963	657	306	46.6 %
Merger and acquisition costs	—	3,625	(3,625)	(100.0)%
Sub-total	21,408	23,830	(2,422)	(10.2)%
Operating Expenses				
Occupancy expense	3,101	3,116	(15)	(0.5)%
Advertising	762	671	91	13.6 %
Data processing expense	3,048	3,020	28	0.9 %
Professional fees	2,196	1,513	683	45.1 %
Depreciation of premises and equipment	685	810	(125)	(15.4)%
Telephone communications	203	277	(74)	(26.7)%
Office supplies	149	149	—	— %
FDIC insurance	334	654	(320)	(48.9)%
Core deposit intangible amortization	688	784	(96)	(12.2)%
Other	3,659	3,325	334	10.0 %
Total Operating Expenses	$ 14,825	$ 14,319	$ 506	3.5 %
Total Noninterest Expense	$ 36,233	$ 38,149	$ (1,916)	(5.0)%

Noninterest expense decreased $1.9 million or 5.0%, to $36.2 million in 2019 compared to $38.1 million in 2018, of which $3.6 million of the variance was due to merger and acquisition costs incurred during 2018. The Company's 2019 expense run rate has been positively impacted by the increased efficiencies from the County First acquisition and management's continued focus on containing expense growth. The Company began to realize cost savings from the County First acquisition in the second half of 2018 with the closing of four branches and an operations center, an overall reduction in headcount and the elimination of duplicate processes and vendors.

Salaries and benefits increased 4.6% or $897,000 to $20.4 million, which was slightly higher than the 4.0% estimate provided by management during 2019. The slight increase over 4.0% was primarily due to incentive accruals for meeting internal bonus targets by lenders and executives as well as higher than anticipated health insurance claims during the third quarter of 2019.

Professional fees increased $683,000 to $2.2 million in 2019 compared to $1.5 million in 2018 due to several strategic initiatives, including the implementation of a new bank operating system and new consumer deposit products, expenses associated with the pay-off of the subordinated debt in 2020, the successful completion of the private placement of the Company's common stock and capital planning.

Advertising expense increased in 2019 primarily due to an increased focus on acquiring consumer deposit accounts.

The Bank took expected FDIC insurance credits totaling $342,000 in the third and fourth quarters of 2019. These credits offset the third and fourth quarter accrued FDIC expense. As of December 31, 2019, the Bank had a remaining credit of $52,000 that it expects to take during the first quarter of 2020.

The following is a breakdown to OREO expense for the years ended December 31, 2019 and 2018:

	Years Ended December 31,			
(dollars in thousands)	2019	2018	$ change	% change
Valuation allowance	$ 901	$ 532	$ 369	$ —
Losses (gains) on dispositions	(188)	8	(196)	—
OREO operating expenses	250	117	133	—
	$ 963	$ 657	$ 306	$ —

In 2019, the Company disposed of commercial real estate for proceeds of $3.1 million and recognized a gain of $190,000. Residential lots were sold for $63,000 with a loss of $2,000 along with sales of commercial equipment for $35,000 for the year ended December 31, 2019.The Company disposed of commercial real estate for proceeds of $807,000 and a gain of $4,000 along with residential lots for proceeds of $190,000 and a loss of $12,000 for the year ended December 31, 2018.

The 2019 average quarterly noninterest expense run rate was $9.1 million primarily due to incentive accruals, higher than anticipated health insurance claims, larger OREO valuation allowances than the prior year and increased professional fees. For the year ended December 31, 2019 the efficiency ratio and net operating expense to average asset ratio were 61.10% and 1.75%, respectively compared to 69.42% and 2.13%, respectively, for the year ended December 31, 2018.

	Years Ended December 31,			
(dollars in thousands)	2018	2017	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 19,548	$ 16,758	$ 2,790	16.6 %
OREO valuation allowance and expenses	657	703	(46)	(6.5)%
Merger and acquisition costs	3,625	829	2,796	337.3 %
Sub-total	23,830	18,290	5,540	30.3 %
Operating Expenses				
Occupancy expense	3,116	2,632	484	18.4 %
Advertising	671	543	128	23.6 %
Data processing expense	3,020	2,354	666	28.3 %
Professional fees	1,513	1,662	(149)	(9.0)%
Depreciation of premises and equipment	810	786	24	3.1 %
Telephone communications	277	191	86	45.0 %
Office supplies	149	119	30	25.2 %
FDIC insurance	654	638	16	2.5 %
Core deposit intangible amortization	784	—	784	n/a
Other	3,325	2,839	486	17.1 %
Total Operating Expenses	$ 14,319	$ 11,764	$ 2,555	21.7 %
Total Noninterest Expense	$ 38,149	$ 30,054	$ 8,095	26.9 %

In 2018, noninterest expenses increased $8.1 million, or 26.9% to $38.2 million compared to the prior year, which amount included $3.6 million in merger related expenses. 2017 noninterest expense totaled $30.1 million which amount included $829,000 in merger-related expenses. Year-over-year increases in noninterest expenses, other than merger and acquisition costs, were due primarily to increases in salary and employee benefits attributable to the addition of County First employees. The Company decreased employee headcount from a high of 200 full time equivalent ("FTEs") employees during the first quarter of 2018 to 189 FTEs in the fourth quarter of 2018. Other increases from the comparable periods were to occupancy expense, data processing expense, core deposit intangible amortization and advertising expense, all of which were due to the acquisition of County First and a larger balance sheet. The Company closed four of the five acquired branches in May 2018. The three held for sale County First branches were sold by July 2018. Branch closings positively impacted the Company's expense run rate in the third and fourth quarters of 2018.

The following is a breakdown to OREO expense for the years ended December 31, 2018 and 2017:

	Years Ended December 31,			
(dollars in thousands)	2018	2017	$ change	% change
Valuation allowance	$ 532	$ 600	$ (68)	(11.3)%
Losses (gains) on dispositions	8	(43)	51	(118.6)%
OREO operating expenses	117	146	(29)	(19.9)%
	$ 657	$ 703	$ (46)	(6.5)%

The Company disposed of commercial real estate for proceeds of $807,000 and a gain of $4,000 along with residential lots for proceeds of $190,000 and a loss of $12,000 for the year ended December 31, 2018. The Company disposed of five residential properties and multiple residential lots for proceeds of $1.5 million and a gain of $43,000 for the year ended December 31, 2017.

The Company's efficiency ratio was 69.42% in 2018 compared to 63.37% in 2017. The Company's net operating expense ratio was 2.13% in 2018 compared to 1.89% in 2017. The increase in the efficiency and net operating expense ratios in 2018 reflect the costs associated with the merger, higher employee headcount for the first six months of 2018 and the duplication of systems and resources to integrate County First during 2018.

Income Tax Expense

For the years ended December 31, 2019, 2018 and 2017, the Company recorded income tax expense of $5.7 million, $4.2 million and $9.2 million, respectively.

The Company's consolidated effective tax rate was 27.06% for the year ended December 31, 2019. The 2019 the effective tax rate was slightly lower than the prior year due to a first quarter 2019 adjustment to net deferred tax assets related to the accounting treatment for acquired Bank Owned Life Insurance and a reduction in non-deductible merger expenses. This tax benefit was partially offset by certain holding company expenses that are not deductible for state tax purposes.

The Company's consolidated effective tax rate was 27.10% for the year ended December 31, 2018, due to lower tax rates enacted with the passage of the Tax Cut and Jobs Act of 2017 partially offset by certain non-deductible merger-related expenses and holding company expenses that are not deductible for state tax purposes.

The Company's consolidated effective tax rate was 55.95% for the year ended December 31, 2017. The Company's 2017 income tax expense increased $2.7 million due to the revaluation of deferred tax assets because of the reduction in the corporate income tax rate under the enacted Tax Cuts and Jobs Act which was enacted on December 22, 2017. In addition, income tax expense was impacted by non-deductible facilitative merger and acquisition costs of $724,000.

COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2019 AND 2018

Assets

Total assets increased $108.3 million or 6.41% to $1.8 billion at December 31, 2019 compared to total assets of $1.7 billion at December 31, 2018 primarily as a result of organic retail deposit and loan growth. Cash and cash equivalents decreased $567,000, or 1.72%, to $32.5 million and total securities decreased $7.8 million, or 3.54%, to $213.1 million. The differences in allocations between the cash and investment categories reflect operational needs. Gross loans increased 7.96% or $107.3 million from $1,346.9 million at December 31, 2018 to $1,454.2 million at December 31, 2019 due to organic loan growth.

Cash and Cash Equivalents

Cash and cash equivalents totaled $32.5 million at December 31, 2019, compared to $33.0 million at December 31, 2018. Management believes the current balance of cash and cash equivalents adequately serves the Company's liquidity needs. Total cash and cash equivalents fluctuate on a daily basis due to transactions in process and other liquidity demands. Management believes liquidity needs are satisfied by the current balance of cash and cash equivalents, readily available access to traditional and wholesale funding sources, and the portions of the investment and loan portfolios that mature within one year. These sources of funds should enable the Company to meet cash obligations as they come due.

Investment Securities

Investment securities and FHLB stock at December 31, 2019, 2018 and 2017, estimated fair value were $216.5 million, $222.2 million, and $173.6 million, respectively. The Company held HTM securities at December 31, 2018 and 2017. In December 2019, the Company reclassified the HTM portfolio to the AFS portfolio. The Bank's primary reasons for the reclassification were to better manage interest rate risks and provide additional on-balance sheet liquidity. Management believes that the reclassification and active oversight of the investment portfolio allows the Bank to take appropriate actions to defend interest-rate sensitivity in either rates up or down environments, and over time should lead to improved earnings of the Bank in a safe and sound manner.

The following table sets forth the carrying value of the Company's investment securities portfolio and FHLB of Atlanta stock at the dates indicated. HTM securities and FHLB of Atlanta stocks are carried at amortized cost and AFS securities are carried at fair value.

	At December 31,		
(dollars in thousands)	2019	2018	2017
Asset-backed securities:			
Freddie Mac, Fannie Mae and Ginnie Mae	$ 183,024	$ 186,424	$ 135,142
U.S. Agencies	9,733	22,383	21,177
Other	371	482	651
Total asset-backed securities	193,128	209,289	156,970
Callable GSE Agency Bonds	2,002	5,009	5,017
Certificates of Deposit Fixed	250	950	—
U.S. Treasury Bills	1,489	999	1,000
Municipal bonds	11,318	—	—
Total investment securities available-for-sale	208,187	216,247	162,987
Other equity securities			
Bond mutual funds	4,669	4,428	4,423
Corporate equity securities	209	209	121
Total investment securities	213,065	220,884	167,531
FHLB stock	3,447	3,821	7,276
Total investment securities and FHLB stock	$ 216,512	$ 224,705	$ 174,807

The amortized cost of AFS investment securities by contractual maturity at December 31, 2019 are shown below. The Company has allocated the AFS investment securities into the four maturity groups listed below using the expected average life of the individual securities based on statistics provided by industry sources. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. The maturities and weighted average yields at December 31, 2019 are shown below.

December 31, 2019	One Year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years		Total Investment Securities	
(dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Fair Value
AFS Investment securities:										
Asset-backed securities issued by GSEs and U.S. Agencies	$ 40,209	2.68%	$ 80,043	2.68%	$ 55,481	2.68%	$ 17,149	2.64%	$ 192,882	$195,130
Municipal securities	—	—%	—	—%	11,491	3.02%	—	—%	11,491	11,318
Certificates of deposit fixed	250	2.20%	—	—%	—	—%	—	—%	250	250
U.S. Treasury bills	1,490	1.51%	—	—%	—	—%	—	—%	1,490	1,489
Total AFS investment securities	$ 41,949	2.64%	$ 80,043	2.68%	$ 66,972	2.74%	$ 17,149	2.64%	$ 206,113	$208,187

Credit Quality of Investments Securities

The tables below present the Standard & Poor's ("S&P") or equivalent credit rating from other major rating agencies for AFS and HTM investment securities by carrying value at December 31, 2019 and 2018. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed securities and GSE agency bonds with S&P AA+ ratings were treated as AAA based on regulatory guidance.

December 31, 2019		**December 31, 2018**	
Credit Rating	**Amount**	**Credit Rating**	**Amount**
(dollars in thousands)		(dollars in thousands)	
AAA	$ 200,481	AAA	$ 215,764
AA	7,334	AA	—
A	372	A	—
BB	—	BB	483
B+	—	B+	—
Total	$ 208,187	Total	$ 216,247

Earnings performance and liquidity of the investment portfolio is monitored and managed by management through monthly reporting and Asset and Liability Committee ("ALCO") meetings. In addition, ALCO also monitors net interest income and interest rate risk for the Company. Analysis of expected cash inflows and outflows, including the investment securities portfolio, ensures liquidity is available to satisfy depositor requirements and the various credit needs of customers. Management believes the risk characteristics inherent in the investment portfolio are acceptable.

At December 31, 2019, and 2018 greater than 96% and 99% of the AFS and HTM portfolios were rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency, respectively. At December 31, 2019 AFS asset-backed securities issued by GSEs and U.S. Agencies had an average life of 4.39 years and 4.37 years and average duration of 3.94 years and 3.86 years and are guaranteed by their issuer as to credit risk, respectively. At December 31, 2019, AFS municipal bonds issued by states, political subdivisions or agencies had an average life of 9.51 years and an average duration of 8.18 years. There were no HTM securities at December 31, 2019. At December 31, 2018, HTM asset-backed securities issued by GSEs and U.S. Agencies had an average life of 4.88 years and average duration of 4.25 years and are guaranteed by their issuer as to credit risk.

Gross unrealized losses on investment securities decreased from $5.4 million at December 31, 2018 to $645,000 at December 31, 2019 (see Note 2 in Consolidated Financial Statements). Gross unrealized losses at December 31, 2019 and December 31, 2018 for AFS securities were $645,000 and $2.8 million, respectively, of amortized cost of $206.1 million and $122.5 million, respectively. There were no HTM investments securities at December 31, 2019. Gross unrealized losses at December 31, 2018 for HTM securities were $2.7 million, and the amortized cost was $96.3 million. The change in unrealized losses was the result of changes in interest rates, while credit risks remained stable. The Company intends to, and has the ability to, hold investment securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. Management believes that the investment securities with unrealized losses will either recover in market value or be paid off as agreed.

Loan Portfolio

The Bank's primary market areas consist of the tri-county area in Southern Maryland and the greater Fredericksburg area in Virginia. The portfolio consists primarily of commercial and residential lending. Loans totaled $1,454.2 million as of December 31, 2019 and $1,346.9 million as of December 31, 2018. During 2019, the Bank experienced loan growth of $107.3 million or 8.0%. Growth in in the commercial and retail portfolios was $95.4 million or 8.3% and $11.9 million or 6.2%, respectively.

The acquisition of County First in 2018 as well as 2019 organic loan growth changed the composition of the loan portfolios. The growth in the commercial real estate and commercial portfolios should increase asset sensitivity over time. Commercial real estate increased from 65.18% of gross loans at December 31, 2018 to 66.34% at December 31, 2019. The following is a breakdown of the Company's loan portfolios as of the dates indicated:

	At December 31,									
	2019		2018		2017		2016		2015	
(dollars in thousands)	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate	$ 964,777	66.3%	$ 878,016	65.2%	$ 727,314	63.3%	$ 667,105	61.2%	$ 538,888	58.6%
Residential first mortgages	167,710	11.5%	156,709	11.6%	170,374	14.8%	171,004	15.7%	131,401	14.3%
Residential rentals [(1)]	123,601	8.5%	124,298	9.2%	110,228	9.6%	101,897	9.4%	93,157	10.1%
Construction and land development	34,133	2.4%	29,705	2.2%	27,871	2.4%	36,934	3.4%	36,189	3.9%
Home equity and second mortgages	36,098	2.5%	35,561	2.6%	21,351	1.9%	21,399	2.0%	21,716	2.4%
Commercial loans	63,102	4.3%	71,680	5.3%	56,417	4.9%	50,484	4.6%	67,246	7.3%
Consumer loans	1,104	0.1%	751	0.1%	573	—%	422	—%	366	—%
Commercial equipment	63,647	4.4%	50,202	3.7%	35,916	3.1%	39,737	3.6%	29,931	3.3%
Total Loans	1,454,172	100.0%	1,346,922	100.0%	1,150,044	100.0%	1,088,982	100.0%	918,894	100.0%
Deferred loan fees and premiums	1,879		1,183		1,086		397		(1,154)	
Allowance for loan losses	10,942		10,976		10,515		9,860		8,540	
Loans receivable, net	$1,445,109		$1,337,129		$1,140,615		$1,079,519		$ 909,200	

[(1)] Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2015.

The Bank’s non-acquired loan portfolios increased $137.1 million or 11.1% from $1,240.0 million at December 31, 2018 to $1,377.1 million at December 31, 2019. The following is a breakdown of the Company’s non-acquired loan portfolios at December 31, 2019 and 2018:

Non-Acquired Loan Portfolios

(dollars in thousands)	December 31, 2019	%	December 31, 2018	%	$ Change	% Change
Commercial real estate	$ 911,850	66.22%	$ 810,248	65.33%	$ 101,602	12.5 %
Residential first mortgages	167,710	12.18%	156,243	12.60%	11,467	7.3 %
Residential rentals	113,090	8.21%	105,458	8.50%	7,632	7.2 %
Construction and land development	34,133	2.48%	29,705	2.40%	4,428	14.9 %
Home equity and second mortgages	24,863	1.81%	21,703	1.75%	3,160	14.6 %
Commercial loans	63,102	4.58%	70,146	5.66%	(7,044)	(10.0)%
Consumer loans	1,011	0.07%	562	0.05%	449	79.9 %
Commercial equipment	61,335	4.45%	45,970	3.71%	15,365	33.4 %
	$ 1,377,094	100.00%	$ 1,240,035	100.00%	$ 137,059	11.1 %

Loans consist of the following at December 31, 2019 and 2018:

BY ACQUIRED AND NON-ACQUIRED	December 31, 2019	%	December 31, 2018	%
Acquired loans - performing	$ 74,654	5.13%	$ 103,667	7.70%
Acquired loans - purchase credit impaired ("PCI")	2,424	0.17%	3,220	0.24%
Total acquired loans	77,078	5.30%	106,887	7.94%
Non-acquired loans**	1,377,094	94.70%	1,240,035	92.06%
Gross loans	1,454,172	100.00%	1,346,922	100.00%
Net deferred costs (fees)	1,879	0.13%	1,183	0.09%
Total loans, net of deferred costs	$ 1,456,051		$ 1,348,105	

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

Maturity of Loan Portfolio

The following table sets forth certain information at December 31, 2019 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less.

December 31, 2019 (dollars in thousands) **Description of Asset**	**Due in one year or less**	**After one but within five years**	**After five years**	**Total**
Real Estate Loans				
Commercial	$ 113,345	$ 243,771	$ 607,661	$ 964,777
Residential first mortgage	7,896	37,219	122,595	167,710
Residential rentals	5,939	33,065	84,597	123,601
Construction and land development	29,198	4,935	—	34,133
Home equity and second mortgage	178	378	35,542	36,098
Commercial loans	63,102	—	—	63,102
Consumer loans	375	650	79	1,104
Commercial equipment	14,128	35,435	14,084	63,647
Total loans	$ 234,161	$ 355,453	$ 864,558	$ 1,454,172

The following table sets forth the dollar amount of all loans due after one year from December 31, 2019, which have predetermined interest rates and have floating or adjustable interest rates.

December 31, 2019 (dollars in thousands) **Description of Asset**	**Fixed Rates**	**Floating or Adjustable Rates**	**Total**
Real Estate Loans			
Commercial	$ 222,587	$ 628,845	$ 851,432
Residential first mortgage	109,177	50,637	159,814
Residential rentals	25,546	92,116	117,662
Construction and land development	1,102	3,833	4,935
Home equity and second mortgage	442	35,478	35,920
Commercial loans	—	—	—
Consumer loans	729	—	729
Commercial equipment	43,087	6,432	49,519
	$ 402,670	$ 817,341	$ 1,220,011

Loan Concentrations

At December 31, 2019, commercial loans comprised the largest component of the loan portfolio with a significant amount real estate secured. The Bank's commercial loans are concentrated in our market area; however, these loans are distributed among many different borrowers in numerous industries.

Non-owner occupied commercial real estate as a percentage of risk-based capital at December 31, 2019 and 2018 were $639.1 million or 319.98% and $559.3 million or 302.20%, respectively. Construction loans as a percentage of risk-based capital at December 31, 2019 and 2018 were $147.2 million or 73.68% and $109.7 million and 59.30%, respectively.

Asset Quality

The following table shows asset quality ratios at and for the years ended December 31, 2019, 2018, 2017, 2016 and 2015, respectively:

(dollars in thousands, except per share amounts)	At or for the Years Ended December 31,				
	2019	**2018**	**2017**	**2016**	**2015**
SELECTED ASSET QUALITY DATA					
Gross loans	$ 1,454,172	$ 1,346,922	$ 1,150,044	$ 1,088,982	$ 918,894
Classified assets	34,636	40,819	50,298	39,246	43,346
Allowance for loan losses	10,942	10,976	10,515	9,860	8,540
Nonperforming loans (>=90 Days) [(1)]	12,778	11,110	2,483	7,705	10,740
Non-accrual loans [(2)]	17,857	19,282	4,693	8,374	11,433
Accruing troubled debt restructures (TDRs) **(3)**	650	6,676	10,021	10,448	13,133
Other Real Estate Owned (OREO)	7,773	8,111	9,341	7,763	9,449
Non-accrual loans, OREO and TDRs	$ 26,280	$ 34,069	$ 24,055	$ 26,585	$ 34,015
SELECTED ASSET QUALITY RATIOS					
Classified assets to total assets	1.93%	2.42%	3.58%	2.94%	3.79%
Classified assets to risk-based capital	16.21	21.54	32.10	26.13	30.19
Allowance for loan losses to total loans	0.75	0.81	0.91	0.91	0.93
Allowance for loan losses to non-accrual loans	61.28	56.92	224.06	117.75	74.70
Net charge-offs to avg. outstanding loans	0.16	0.07	0.03	0.11	0.16
Nonperforming loans to total loans	0.88	0.82	0.22	0.71	1.17
Non-accrual loans to total loans	1.23	1.43	0.41	0.77	1.24
Non-accrual loans and TDRs to total loans	1.27	1.93	1.28	1.73	2.67
Non-accrual loans and OREO to total assets	1.43	1.62	1.00	1.21	1.83
Non-accrual loans, OREO and TDRs to total assets	1.46	2.02	1.71	1.99	2.98

[(1)] Nonperforming loans include all loans that are 90 days or more delinquent.

[(2)] Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer.

[(3)] TDR loans include both non-accrual and accruing performing loans. All TDR loans are included in the calculation of asset quality financial ratios. Non-accrual TDR loans are included in the non-accrual balance and accruing TDR loans are included in the accruing TDR balance.

Classified Assets and Special Mention Assets

The Company continues to pursue expeditiously resolving non-performing or substandard credits that are not likely to become performing or passing credits in a reasonable timeframe. Management believes this strategy is in the best long-term interest of the Company.

Classified assets decreased $6.2 million from $40.8 million at December 31, 2018 to $34.6 million at December 31, 2019 and as a percentage of assets and risk-based capital are the lowest for the periods presented. Management considers classified assets to be an important measure of asset quality. The following is a breakdown of the Company's classified and special mention assets at December 31, 2019, 2018, 2017, 2016 and 2015, respectively:

	As of				
(dollars in thousands)	**12/31/2019**	**12/31/2018**	**12/31/2017**	**12/31/2016**	**12/31/2015**
Classified loans					
Substandard	$ 26,863	$ 32,226	$ 40,306	$ 30,463	$ 31,943
Doubtful	—	—	—	137	861
Loss	—	—	—	—	—
Total classified loans	26,863	32,226	40,306	30,600	32,804
Special mention loans	—	—	96	—	1,642
Total classified and special mention loans	$ 26,863	$ 32,226	$ 40,402	$ 30,600	$ 34,446
Classified loans	$ 26,863	$ 32,226	$ 40,306	$ 30,600	$ 32,804
Classified securities	—	482	651	883	1,093
Other real estate owned	7,773	8,111	9,341	7,763	9,449
Total classified assets	$ 34,636	$ 40,819	$ 50,298	$ 39,246	$ 43,346
Total classified assets and special mention loans	$ 34,636	$ 40,819	$ 50,394	$ 39,246	$ 44,988
Total classified assets as a percentage of total assets	**1.93%**	**2.42%**	**3.58%**	**2.94%**	**3.79%**
Total classified assets as a percentage of Risk Based Capital	**16.21%**	**21.54%**	**32.10%**	**26.13%**	**30.19%**

Non-Performing Assets

The following table sets forth information with respect to the Bank's non-performing assets. There were no loans 90 days or more past due that were still accruing interest at the dates indicated.

	December 31,				
(dollars in thousands)	2019	2018	2017	2016	2015
Non-accrual loans:					
Commercial real estate	$ 12,249	$ 14,632	$ 1,987	$ 2,371	$ 2,875
Residential first mortgages	830	1,374	985	623	1,948
Residential rentals [1]	937	963	825	577	605
Construction and land dev.	—	—	—	3,048	3,555
Home equity and second mortgages	448	147	257	61	48
Commercial loans	3,127	866	172	1,044	2,054
Consumer loans	—	—	—	—	—
Commercial equipment	266	1,300	467	650	348
Total non-accrual loans [2]	**17,857**	**19,282**	**4,693**	**8,374**	**11,433**
OREO	**7,773**	**8,111**	**9,341**	**7,763**	**9,449**
TDRs: [2]					
Commercial real estate	1,420	5,612	9,273	9,587	9,839
Residential first mortgages	64	66	527	545	881
Residential rentals [3]	—	216	221	227	2,058
Construction and land dev.	—	729	729	3,777	4,283
Home equity and second mortgages	—	—	—	872	—
Commercial loans	—	53	4	—	1,384
Commercial equipment	565	29	36	113	123
Total TDRs	2,049	6,705	10,790	15,121	18,568
Total Accrual TDRs	**650**	**6,676**	**10,021**	**10,448**	**13,133**
Total non-accrual loans, OREO and Accrual TDRs	**$ 26,280**	**$ 34,069**	**$ 24,055**	**$ 26,585**	**$ 34,015**
Interest income due at stated rates, but not recognized on non-accruals	$ 620	$ 537	$ 185	$ 1,103	$ 987

[1] Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at December 31, 2016 and 2015.

[2] Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer.

[3] TDR loans include both non-accrual and accruing performing loans. All TDR loans are included in the calculation of asset quality financial ratios. Non-accrual TDR loans are included in the non-accrual balance and accruing TDR loans are included in the accruing TDR balance.

Non-accrual loans and OREO to total assets decreased from 1.62% at December 31, 2018 to 1.43% at December 31, 2019. Non-accrual loans, OREO and TDRs to total assets decreased from 2.02% at December 31, 2018 to 1.46% at December 31, 2019.

Non-accrual loans decreased $1.4 million from $19.3 million or 1.43% of total loans at December 31, 2018 to $17.9 million or 1.23% of total loans at December 31, 2019. Non-accrual loans can be current but classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. In accordance with the Company's policy, interest income is recognized on a cash basis or cost-recovery method, until qualifying for return to accrual status. Loans are reviewed on a regular basis and are placed on non-accrual status

when, in the opinion of management, the collection of additional interest is doubtful. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Non-accrual loans include certain loans that are current with all loan payments and are placed on non-accrual status due to customer operating results and cash flows. Non-accrual loans are evaluated for impairment on a loan-by-loan basis in accordance with the Company's impairment methodology.

At December 31, 2019, non-accrual loans of $17.9 million included 39 loans, of which $15.0 million, or 84% represented 18 loans and seven customer relationships. At December 31, 2018, non-accrual loans of $19.3 million included 38 loans, of which $15.3 million, or 79% represented 13 loans and four customer relationships. During the year ended December 31, 2019, non-accrual loans decreased $1.4 million primarily as a result of one loan relationship written off during 2019. At December 31, 2019, there were $5.1 million (28%) of non-accrual loans current with all payments of principal and interest with no impairment and $12.8 million (72%) of delinquent non-accrual loans with a total of $522,000 specifically reserved.

Non-accrual loans at December 31, 2019 and 2018 included three and one TDRs totaling $1.4 million and $29,000, respectively. These loans were classified solely as non-accrual for the calculation of financial ratios. Loan delinquency (90 days or greater delinquent and 31-89 days delinquent) increased $1.1 million from $12.2 million, or 0.91% of loans, at December 31, 2018 to $13.3 million, or 0.92% of loans, at December 31, 2019.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $11.7 million and $17.4 million at December 31, 2019 and 2018, respectively. Interest due but not recognized on these balances at December 31, 2019 and 2018 was $318,000 and $456,000, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $6.1 million and $1.9 million at December 31, 2019 and 2018, respectively. Interest due but not recognized on these balances at December 31, 2019 and 2018 was $302,000 and $81,000, respectively.

The following is a breakdown by loan classification of the Company's TDRs at December 31, 2019 and 2018.

	December 31, 2019		December 31, 2018	
(dollars in thousands)	**Dollars**	**Number of Loans**	**Dollars**	**Number of Loans**
Commercial real estate	$ 1,420	3	$ 5,612	7
Residential first mortgages	64	1	66	1
Residential rentals	—	—	216	1
Construction and land development	—	—	729	2
Commercial loans	—	—	53	1
Commercial equipment	565	4	29	1
Total TDRs	$ 2,049	8	$ 6,705	13
Less: TDRs included in non-accrual loans	(1,399)	(3)	(29)	(1)
Total performing accrual TDR loans	$ 650	5	$ 6,676	12

TDRs decreased $4.7 million from $6.7 million at December 31, 2018 to $2.0 million at December 31, 2019. TDRs that are included in non-accrual are classified solely as non-accrual loans for the calculation of financial ratios. The Company had specific reserves of $87,000 on three TDRs totaling $88,000 at December 31, 2019 and $165,000 on one TDR totaling $1.6 million at December 31, 2018. During the year ended December 31, 2019, TDR disposals, which included payoffs and refinancing decreased by seven loans totaling $4.4 million. TDR loan principal curtailment was $236,000 for the year ended December 31, 2019. There was one TDR added during the year ended December 31, 2019 totaling $25,000. During the year ended December 31, 2018, TDR disposals, which included payoffs and refinancing decreased by three loans totaling $3.9 million. TDR loan principal curtailment was $176,000 for the year ended December 31, 2018. There were zero TDRs added during the year ended December 31, 2018.

Performing TDRs as a percentage of outstanding TDRs at December 31, 2019 and 2018 were $650,000 or 31.7%, and $6.7 million or 99.6%, respectively. Interest income in the amount of $92,000 and $348,000 was recognized on outstanding TDR loans for the years ended December 31, 2019 and 2018, respectively. The Bank's TDRs are performing according to the terms of their agreements at market interest rates appropriate for the level of credit risk of each TDR loan. The average contractual interest rate on performing TDRs at December 31, 2019 and 2018 was 4.51% and 5.08%, respectively.

Other Real Estate Owned

The following is a summary roll-forward of OREO activity for the years ended December 31, 2019 and 2018:

	Years Ended December 31,	
(dollars in thousands)	2019	2018
Balance at beginning of year	$ 8,111	$ 9,341
Additions of underlying property	3,567	307
Disposals of underlying property	(3,004)	(1,005)
Transfers to premises and equipment	—	—
Valuation allowance	(901)	(532)
Balance at end of period	$ 7,773	$ 8,111

During the year ended December 31, 2019, additions of $3.6 million consisted of $3.4 million for commercial real estate acquired at foreclosure on a $3.8 classified loan relationship recorded at the estimated fair value at the date of foreclosure less selling costs, establishing a new cost basis and $146,000 for residential lots. The Company disposed of commercial real estate for proceeds of $3.1 million and gains of $190,000 along with residential lots for proceeds of $63,000 and a loss of $2,000 and commercial equipment for $35,000 for the year ended December 31, 2019. The Bank provided $280,000 in financing for the sale of a commercial building during the first quarter of 2019. The transaction qualified for full accrual sales treatment under ASC Topic 610-20 "Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets".

During the year ended December 31, 2018, additions of $307,000 consisted of $165,000 of capitalized costs to improve a development project and $142,000 for commercial real estate. The Company disposed of commercial real estate for proceeds of $807,000 and gains of $4,000 along with residential lots for proceeds of $190,000 and a loss of $12,000 for the year ended December 31, 2018.

Additions to the valuation allowances of $901,000 and $532,000 were taken to adjust properties to current appraised values for the years ended December 31, 2019 and 2018, respectively. OREO carrying amounts reflect management's estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs.

Allowance for Loan Losses

The following is a breakdown of the Company's general and specific allowances as a percentage of gross loans at December 31, 2019 and 2018:

Breakdown of general and specific allowance as a percentage of gross loans	December 31, 2019	December 31, 2018
General allowance	$ 10,114	$ 9,796
Specific allowance	828	1,180
	$ 10,942	$ 10,976
General allowance	0.70%	0.73%
Specific allowance	0.06%	0.08%
Allowance to gross loans	0.75%	0.81%
Allowance to non-acquired gross loans	0.79%	0.89%
Total acquired loans	$ 77,078	$ 106,887
Non-acquired loans**	$ 1,377,094	$ 1,240,035
Gross loans	$ 1,454,172	$ 1,346,922

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

The provision for loan losses increased $725,000 to $2.1 million for the year ended December 31, 2019 compared to $1.4 million for the year ended December 31, 2018. Net charge-offs increased $1.2 million from $944,000 or 0.07% of average loans for the

year ended December 31, 2018 to $2.2 million or 0.16% of average loans for the year ended December 31, 2019. Moderate organic loan growth, a continued decline in historical loss rates for the periods used to estimate the allowance, a reduction in specific loan loss allocations and improvements in certain qualitative factors lowered the allowance as a percentage of loans by six basis points to 0.75% of total loans at December 31, 2019 compared to 0.81% at December 31, 2018. Improvements to historical charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as delinquency and classified assets, were partially offset by increases in other qualitative factors, such as concentration to capital factors and portfolio growth.

Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to: overall loss experience; current economic conditions; size, growth and composition of the loan portfolio; financial condition of the borrowers; current appraised values of underlying collateral and other relevant factors that, in management's judgment, warrant recognition in determining an adequate allowance. Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as classified assets, were offset by increases in other qualitative factors, such as a downgrade in economic factors and increased portfolio growth. The specific allowance is based on management's estimate of realizable value for particular loans. Management believes that the allowance is adequate.

The following table allocates the allowance for loan losses by loan category at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	At December 31,									
	2019		2018		2017		2016		2015	
(dollars in thousands)	Amount	% [1]	Amount	% [1]	Amount	% [1]	Amount	% [1]	Amount	% [1]
Commercial real estate	$ 7,398	66.34%	$ 6,882	65.18%	$ 6,451	63.25%	$ 5,212	61.25%	$ 3,465	58.64%
Residential first mortgages	464	11.53%	755	11.63%	1,144	14.81%	1,406	15.70%	584	14.30%
Residential rentals [2]	397	8.50%	498	9.23%	512	9.58%	362	9.36%	538	10.14%
Construction and land dev.	273	2.35%	310	2.21%	462	2.42%	941	3.39%	1,103	3.94%
Home equity and second mortgages	149	2.48%	133	2.64%	162	1.86%	138	1.97%	142	2.36%
Commercial loans	1,086	4.34%	1,482	5.32%	1,013	4.91%	794	4.64%	1,477	7.32%
Consumer loans	10	0.08%	6	0.06%	7	0.05%	3	0.04%	2	0.04%
Commercial equipment	1,165	4.38%	910	3.73%	764	3.12%	1,004	3.65%	1,229	3.26%
Total allowance for loan losses	$ 10,942	100.00%	$ 10,976	100.00%	$ 10,515	100.00%	$ 9,860	100.00%	$ 8,540	100.00%

[1] Percent of loans in each category to total loans

[2] Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2015.

The following table sets forth an analysis of activity in the Bank's allowance for loan losses for the periods indicated.

	At December 31,				
(dollars in thousands)	2019	2018	2017	2016	2015
Balance at beginning of period	$ 10,976	$ 10,515	$ 9,860	$ 8,540	$ 8,481
Charge-offs:					
Commercial real estate	148	268	217	—	78
Residential first mortgages	—	115	—	—	30
Residential rentals (1)	53	84	42	14	—
Construction and land dev.	329	—	26	526	—
Home equity and second mortgages	28	7	14	—	100
Commercial loans	1,127	94	13	594	432
Consumer loans	5	2	2	1	—
Commercial equipment	685	647	168	34	818
Total Charge-offs	2,375	1,217	482	1,169	1,458
Recoveries:					
Commercial real estate	15	10	63	58	17
Residential first mortgages	—	—	—	—	1
Residential rentals (1)	46	—	—	—	—
Construction and land dev.	—	—	—	1	32
Home equity and second mortgages	6	18	1	5	—
Commercial loans	40	189	1	18	11
Consumer loans	2	—	—	—	—
Commercial equipment	102	56	62	48	23
Total Recoveries	211	273	127	130	84
Net Charge-offs	2,164	944	355	1,039	1,374
Provision for Loan Losses	2,130	1,405	1,010	2,359	1,433
Balance at end of period	$ 10,942	$ 10,976	$ 10,515	$ 9,860	$ 8,540
Allowance for loan losses to total loans	0.75%	0.81%	0.91%	0.91%	0.93%
Net charge-offs to average loans	0.16%	0.07%	0.03%	0.11%	0.16%

(1) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2015.

Liabilities

Deposits and Borrowings

The Bank uses both retail deposits and wholesale funding. Retail deposits include municipal deposits. Wholesale funding includes short-term borrowings, long-term borrowings and brokered deposits. Retail deposits continue to be the most significant source of funds totaling $1,510.8 million or 97.0% of funding at December 31, 2019 compared to $1,376.5 million or 92.7% of funding at December 31, 2018. Wholesale funding, which consisted of FHLB advances and brokered deposits, was $46.4 million or 3.0% of funding at December 31, 2019 compared to $108.5 million or 7.3% of funding at December 31, 2018. In addition to funding for operations, the Company had junior subordinated debentures of $12.0 million and subordinated notes of $23.0 million at December 31, 2019 and 2018, respectively.

On February 15, 2020, the Company redeemed the Company's outstanding $23.0 million of 6.25% fixed-to-floating rate subordinated notes. The redemption of the $23.0 million in subordinated notes in February 2020 will positively impact net interest margin and be accretive to earnings. The annualized increase in net interest margin for a $1.4 million reduction in interest expense is estimated between eight and nine basis points.

The following is a breakdown of the Company's deposit portfolio at December 31, 2019, 2018 and 2017:

	December 31,		
(dollars in thousands)	**2019**	**2018**	**2017**
Noninterest-bearing demand	$ 241,174	$ 209,378	$ 159,844
Interest-bearing:			
Demand	523,802	437,169	215,447
Money market deposits	283,438	266,160	226,351
Savings	69,254	69,893	52,990
Certificates of deposit	394,169	447,029	451,605
Total interest-bearing	1,270,663	1,220,251	946,393
Total Deposits	$ 1,511,837	$ 1,429,629	$ 1,106,237
Transaction accounts	$ 1,117,668	$ 982,600	$ 654,632

Total deposits increased $82.2 million, or 5.8%, to $1,511.8 million at December 31, 2019, compared to $1,429.6 million at December 31, 2018. During the same period, noninterest bearing demand deposits increased $31.8 million, or 15.19%, to $241.2 million (15.95% of total deposits). Transaction deposit accounts increased $135.1 million from $982.6 million (68.7% of deposits) at December 31, 2018 to $1,117.7 million (73.93% of deposits) at December 31, 2019. Reciprocal deposits are included in transaction deposits and are used to maximize FDIC insurance available to our customers.

At December 31, 2019 and 2018 total deposits consisted of $1,510.8 million and $1,376.5 million in retail deposits and $1.0 million and $53.1 million in wholesale deposits. Wholesale deposits include brokered deposits and do not include the portion of reciprocal deposits classified as brokered deposits for call reporting purposes. The Bank increased retail deposits during 2019 and 2018 as a result of the acquisition of County First, targeted growth in relationships with local municipal agencies and continued organic growth in core markets. The Bank's municipal customers typically utilize treasury and cash management services involving multiple accounts as well as other services and products such as payroll, lock box services, positive pay, and automated clearing house transactions. Most of the municipal relationships' balances are maintained in reciprocal deposits. Management believes that the diversity and complexity of products and services utilized, safeguards the stability of these relationships. The Bank's Asset and Liability Management process closely monitors municipal deposit concentrations to manage the impact of seasonal balance fluctuations.

For FDIC call reporting purposes reciprocal deposits are classified as brokered deposits when they exceed 20% of a bank's liabilities or $5.0 billion. Reciprocal deposits increased $115.1 million to $350.0 million at December 31, 2019 compared to $234.9 million at December 31, 2018. Reciprocal deposits as a percentage of the Bank's liabilities at December 31, 2019 were 22.0% and as a result $31.4 million of reciprocal deposits were considered brokered deposits for call reporting purposes. There were no reciprocal deposits considered brokered deposits at December 31, 2018.

The FDIC's examination policies require that the Company monitor customer deposit concentrations that are 2% or more of total deposits. At December 31, 2019, the Bank had two customer deposit relationships that exceeded 2% of total deposits, totaling $297.1 million which represented 19.6% of total deposits. At December 31, 2018, one customer deposit relationship exceeded 2%

of total deposits, totaling $158.8 million which represented 11.1% of total deposits. The reported concentrations at December 31, 2019 and 2018 were with local municipal agencies.

At December 31, 2019, the Company had on-balance sheet liquidity of $37.3 million in cash and cash equivalents, and equity securities carried at fair value through income as well as $153.5 million in unpledged AFS securities. The Company had $216.3 million in available FHLB lines at December 31, 2019, which does not include any AFS securities. At December 31, 2019, total available collateral for FHLB borrowing was $369.8 million and total available FHLB collateral and cash was $407.1 million.

The Company uses brokered deposits and other wholesale funding to supplement funding when loan growth exceeds core deposit growth and for asset-liability management purposes. Brokered deposits have decreased $52.1 million or 98.1% to $1.0 million at December 31, 2019 compared to $53.1 million at December 31, 2018. Federal Home Loan Bank ("FHLB") long-term debt and short-term borrowings ("advances") decreased $10.1 million, or 18.2%, to $45.4 million at December 31, 2019 compared to $55.4 million at December 31, 2018. Wholesale funding, which includes brokered deposits and FHLB advances, decreased $62.2 million from $108.5 million (6.4% of assets) at December 31, 2018 to $46.4 million (2.6% of assets) at December 31, 2019. Cash from organic retail deposit growth was used to pay down debt and brokered deposits.

Liquidity has improved with the increase in transaction deposits and decrease in wholesale funding. The Company's net loan to deposit ratio was 95.6% at December 31, 2019 compared to 93.5% at December 31, 2018. For the year ended December 31, 2019 and 2018, the average loan to deposit ratios were 94.2% and 96.6%, respectively. Management is optimistic that increased liquidity, improved funding composition and the ability to migrate available liquidity into higher yielding interest-earning assets will positively impact net interest income and margins during 2020. Management expects some seasonality in deposits that will likely increase the loan to deposit ratio into the low to mid 90s in the first quarter of 2020. The Company intends to use available on-balance sheet liquidity to fund loans, increase investments and pay down wholesale funding.

Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and other commercial banks. FHLB long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. At December 31, 2019 and 2018, 100% of the Bank's long-term debt was fixed for rate and term, as the conversion optionality of the advances have either been exercised or expired.

The following table sets forth for the periods indicated the average balances outstanding and average interest rates for each major category of deposits.

	For the Years Ended December 31,					
	2019		2018		2017	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$ 70,130	0.10%	$ 73,268	0.08%	$ 53,560	0.05%
Interest-bearing demand and money market accounts	710,709	0.95%	584,341	0.69%	419,817	0.35%
Certificates of deposit	448,924	1.90%	452,494	1.46%	443,181	1.00%
Total interest-bearing deposits	1,229,763	1.25%	1,110,103	0.96%	916,558	0.65%
Noninterest-bearing demand deposits	226,964		217,897		154,225	
	$1,456,727	1.06%	$1,328,000	0.80%	$1,070,783	0.56%

The following table indicates the amount of the Bank's certificates of deposit and other time deposits of $100,000 or more and $250,000 or more by time remaining until maturity as of December 31, 2019.

(dollars in thousands)	At December 31, 2019	At December 31, 2019
Time Deposit Maturity Period	**$100,000 or More**	**$250,000 or More**
Three months or less	$ 47,826	$ 19,378
Three through six months	63,188	25,905
Six through twelve months	103,637	38,265
Over twelve months	46,493	15,102
Total	$ 261,144	$ 98,650

Note 7 includes the scheduled contractual maturities of total certificates of deposits of $394.2 million at December 31, 2019.

The following table sets forth information about short-term borrowings for the years indicated. Long-term debt of $$40.4 million, junior subordinated debentures of $12.0 million and subordinated notes of $23.0 million are not included in the table. For more information on borrowings, see Notes 8, 9 and 10 in the Consolidated Financial Statements.

	At or for the Year Ended December 31,		
(dollars in thousands)	2019	2018	2017
Short-term borrowings			
Short-term borrowings outstanding at end of period	$ 5,000	$ 35,000	$ 88
Weighted average rate on short-term borrowings	1.81%	2.51%	1.34%
Maximum outstanding short-term borrowings at any month end	59,500	74,000	109
Average outstanding short-term borrowings	30,965	42,286	92
Approximate average rate paid on short-term borrowings	2.50%	1.81%	1.15%

Stockholders' Equity

The following table shows the Company's equity and the dollar and percentage changes for the periods presented.

(dollars in thousands)	December 31, 2019	December 31, 2018	$ Change	% Change
Common Stock at par of $0.01	$ 59	$ 56	$ 3	5.4 %
Additional paid in capital	95,474	84,397	11,077	13.1 %
Retained earnings	85,059	72,594	12,465	17.2 %
Accumulated other comprehensive loss	1,504	(1,847)	3,351	(181.4)%
Unearned ESOP shares	(602)	(718)	116	(16.2)%
Total Stockholders' Equity	$ 181,494	$ 154,482	$ 27,012	17.5 %

Total stockholders' equity increased $27.0 million, or 17.5%, to $181.5 million at December 31, 2019 compared to $154.5 million at December 31, 2018. This increase primarily resulted from net income of $15.3 million, $10.6 million of net proceeds from the December 2019 private placement common stock offering, an increase in accumulated other comprehensive income of $3.4 million and net stock related activities in connection with stock-based compensation and ESOP activity of $442,000. These increases to stockholders' equity were partially offset by decreases due to common dividends paid of $2.7 million, and repurchases of common stock of $17,000

Common stockholders' equity of $181.5 million at December 31, 2019 resulted in a book value of $30.76 per common share compared to $27.70 at December 31, 2018. The Company's tangible book value was $28.57 at December 31, 2019 compared to $25.25 at December 31, 2018. Prior to 2018, the Company had no intangible assets. The Company remains well capitalized at December 31, 2019 with a Tier 1 capital to average assets (leverage ratio) of 10.08% compared to 9.50% at December 31, 2018. The Company's ratio of tangible common equity to tangible assets increased to 9.44% at December 31, 2019 from 8.41% at December 31, 2018. The Company's Common Equity Tier 1 ("CET1") ratio was 11.11% at December 31, 2019 compared to 10.36% at December 31, 2018.

During the year ended December 31, 2019, $155,000 or 4,815 Employee Stock Ownership Plan ("ESOP") shares were allocated with the payment of promissory notes. This was offset by the purchase of 3,271 shares of the Company's common shares for $39,000 by the ESOP during 2019. During the year ended December 31, 2018, $174,000 or 6,061 ESOP shares were allocated with the payment of promissory notes. This was offset by the purchase of 4,244 shares of the Company's common shares for $137,000 by the ESOP during 2018. The ESOP has promissory notes with the Company for the purchase of TCFC common stock for the benefit of the participants in the Plan. Loan terms are at prime rate plus one-percentage point and amortize over seven (7) years. As principal is repaid, common shares are allocated to participants based on the participant account allocation rules described in the Plan. The Bank is a guarantor of the ESOP debt with the Company. Unencumbered shares held by the ESOP are treated as outstanding in computing earnings per share. Shares issued to the ESOP but pledged as collateral for loans obtained to provide funds to acquire the shares are not treated as outstanding in computing earnings per share.

LIQUIDITY AND CAPITAL RESOURCES

Capital Resources

The Company has no business other than holding the stock of the Bank and does not currently have any material funding requirements, except for the payment of dividends on common stock, and the payment of interest on subordinated debentures and subordinated notes, and noninterest expense.

The Company evaluates capital resources by the ability to maintain adequate regulatory capital ratios. The Company and the Bank annually update a three-year strategic capital plan. In developing its plan, the Company considers the impact to capital of asset growth, income accretion, dividends, holding company liquidity, investment in markets and people and stress testing.

During the years ended December 31, 2019 and 2018, the Company performed ongoing assessments using the new regulatory capital ratios and determined that the Company meets the new requirements specified in the Basel III rules upon full adoption of such requirements. In addition, our subsidiary bank made the election to continue to exclude most accumulated other comprehensive income ("AOCI") from capital in connection with its March 31, 2015 quarterly financial filing and, in effect, to retain the AOCI treatment under the prior capital rules.

Federal banking regulations require the Company and the Bank to maintain specified levels of capital. As of December 31, 2019 and 2018, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the new Basel III Capital Rules. Management believes, as of December 31, 2019 and 2018, that the Company and the Bank met all capital adequacy requirements to which they were subject. See Note 11 of the Consolidated Financial Statements.

Liquidity

Liquidity is our ability to meet cash demands as they arise. Such needs can develop from loan demand, deposit withdrawals or acquisition opportunities. Potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers are other factors affecting our liquidity needs. Many of these obligations and commitments are expected to expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position.

Based on management's going concern evaluation, we believe that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the Company's or the Bank's ability to continue as a going concern, within one year of the date of the issuance of the financial statements.

Asset liquidity is provided by cash and assets which are readily marketable, or which will mature in the near future. Liquid assets include cash, federal funds sold, and short-term investments in cash deposits with other banks. Liquidity is also provided by access to funding sources, which include core depositors and brokered deposits. Other sources of funds include our ability to borrow, such as purchasing federal funds from correspondent banks, sales of securities under agreements to repurchase and advances from the FHLB.

At December 31, 2019 and 2018, the Bank had $96.6 million and $56.8 million, respectively, in loan commitments outstanding. In addition, at December 31, 2019 and 2018, the Bank had $22.3 million and $21.2 million, respectively, in letters of credit and approximately $230.5 million and $211.5 million, respectively, available under lines of credit. Certificates of deposit due within one year of December 31, 2019 and 2018 totaled $309.0 million or 78.40% and $278.8 million, or 62.40%, respectively, of total certificates of deposit outstanding. If maturing deposits do not remain, the Bank will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposits. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

The Company's principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank's principal sources of funds for investment and operations are net income, deposits, sales of loans, borrowings, principal and interest payments on loans, principal and interest received on investment securities and proceeds from the maturity and sale of investment securities. The Bank's principal funding commitments are for the origination or purchase of loans, the purchase of securities and the payment of maturing deposits. Deposits are considered the primary source of funds supporting the Bank's lending and investment activities. The Bank also uses borrowings from the FHLB of Atlanta to supplement deposits. The amount of FHLB advances available to the Bank is limited to the lower of 30% of Bank assets or the amount supportable by eligible collateral including FHLB stock, loans and securities. In addition, the Bank has established unsecured and secured lines of credit with the Federal Reserve Bank and commercial banks. For a discussion of these agreements including collateral see Note 11 in the Consolidated Financial Statements.

The Bank's most liquid assets are cash, cash equivalents and federal funds sold. The levels of such assets are dependent on the Bank's operating, financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows.

Comparison for the Years Ending December 31, 2019 and 2018

Cash and cash equivalents as of December 31, 2019 totaled $32.5 million, a decrease of $0.6 million from the December 31, 2018 total of $33.0 million. Changes to the level of cash and cash equivalents have minimal impact on operational needs as the Bank has substantial sources of funds available from other sources.

During the year ended December 31, 2019, all financing activities provided $80.2 million in cash compared to $34.4 million in cash provided for the same period in 2018. The Company was provided $45.8 million more cash from financing activities compared to the prior year, primarily due to a decrease in reductions of net borrowings partially offset by decreased deposit growth. Net deposits increased $82.2 million in 2019 compared to $124.2 million in 2018. Long-term debt increased a net of $19.9 million from $20.4 million at December 31, 2018 to $40.4 million at December 31, 2019 and provided $55.0 million more cash in 2019 compared to 2018. Short-term borrowings decreased a net of $30.0 million from $35.0 million at December 31, 2018 to $5.0 million at December 31, 2019. Short-term borrowings used $22.5 million less cash in 2019 compared to 2018. The Company was provided a net increase in cash of $10.3 million for stock related activities in 2019 compared to 2018. The increase was primarily due to a $10.6 million private placement in December 2019, an increase in unearned ESOP shares, and a decrease in common stock repurchased was partially offset by an increase in common dividends paid on 2019. During the first quarter of 2018, the Company used cash and the sale of securities acquired in the County First acquisition to pay down wholesale brokered deposits and FHLB debt, which represents the reduction in both deposits and debt. Acquired deposits of approximately $200 million are not included in the cash flow statement.

The Bank's principal use of cash has been in investing activities including its investments in loans, investment securities and other assets. In 2019, the level of net cash used in investing increased to $96.5 million from $36.2 million in 2018. The increase in cash used of $60.3 million was primarily the result of the net increase in cash used of $55.2 million from loan activities and the one-time receipt of $32.5 million of cash from the 2018 County First acquisition, partially offset by a net decrease of $26.1 million in securities transactions and cash used of $1.0 million for purchase of premises and equipment. Cash used increased for the funding of loans originated, which increased $138.7 million from $346.3 million for the year ended December 31, 2018 to $485.0 million for the year ended December 31, 2019. Cash used decreased as principal received on loans in 2019 increased over the prior year comparable period. Principal collected on loans increased $83.5 million from $289.7 million for the year ended December 31, 2018 to $373.2 million for the year ended December 31, 2019.The Company's cash used decreased $26.1 million due to net purchases of securities of $13.3 million for the year ended December 31, 2019 compared to $12.8 million for the year ended December 31, 2018.

Operating activities provided cash of $15.7 million for the year ended December 31, 2019 compared to $19.4 million of cash provided for the same period of 2018.

OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America and to general practices within the banking industry, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For a discussion of these agreements, including collateral and other arrangements, see Note 18 in the Consolidated Financial Statements.

For the years ended December 31, 2019 and 2018, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operations or cash flows.

CONTRACTUAL OBLIGATIONS

In the normal course of its business, the Bank commits to make future payments to others to satisfy contractual obligations. These obligations include commitments to repay short and long-term borrowings and commitments incurred under operating lease agreements. The following schedules provide detail of contractual obligations as of December 31, 2019:

	Payments due by period				
(dollars in thousands)	Total	Less than One Year	One to Three Years	Three to Five Years	More Than 5 Years
Short-term debt obligations	$ 5,000	$ 5,000	$ —	$ —	$ —
Long-term debt obligations	40,370	20,000	15,188	5,000	182
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	—	—	—	12,000
Subordinated notes - 6.25%[1]	23,000	23,000	—	—	—
Time deposits	394,169	309,043	72,585	12,541	—
Operating lease obligations [2]	11,974	697	1,272	1,232	8,773
Purchase Obligations [3]	11,730	2,472	5,160	4,098	—
Total	$ 498,243	$ 360,212	$ 94,205	$ 22,871	$ 20,955

[1] The subordinated notes may be redeemed in whole or in part on February 15, 2020. See Note 10 for more information.
[2] Payments are for lease of real property.
[3] Represents payments under contract based on average monthly service charges for 2019.

IMPACT OF INFLATION AND CHANGING PRICES

The Consolidated Financial Statements and notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

End Notes

[1] The Company's actual betas were calculated measuring the changes in deposit rates and overall funding rates compared to the Federal Funds Rate.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

Interest rate risk is defined as the exposure to changes in net interest income and capital that arises from movements in interest rates. Depending on the composition of the balance sheet, increasing or decreasing interest rates can negatively affect the Company's results of operations and financial condition.

The Company measures interest rate risk over the short and long term. The Company measures interest rate risk as the change in net interest income ("NII") caused by a change in interest rates over twelve and twenty-four months. The Company's NII simulations provide information about short-term interest rate risk exposure. The Company also measures interest rate risk by measuring changes in the values of assets and liabilities due to changes in interest rates. The economic value of equity ("EVE") is defined as the present value of future cash flows from existing assets, minus the present value of future cash flows from existing liabilities. EVE simulations reflect the interest rate sensitivity of assets and liabilities over a longer time period, considering the maturities, average life and duration of all balance sheet accounts.

The Board of Directors has established an interest rate risk policy, which is administered by the Bank's Asset Liability Committee ("ALCO"). The policy establishes limits on risk, which are quantitative measures of the percentage change in NII and EVE resulting from changes in interest rates. Both NII and EVE simulations assist in identifying, measuring, monitoring and controlling interest rate risk and are used by management and the ALCO Committee to ensure that interest rate risk exposure will be maintained within Board policy guidelines. The ALCO Committee reports quarterly to the Board of Directors. Mitigating strategies are used to maintain interest rate risk within established limits.

The Company's interest rate risk ("IRR") model uses assumptions which include factors such as call features, prepayment options and interest rate caps and floors included in investment and loan portfolio contracts. Additionally, the IRR model estimates the lives and interest rate sensitivity of the Company's non-maturity deposits. These assumptions have a significant effect on model results. The assumptions are developed primarily based upon historical behavior of Bank customers. The Company also considers industry and regional data in developing IRR model assumptions. There are inherent limitations in the Company's IRR model and underlying assumptions. When interest rates change, actual movements of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model.

The Company prepares a current base case and several alternative simulations at least quarterly. Current interest rates are shocked by +/- 100, 200, 300, and 400 basis points ("bp"). In addition, the Company simulates additional rate curve scenarios (e.g., bear flattener). The Company may elect not to use particular scenarios that it determines are impractical in a current rate environment.

The Company's internal limits for parallel shock scenarios are as follows:

Shock in Basis Points	Net Interest Income ("NII")	Economic Value of Equity ("EVE")
+ - 400	25%	40%
+ - 300	20%	30%
+ - 200	15%	20%
+ - 100	10%	10%

It is management's goal to manage the portfolios of the Bank so that net interest income at risk over twelve-month and twenty-four-month periods and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels. As of December 31, 2019, and 2018, the Company did not exceed any Board approved sensitivity limits. Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. The below schedule estimates the changes in net interest income over a twelve-month period for parallel rate shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Net Interest Income			
Change in Interest Rates:	**+ 200bp**	**+ 100bp**	**- 100bp**
Policy Limit	(15.00)%	(10.00)%	(10.00)%
December 31, 2019	(8.06)%	(3.21)%	(2.50)%
December 31, 2018	(8.02)%	(3.73)%	0.79 %

Measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The below schedule estimates the changes in the economic value of equity at parallel shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Economic Value of Equity (EVE)

Change in Interest Rates:	**+ 200bp**	**+ 100bp**	**- 100bp**
Policy Limit	(20.00)%	(10.00)%	(10.00)%
December 31, 2019	(2.44)%	0.90 %	21.92 %
December 31, 2018	(5.40)%	(1.82)%	16.30 %

Item 8. Financial Statements and Supplementary Data

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of The Community Financial Corporation (the "Company") is responsible for the preparation, integrity and fair presentation of the financial statements included in this Annual Report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning the effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining effective internal control over financial reporting. The Company's internal control over financial reporting includes those policies and procedures that pertain to the Company's ability to record, process, summarize and report reliable financial data. The internal control system contains monitoring mechanisms, and appropriate actions taken to correct identified deficiencies. Management believes that internal controls over financial reporting, which are subject to scrutiny by management and the Company's internal auditors, support the integrity and reliability of the financial statements. Management recognizes that there are inherent limitations in the effectiveness of any internal control system, including the possibility of human error and the circumvention or overriding of internal controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. In addition, because of changes in conditions and circumstances, the effectiveness of internal control over financial reporting may vary over time. The Audit Committee of the Board of Directors (the "Committee"), is comprised entirely of outside directors who are independent of management. The Committee is responsible for the appointment and compensation of the independent auditors and makes decisions regarding the appointment or removal of members of the internal audit function. The Committee meets periodically with management, the independent auditors, and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting, and auditing procedures of the Company in addition to reviewing the Company's financial reports. The independent auditors and the internal auditors have full and unlimited access to the Audit Committee, with or without the presence of management, to discuss the adequacy of internal control over financial reporting, and any other matters which they believe should be brought to the attention of the Audit Committee.

Management assessed the Company's system of internal control over financial reporting as of December 31, 2019. This assessment was conducted based on the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission "Internal Control — Integrated Framework (2013)." Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2019. Management's assessment concluded that there were no material weaknesses within the Company's internal control structure. There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The 2019 financial statements have been audited by the independent registered public accounting firm of Dixon Hughes Goodman LLP ("DHG"). Personnel from DHG were given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees thereof. Management believes that all representations made to all the independent auditors were valid and appropriate. The resulting report from DHG accompanies the financial statements. DHG has also issued a report on the effectiveness of internal control over financial reporting. This report has also been made a part of this Annual Report.

/s/ William J. Pasenelli	/s/ Todd L. Capitani
William J. Pasenelli	Todd L. Capitani
President and Chief Executive Officer	Executive Vice President and Chief Financial Officer
March 4, 2020	March 4, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors of The Community Financial Corporation

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of The Community Financial Corporation (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows, for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 4, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.

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

/s/ Dixon Hughes Goodman LLP

We have served as the Company's auditor since 2016.

Gaithersburg, Maryland
March 4, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors of The Community Financial Corporation

Opinion on Internal Control Over Financial Reporting

We have audited The Community Financial Corporation (the "Company")'s internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, The Community Financial Corporation 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 the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of The Community Financial Corporation as of December 31, 2019 and 2018 and for each of the years in the three years ended December 31, 2019, and our report dated March 4, 2020, expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible 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 internal control over financial reporting based on our audit. We are a public accounting firm registered with the 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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.

/s/ Dixon Hughes Goodman LLP

Gaithersburg, Maryland
March 4, 2020

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share amounts)	December 31, 2019	December 31, 2018
Assets		
Cash and due from banks	$ 25,065	$ 24,064
Federal funds sold	—	5,700
Interest-bearing deposits with banks	7,404	3,272
Securities available for sale (AFS), at fair value	208,187	119,976
Securities held to maturity (HTM), at amortized cost	—	96,271
Equity securities carried at fair value through income	4,669	4,428
Non-marketable equity securities held in other financial institutions	209	209
Federal Home Loan Bank (FHLB) stock - at cost	3,447	3,821
Loans receivable	1,456,051	1,348,105
Less: allowance for loan losses	(10,942)	(10,976)
Net loans	1,445,109	1,337,129
Goodwill	10,835	10,835
Premises and equipment, net	21,662	22,922
Premises and equipment held for sale	430	—
Other real estate owned (OREO)	7,773	8,111
Accrued interest receivable	5,019	4,957
Investment in bank owned life insurance	37,180	36,295
Core deposit intangible	2,118	2,806
Net deferred tax assets	6,168	6,693
Right of use assets - operating leases	8,382	—
Other assets	3,879	1,738
Total Assets	$ 1,797,536	$ 1,689,227
Liabilities and Stockholders' Equity		
Deposits		
Non-interest-bearing deposits	$ 241,174	$ 209,378
Interest-bearing deposits	1,270,663	1,220,251
Total deposits	1,511,837	1,429,629
Short-term borrowings	5,000	35,000
Long-term debt	40,370	20,436
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000
Subordinated notes - 6.25%	23,000	23,000
Lease liabilities - operating leases	8,495	—
Accrued expenses and other liabilities	15,340	14,680
Total Liabilities	1,616,042	1,534,745
Stockholders' Equity		
Common stock - par value $.01; authorized - 15,000,000 shares; issued 5,900,249 and 5,577,559 shares, respectively	59	56
Additional paid in capital	95,474	84,397
Retained earnings	85,059	72,594
Accumulated other comprehensive income (loss)	1,504	(1,847)
Unearned ESOP shares	(602)	(718)
Total Stockholders' Equity	181,494	154,482
Total Liabilities and Stockholders' Equity	$ 1,797,536	$ 1,689,227

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)	Years Ended December 31, 2019	2018	2017
Interest and Dividend Income			
Loans, including fees	$ 65,602	$ 59,755	$ 49,611
Interest and dividends on investment securities	6,414	5,153	3,906
Interest on deposits with banks	437	265	53
Total Interest and Dividend Income	72,453	65,173	53,570
Interest Expense			
Deposits	15,378	10,682	5,946
Short-term borrowings	774	767	1,057
Long-term debt	2,767	2,837	3,179
Total Interest Expense	18,919	14,286	10,182
Net Interest Income	53,534	50,887	43,388
Provision for loan losses	2,130	1,405	1,010
Net Interest Income After Provision For Loan Losses	51,404	49,482	42,378
Noninterest Income			
Loan appraisal, credit, and miscellaneous charges	335	183	157
Gain on sale of assets	—	1	47
Net gains on sale of investment securities	226	—	175
Unrealized gain (loss) on equity securities	134	(81)	—
Loss on premises and equipment held for sale	(1)	—	—
Income from bank owned life insurance	885	902	773
Service charges	3,308	3,063	2,595
Referral fee income	879	—	—
Gain on sale of loans held for sale	—	—	294
Total Noninterest Income	5,766	4,068	4,041
Noninterest Expense			
Salary and employee benefits	20,445	19,548	16,758
Occupancy expense	3,101	3,116	2,632
Advertising	762	671	543
Data processing expense	3,048	3,020	2,354
Professional fees	2,196	1,513	1,662
Merger and acquisition costs	—	3,625	829
Depreciation of premises and equipment	685	810	786
Telephone communications	203	277	191
Office supplies	149	149	119
FDIC Insurance	334	654	638
OREO valuation allowance and expenses	963	657	703
Core deposit intangible amortization	688	784	—
Other	3,659	3,325	2,839
Total Noninterest Expense	36,233	38,149	30,054
Income before income taxes	20,937	15,401	16,365
Income tax expense	5,665	4,173	9,157
Net Income	$ 15,272	$ 11,228	$ 7,208
Earnings Per Common Share			
Basic	$ 2.75	$ 2.02	$ 1.56
Diluted	$ 2.75	$ 2.02	$ 1.56
Cash dividends paid per common share	$ 0.50	$ 0.40	$ 0.40

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)	Years Ended December 31, 2019	2018	2017
Net Income	$ 15,272	$ 11,228	$ 7,208
Net unrealized holding gains (losses) arising during period, net of tax expense (benefit) of $987, $(242) and $(41), respectively	2,600	(637)	(62)
Reclassification due to reclassification of held-to-maturity securities to available-for-sale securities net of tax $223, $0, and $0, respectively	587	—	—
Reclassification adjustment for income (losses) included in net income, net of tax expense (benefit) of $62, $0 and $(3), respectively	164	—	(5)
Comprehensive Income	$ 18,623	$ 10,591	$ 7,141

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2019, 2018 and 2017

(dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance at January 1, 2017	$ 46	$ 47,377	$ 58,100	$ (928)	$ (169)	$ 104,426
Net Income	—	—	7,208	—	—	7,208
Unrealized holding loss on investment securities net of tax of $44	—	—	—	(67)	—	(67)
Reclassification due to Accounting Standard Update 2018-02	—	—	196	(196)	—	—
Cash dividend at $0.40 per common share	—	—	(1,804)	—	—	(1,804)
Net change in fair market value over cost of leveraged ESOP shares released	—	110	—	—	—	110
Dividend reinvestment	—	52	(52)	—	—	—
Exercise of stock options	—	155	—	—	—	155
Net change in unearned ESOP shares	—	—	—	—	(586)	(586)
Repurchase of common stock	—	—	—	—	—	—
Stock based compensation	—	515	—	—	—	515
Balance at December 31, 2017	$ 46	$ 48,209	$ 63,648	$ (1,191)	$ (755)	$ 109,957
Net Income	—	—	11,228	—	—	11,228
Unrealized holding loss on investment securities net of tax of $242	—	—	—	(637)	—	(637)
Reclassification due to Accounting Standard Update (ASU 2016-01)	—	—	19	(19)	—	—
Cash dividend at $0.40 per common share	—	—	(2,163)	—	—	(2,163)
Net change of fair market value over cost of leveraged ESOP shares released	—	34	—	—	—	34
Dividend reinvestment	—	68	(68)	—	—	—
Shares issued for County First Merger	10	35,612	—	—	—	35,622
Net change in unearned ESOP shares	—	—	—	—	37	37
Repurchase of common stock	—	—	(70)	—	—	(70)
Stock based compensation	—	474	—	—	—	474
Balance at December 31, 2018	$ 56	$ 84,397	$ 72,594	$ (1,847)	$ (718)	$ 154,482
Net Income	—	—	15,272	—	—	15,272
Unrealized holding gain on investment securities net of tax of $1,049	—	—	—	2,764	—	2,764
Reclassification due to reclassification of held-to-maturity securities to available-for-sale securities net of tax $223	—	—	—	587	—	587
Cash dividend at $0.50 per common share	—	—	(2,668)	—	—	(2,668)
Net change in fair market value below cost of leveraged ESOP shares released	—	(3)	—	—	—	(3)
Dividend reinvestment	—	122	(122)	—	—	—
Proceeds from private placement	3	10,629	—	—	—	10,632
Net change in unearned ESOP shares	—	—	—	—	116	116
Repurchase of common stock	—	—	(17)	—	—	(17)
Stock based compensation	—	329	—	—	—	329
Balance at December 31, 2019	$ 59	$ 95,474	$ 85,059	$ 1,504	$ (602)	$ 181,494

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	Year Ended December 31, 2019	2018	2017
Cash Flows from Operating Activities			
Net income	$ 15,272	$ 11,228	$ 7,208
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	2,130	1,405	1,010
Depreciation and amortization	1,637	1,679	1,598
Provision for loss on premises held for sale	1	—	—
Loans originated for resale	—	—	(2,529)
Proceeds from sale of loans originated for sale	—	—	2,823
Gain on sale of loans held for sale	—	—	(294)
Net (gains) losses on the sale of OREO	(188)	8	(43)
Gains on sales of investment securities	(226)	—	(175)
Unrealized (gain) loss on equity securities	(134)	81	—
Gain on sale of assets	—	(1)	(47)
Net amortization of premium/discount on investment securities	(96)	215	393
Net accretion of premiums and discounts	(864)	(750)	—
Amortization of core deposit intangible	688	784	—
Net change in right of use assets and lease liabilities	113	—	—
Increase in OREO valuation allowance	901	532	599
Increase in cash surrender value of bank owned life insurance	(885)	(898)	(773)
(Increase) decrease in deferred income tax benefit	(748)	(290)	1,887
Increase in accrued interest receivable	(62)	(34)	(532)
Stock based compensation	329	474	515
Net change due to (deficit) excess of fair market value over cost of leveraged ESOP shares released	(3)	33	110
Increase in net deferred loan costs	(696)	(96)	(689)
Increase in accrued expenses and other liabilities	660	1,360	322
(Increase) decrease in other assets	(2,139)	3,670	(1,281)
Net Cash Provided by Operating Activities	15,690	19,400	10,102
Cash Flows from Investing Activities			
Purchase of AFS investment securities	(49,951)	(66,137)	(26,251)
Proceeds from redemption or principal payments of AFS investment securities	18,387	8,881	7,110
Purchase of HTM investment securities	(11,471)	(11,130)	(13,135)
Proceeds from maturities or principal payments of HTM investment securities	24,043	16,995	18,048
Proceeds from sale of HTM investment securities	—	—	4,947
Proceeds from sale of AFS investment securities	31,889	34,919	3,702
Net decrease (increase) of FHLB and FRB stock	374	3,659	(41)
Loans originated or acquired	(485,002)	(346,321)	(325,155)
Principal collected on loans	373,165	289,690	260,303
Purchase of premises and equipment	(808)	(1,777)	(779)
Proceeds from sale of OREO	2,912	996	1,300
Acquisition net cash acquired	—	32,287	—
Proceeds from disposal of asset	—	1,748	387
Net Cash Used in Investing Activities	(96,462)	(36,190)	(69,564)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

(dollars in thousands)	Years Ended December 31, 2019	2018	2017
Cash Flows from Financing Activities			
Net increase in deposits	$ 82,208	$ 124,169	$ 67,412
Proceeds from long-term debt	35,000	20,000	10,000
Payments of long-term debt	(15,066)	(55,064)	(20,061)
Net (decrease) increase in short term borrowings	(30,000)	(52,500)	8,500
Exercise of stock options	—	—	155
Proceeds from private placement	10,632	—	—
Dividends paid	(2,668)	(2,163)	(1,804)
Net change in unearned ESOP shares	116	37	(586)
Repurchase of common stock	(17)	(70)	—
Net Cash Provided by Financing Activities	80,205	34,409	63,616
(Decrease) Increase in Cash and Cash Equivalents	$ (567)	$ 17,619	$ 4,154
Cash and Cash Equivalents - January 1	33,036	15,417	11,263
Cash and Cash Equivalents - December 31	$ 32,469	$ 33,036	$ 15,417
Supplemental Disclosures of Cash Flow Information			
Cash paid during the period for			
Interest	$ 18,914	$ 14,246	$ 10,001
Income taxes	$ 6,503	$ 3,494	$ 7,453
Supplemental Schedule of Non-Cash Operating Activities			
Issuance of common stock for payment of compensation	$ 207	$ 387	$ 203
Transfer from loans to OREO	$ 3,567	$ 307	$ 3,634
Financed amount of sale of OREO	$ 280	$ —	$ 200
Right-of-use assets acquired in the exchange for lease liability upon adoption of ASC 842	$ 8,933	$ —	$ —
Transfer from premises and equipment to premises and equipment held for sale	$ 430	$ —	$ —
Supplemental Schedule of Non-Cash Investing and Financing Activities			
Transfer of held-to-maturity securities to available for sale securities	$ 83,128	$ —	$ —
Business Combination Non-Cash Disclosures			
Assets acquired in business combination (net of cash received)	$ —	$ 192,259	$ —
Liabilities assumed in business combination	$ —	$ 200,660	$ —

See notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Consolidated Financial Statements include the accounts of The Community Financial Corporation and its wholly-owned subsidiary Community Bank of the Chesapeake (the “Bank”), and the Bank’s wholly-owned subsidiary Community Mortgage Corporation of Tri-County (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Accounting Changes and Reclassifications

Certain items in prior financial statements have been reclassified to conform to the current presentation.

On January 1, 2018 the Company adopted Accounting Standards Update ("ASU") 2016-01 ″Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". In accordance with ASU 2016-01, the Company accounts for its investment in equity securities with a readily determinable fair value with unrealized gains and losses included in earnings. $19,000 was reclassified from Accumulated Other Comprehensive Income (“AOCI”) into Retained Earnings.

Nature of Operations

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and Fredericksburg, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

The Bank is headquartered in Southern Maryland with 12 branches located in Maryland and Virginia. The Bank is a wholly owned subsidiary of The Community Financial Corporation (the “Company”). The Bank’s branches are located in Waldorf (two branches), Bryans Road, Dunkirk, Leonardtown, La Plata (two branches), Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Fredericksburg, Virginia. The Bank has two operation centers located at the main office in Waldorf, Maryland and in Fredericksburg, Virginia. The Company maintains four loan production offices (“LPOs”) in La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown LPO is co-located with the branch and the Fredericksburg LPO is co-located with the operation center.

On January 1, 2018, the Company completed the acquisition of County First Bank (“County First”) after regulatory approval and County First shareholder approvals were obtained. The Company’s assets increased to $1.6 billion during the first quarter of 2018. See *Note 4 – Goodwill and Other Intangible Assets* for additional information.

Use of Estimates

In preparing Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of OREO, the valuation of goodwill and deferred tax assets.

Significant Group Concentrations of Credit Risk

Most of the Company’s activities are with customers located in the Fredericksburg area of Virginia and the Southern Maryland counties of Calvert, Charles and St. Mary’s. Notes 2 and 3 discuss the types of securities and loans held by the Company. The Company does not have significant concentration in any one customer or industry.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less when purchased to be cash equivalents.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity (“HTM”) and recorded at amortized cost. At December 31, 2019 the Company had no HTM securities. See Note 2 *Securities* for additional information. Securities purchased and held principally for trading in the near term are classified as “trading securities” and are reported at fair value, with unrealized gains and losses included in earnings. The Company held no trading securities for the years ended December 31, 2019 and 2018. Securities not classified as HTM or trading securities are classified as available for sale (“AFS”) and recorded at estimated fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Equity securities with readily determinable fair values are recorded at fair value with unrealized gains and losses included in noninterest income in the consolidated statements of income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the estimated fair value of HTM and AFS securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers: (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. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Investments in Federal Reserve Bank and Federal Home Loan Bank of Atlanta stocks are recorded at cost and are considered restricted as to marketability. The Bank is required to maintain investments in the Federal Home Loan Bank based upon levels of borrowings.

Debt securities are evaluated quarterly to determine whether a decline in their value is other-than-temporary impairment (“OTTI”). The term other-than-temporary is not necessarily intended to indicate a permanent decline in value. It means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Under accounting guidance, for recognition and presentation of other-than-temporary impairments the amount of other-than-temporary impairment that is recognized through earnings for debt securities is determined by comparing the present value of the expected cash flows to the amortized cost of the security. The discount rate used to determine the credit loss is the expected book yield on the security. The Company does not evaluate declines in the value of securities of Government Sponsored Enterprises (“GSEs”) or investments backed by the full faith and credit of the United States government (e.g. US Treasury Bills), for other-than-temporary impairment.

Loans Held for Sale

The Company exited the residential mortgage origination line of business in April 2015 for individual owner occupied residential first mortgages and established third party sources to supply its residential whole loan portfolio. The Company continues to underwrite loans for non-owner occupied residential rental properties. The Company may sell certain loans forward into the secondary market at a specified price with a specified date on a best efforts basis. These forward sales are derivative financial instruments. The Company does not recognize gains or losses due to interest rate changes for loans sold forward on a best efforts basis. The Bank had no loans held for sale at December 31, 2019 and 2018, respectively, and sold no 1-4 family residential mortgage loans for the year ended December 31, 2019 and 2018.

Loans Receivable

The Company originates real estate mortgages, construction and land development loans, commercial loans and consumer loans. The Company purchases residential owner-occupied first mortgages from established third-parties. A substantial portion of the loan portfolio is comprised of loans throughout Southern Maryland and the Fredericksburg area of Virginia. The ability of the Company’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

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

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered credit impaired. Evidence of credit quality deterioration as of the purchase date may include statistics such as internal risk grade, past due and nonaccrual status, recent borrower credit scores and recent loan-to-value (“LTV”) percentages. Purchased credit-impaired (“PCI”) loans are initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Management estimates the cash flows expected to be collected at acquisition using specific credit review of certain loans, quantitative credit risk, interest rate risk and prepayment risk models, and qualitative economic and environmental assessments, each of which incorporate our best estimate of current key relevant factors, such as property values, default rates, loss severity and prepayment speeds.

Under the accounting guidance for PCI loans, the excess of the total cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan, or pool of loans, in situations where there is a reasonable expectation about the timing and amount of cash flows to be collected. The difference between the contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference and is available to absorb future charge-offs.

In addition, subsequent to acquisition, we periodically evaluate our estimate of cash flows expected to be collected. These evaluations require the continued usage of key assumptions and estimates, similar to the initial estimate of fair value. Estimates of cash flows for PCI loans require significant judgment given the impact of property value changes, changing loss severities, prepayment speeds and other relevant factors. Decreases in the expected cash flows will generally result in a charge to the provision for loan losses resulting in an increase to the allowance for loan losses. Significant increases in the expected cash flows will generally result in an increase in interest income over the remaining life of the loan, or pool of loans. Disposals of loans, which may include sales of loans to third parties, receipt of payments in full or part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of additional interest is doubtful. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Non-accrual loans include certain loans that are current with all loan payments and are placed on non-accrual status due to customer operating results and cash flows. Non-accrual loans are evaluated for impairment on a loan-by-loan basis in accordance with the Company’s impairment methodology. Interest is recognized on non-accrual loans on a cost recovery or cash-basis.

Consumer loans are typically charged-off no later than 90 days past due. Mortgage and commercial loans are fully or partially charged-off when in management’s judgment all reasonable efforts to return a loan to performing status have occurred. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

In 2019 the Bank entered into a Servicing and Intercreditor Agreement ("SIA") with a correspondent bank which allows us to offer interest rate protection to our customers. In most cases, the Bank is paid a referral fee for these transactions.

Allowance for Loan Losses and Impaired Loans

The allowance for loan losses is established as probable losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan is uncollectible. Subsequent recoveries, if any, are credited to the allowance. Management believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America and is in compliance with appropriate regulatory guidelines.

Management regularly evaluates the allowance for loan losses considering historical collection experience, the composition and size of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance for loan losses consists of a general and a specific component. The general component is based upon historical loss experience and a review of qualitative risk factors by portfolio segment (See Note 3 for a description of portfolio segments). The historical loss experience factor is tracked over various time horizons for each portfolio segment. Qualitative risk factors include trends by portfolio segment in charge-offs, delinquencies, classified loans, loan concentrations and the rate of portfolio segment growth as well as an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends.

The specific component of the allowance for loan losses relates to individual impaired loans with an identified impairment loss. The Company evaluates substandard and doubtful classified loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructured loans ("TDRs") to determine whether a loan is impaired. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. In determining impairment, management considers payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, considering the length of the delay, the reasons for the delay, the borrower's payment record and the amount of the shortfall in relation to the principal and interest owed. Loans not impaired are included in the pool of loans evaluated in the general component of the allowance.

If a specific loan is deemed to be impaired, it is evaluated for impairment. Impairment is measured on a loan-by-loan basis using one of three acceptable methods: 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. For loans that have an impairment, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than carrying value of that loan. The Company will use the fair value of collateral if repayment is expected solely from the collateral.

TDRs are loans that have been modified to provide for a reduction or a delay in the payment of either interest or principal because of deterioration in the financial condition of the borrower. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR. Once an obligation has been classified as a TDR it continues to be considered a TDR until paid in full or until the debt is refinanced and considered unimpaired. All TDRs are considered impaired and are evaluated for impairment on a loan-by-loan basis. The Company does not participate in any specific government or Company-sponsored loan modification programs. All restructured loan agreements are individual contracts negotiated with a borrower.

Servicing

Servicing assets are recognized as separate assets when rights are acquired or retained through the purchase or sale of financial assets and are evaluated for impairment based upon the estimated fair value of the rights as compared to amortized cost. Servicing fee income is recorded over the servicing period. Servicing assets are not a significant asset of the Bank's operations.

Premises and Equipment

Land is carried at cost. Premises, improvements and equipment are carried at cost, less accumulated depreciation and amortization, computed by the straight-line method over the estimated useful lives of the assets, which are as follows:

Buildings and Improvements: 10 to 50 years
Furniture and Equipment: three to 15 years
Automobiles: four to five years

Maintenance and repairs are charged to expense as incurred, while improvements that extend the useful life of premises and equipment are capitalized.

The Company leases certain properties and land under operating leases. For leases in effect upon adoption of ASU 2016-02, "Leases (Topic 842)" at January 1, 2019 and for any leases commencing thereafter, the Company recognizes a liability to make lease payments, the "lease liability", and an asset representing the right to use the underlying asset during the lease term, the "right-of-use asset". The lease liability is measured at the present value of the remaining lease payments, discounted at the Company's incremental borrowing rate. The right-of-use asset is measured at the amount of the lease liability adjusted for the remaining balance of any lease incentives received, any cumulative prepaid or accrued rent if the lease payments are uneven throughout the lease term, any unamortized initial direct costs, and any impairment of the right-of-use-asset. Operating lease expense consists of a single lease cost calculated so that the remaining cost of the lease is allocated over the remaining lease term on a straight-line basis.

Certain of the Company's leases contain options to renew the lease. Renewal options are included in the calculation of the lease liabilities when they are reasonably certain to be exercised. The Company's leases do not contain residual value guarantees. The Company's variable lease payments are expensed and classified as operating activities in the statement of cash flows. The Company does not have any material restrictions or covenants imposed by leases that would impact the Company's ability to pay dividends or cause the Company to incur additional financial obligations.

Other Real Estate Owned ("OREO")

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the estimated fair value at the date of foreclosure less selling costs, establishing a new cost basis. Subsequent to foreclosure, management performs periodic valuations, and the assets are carried at the lower of the initial recorded carrying value (initial cost basis) or estimated fair value less the cost to sell. Based on updated valuations, the Bank has the ability to reverse valuation allowances recorded up to the amount of the initial cost basis. Revenues and expenses from operations and changes in the valuation allowance are included in noninterest expense. Gains or losses on disposition are included in noninterest expense.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1)the assets have been isolated from the Company; (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.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of businesses acquired over the fair value of the net assets acquired. Goodwill is assigned to reporting units and tested for impairment at least annually in the fourth quarter or on an interim basis if an event occurs or circumstances changed that would more likely than not reduce the fair value of the reporting unit below its carrying value. See Note 4 – Goodwill and Other Intangible Assets.

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Our intangible assets relate to core deposits. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Intangible assets with indefinite useful lives are not amortized until their lives are determined to be definite. Intangible assets, premises and equipment and other long-lived assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value. See Note 4 - Goodwill and Other Intangible Assets.

Business Combinations

U.S. GAAP requires that the acquisition method of accounting be used for all business combinations and that an acquirer be identified for each business combination. Under U.S. GAAP, the acquirer is the entity that obtains control of one or more businesses in the business combination, and the acquisition date is the date the acquirer achieves control. U.S. GAAP requires that the acquirer recognize the fair value of assets acquired, liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date. The Company determines the fair values of loans, core deposit intangible, and deposits with the assistance of a third-party vendor.

Loans acquired in business combinations are recorded in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 805, "Business Combinations." Accordingly, acquired loans are segregated between PCI loans (ASC 310-30) and Non-PCI loans (ASC-310-20) and are recorded at fair value without the carryover of the related allowance for loan losses. For PCI loans, the excess of expected cash flows above the fair value will be accreted to interest income over the remaining lives of the loans in accordance with FASB ASC 310-30. For Non-PCI loans, the total discount/premium will be accreted to interest income over the remaining lives of the loans in accordance with FASB ASC 310-20.

On January 1, 2018, the Company completed its merger of County First Bank ("County First") with and into the Bank, with the Bank as the surviving bank (the "Merger"). The aggregate merger consideration consisted of 918,526 shares of the Company's common stock and $2.1 million in cash. Based upon the $38.78 per share price of the Company's common stock, the transaction value was $37.7 million. The assets acquired, and liabilities assumed from County First were recorded at their fair value as of the closing date of the merger. Goodwill of $10.3 million was recorded at the time of the acquisition. As a result of refinements to the fair value mark on fixed assets, and deferred taxes, goodwill was $10.8 million at December 31, 2018 which is an increase of $558,236 from the goodwill estimated at the time of acquisition.

Advertising Costs

The Company expenses advertising costs as incurred.

Income Taxes

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense.

Off Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial lines of credit, letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Stock-Based Compensation

The Company has stock-based incentive arrangements to attract and retain key personnel in order to promote the success of the business. In May 2015, the 2015 Equity Compensation Plan (the "2015 plan") was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees.

Compensation cost for all stock-based awards is measured at fair value on date of grant and recognized over the vesting period. Such value is recognized as expense over the service period, net of estimated forfeitures. The estimation of stock awards that ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. The Company considers many factors when estimating expected forfeitures, including types of awards, employee class and historical experience.

The Company and the Bank currently maintain incentive compensation plans which provide for payments to be made in cash or other share-based compensation. The Company has accrued the full amounts due under these plans.

Earnings Per Common Share ("EPS")

Basic earnings per common share represent income available to common stockholders, divided by the weighted average number of common shares outstanding during the period. Unencumbered shares held by the Employee Stock Ownership Plan ("ESOP") are treated as outstanding in computing earnings per share. Shares issued to the ESOP but pledged as collateral for loans obtained to provide funds to acquire the shares are not treated as outstanding in computing earnings per share.

Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential dilutive common shares are determined using the treasury stock method and include incremental shares issuable upon the exercise of stock options and other share-based compensation awards. The Company excludes from the diluted EPS calculation anti-dilutive options, because the exercise price of the options was greater than the average market price of the common shares.

Revenue from Contracts with Customers

The Company records revenue from contracts with customers in accordance with ASC Topic 606, "Revenue from Contracts with Customers." On January 1, 2018, the Company adopted ASU 2014-9 and all subsequent ASUs that modified ASU 2014-9, which have been codified in ASC Topic 606. Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation.

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Adoption of the amendments to the revenue recognition principles, did not materially change our accounting policies

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on AFS securities, are reported as components of comprehensive income as a separate statement in the Consolidated Statements of Comprehensive Income. Additionally, the Company discloses accumulated other comprehensive income as a separate component in the equity section of the balance sheet.

Recent Accounting Pronouncements

ASU 2014-09 - *Revenue from Contracts with Customers*. In May 2014, the FASB issued ASU 2014-09 which is a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration the entity expects to receive in exchange for those good or services. This new standard supersedes and replaces nearly all existing revenue recognition guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this new standard specifies the accounting for some costs to obtain or fulfill a contract with a customer.

The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. Effective January 1, 2018, the Company adopted the new standard. The Company's revenue streams that are in-scope from the update include: financed OREO sales, service charges on deposit accounts, including ATM fees and overdraft fees and wealth management income. Fees from customer contracts are assessed and collected as the transaction occurs. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

ASU 2016-01 - *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to AFS securities.

ASU 2016-01 became effective for us on January 1, 2018. Upon adoption, the new pronouncement did not have a significant impact on our consolidated statements of income as we had only one equity security that was valued at $4.4 million on January 1, 2018. The exit price observations for the loan portfolio are determined with the assistance of an independent third-party using its proprietary valuation model and methodology and may not reflect actual proceeds that we be received in the sale of the loans. The valuation is based on the probability of default, loss given default, recovery delay, prepayment, and discount rate assumptions. The new methodology is a result of the adoption of ASU 2016-01.

ASU 2016-02 - *Leases (Topic 842*). In February 2016, the FASB amended existing guidance that requires lessees to recognize the following for all leases (with the exception of short term leases) at the commencement date (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Leases will be classified as either finance or operating with classification affecting the pattern of expense recognition in the income statement. Under the new guidance, lessor accounting is largely unchanged.

ASU 2016-02 was effective for us on January 1, 2019 and initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842) – Targeted Improvements," which, among other things, provides an additional transition method that allows entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued ASU 2018-20, "Leases (Topic 842) - Narrow-Scope Improvements for Lessors," which provides for certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs.

Upon adoption of ASU 2016-02, ASU 2018-11 and ASU 2018-20 on January 1, 2019, we recognized right-of-use assets and related lease liabilities of $10.2 million and $10.2 million, respectively. We elected to apply certain practical expedients provided under ASU 2016-02 whereby we did not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. We also did not apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). We accounted for lease and non-lease components separately because such amounts are readily determinable under our lease contracts. We utilized the modified-retrospective transition approach prescribed by ASU 2018-11.

ASU 2016-13 – *Financial Instruments – Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments.* ASU 2016-13 significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The standard will replace the existing "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, HTM securities, loan commitments, and financial guarantees. The CECL model does not apply to AFS debt securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as currently required. The ASU also simplifies the accounting model for Purchase Credit Impaired ("PCI") debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach).

The Company has formed a CECL committee with representation from various departments. The committee has selected a third-party vendor solution to assist us in the application of the ASU 2016-13. The committee is currently working through the implementation plan which includes assessment and documentation of processes, internal controls and data sources; model development and documentation; and system configuration, among other things. The adoption of the ASU 2016-13 will result in a change in the amount of the allowance for loan losses as a result of changing from an "incurred loss" model to an "expected loss" model. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses for certain debt securities and other financial assets. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics, and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date. The committee is continuing to evaluate the provisions of ASU 2016-13 to determine the potential impact the new standard will have on the company's consolidated financial statements.

ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2022, with earlier adoption permitted. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective.

ASU 2016-15 – *Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 is intended to reduce diversity in practice in how eight particular transactions are classified in the statement of cash flows. ASU 2016-15 became effective for us on January 1, 2018 and did not have a material impact on the Company's consolidated financial statements.

ASU 2016-16 - *Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory.* ASU 2016-16 provides guidance stating that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017-01 - *Business Combinations (Topic 805) - Clarifying the Definition of a Business.* ASU 2017-1 clarifies the definition and provides a more robust framework to use in determining when a set of assets and activities constitutes a business. ASU 2017-01 is intended to provide guidance when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements as the transaction to acquire County First Bank was already clearly within the scope of ASC 805 Business Combinations.

ASU 2017-04 - *Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment.* ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for us on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on our financial statements.

ASU 2017-05 - *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) - Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.* ASU 2017-05 clarifies the scope of Subtopic 610-20 and adds guidance for partial sales of nonfinancial assets, including partial sales of real estate. Historically, U.S. GAAP contained several different accounting models to evaluate whether the transfer of certain assets qualified for sale treatment. ASU 2017-05 reduces the number of potential accounting models that might apply and clarifies which model does apply in various circumstances. ASU 2017-05 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017-08 - *Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities."* ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 was effective for us on January 1, 2019 and did not have a significant impact on our financial statements.

ASU 2017-09 - *Compensation - Stock Compensation (Topic 718) - Scope of Modification Accounting.* ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the award's fair value, (ii) the award's vesting conditions and (iii) the award's classification as an equity or liability instrument. ASU 2017-09 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2018-02 - *Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* Under ASU 2018-02, entities may elect to reclassify certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017, from accumulated other comprehensive income to retained earnings. ASU 2018-02 also requires certain accounting policy disclosures. We elected to adopt the provisions of ASU 2018-02 during the quarter ended December 31, 2017 resulting in a reclassification of $196,000 from accumulated other comprehensive loss to retained earnings to adjust the tax effect of items within accumulated other comprehensive loss to reflect the newly enacted federal corporate income tax rate. Refer to Note 12, Accumulated Other Comprehensive Income, for additional information.

ASU 2018-05 - *Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 118.* ASU 2018-05 amends the Accounting Standards Codification to incorporate various SEC paragraphs pursuant to the issuance of SAB 118. SAB 118 addresses the application of generally accepted accounting principles in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act. See Note 14 - Income Taxes.

ASU 2018-07 - *Compensation-Stock Compensation (Topic 718).* The ASU expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The ASU was effective for us on January 1, 2019 and did not have a significant impact on our financial statements.

ASU 2018-13 - *Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement*. In August 2018, the FASB issued ASU No. 2018-13. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to early adopt any eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's consolidated financial statements.

ASU 2018-14 - *Compensation - Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20).* ASU 2018-14 amends and modifies the disclosure requirements for employers that sponsor defined benefit pension or other post-retirement plans. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. ASU 2018-14 will be effective for us on January 1, 2021, with early adoption permitted, and is not expected to have a significant impact on our financial statements.

ASU 2018-16 - *Derivatives and Hedging (Topic 815) - Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes.* The amendments in this update permit use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815 in addition to the interest rates on direct U.S. Treasury obligations, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate and the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate. ASU 2018-16 was effective for us on January 1, 2019 and did not have a significant impact on our financial statements.

ASU 2019-04 - In April 2019, the FASB issued ASU No. 2019-04 which codifies improvements to Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), Financial Instruments (Topic 825). With respect to Topic 326, ASU 2019-04 clarifies the scope of the credit losses standard and addresses issues related to accrued interest receivable balances, recoveries, variable interest rates and prepayments, among other things. With respect to Topic 825, ASU 2019-04 clarifies the scope of the guidance for recognizing and measuring financial instruments, the requirement for remeasurement under ASC 820 when using the measurement alternative, which equity securities have to be remeasured at historical exchange rates, and certain disclosure requirements. The amendments to Topic 326 have the same effective dates as ASU 2016-13. The Company is currently evaluating the potential impact of Topic 326 amendments on the Company's Consolidated Financial Statements. The amendments to Topic 825 are effective for interim and annual reporting periods beginning after December 15, 2019 and are not expected to have a material impact on the Company's Consolidated Financial Statements.

ASU 2019-05 - *Financial Instruments-Credit Losses (Topic 326)*. In May 2019, the FASB issued ASU No. 2019-05. This ASU allows entities to irrevocably elect, upon adoption of ASU 2016-13, the fair value option for financial instruments that (1) were previously recorded at amortized cost and (2) are within the scope of ASC 326-20 if the instruments are eligible for the fair value option under ASC 825-10. The fair value option election does not apply to HTM debt securities. Entities are required to make this election on an instrument-by-instrument basis. The Company plans to adopt ASU 2019-05 upon adoption of ASU 2016-13 unless an earlier adoption is permitted in an accounting update. The Company is evaluating the impact of electing the fair value option of ASU 2019-05 on the Company's Consolidated Financial Statements.

ASU 2019-11 - *Codification Improvements to Topic 326, Financial Instruments-Credit Losses.* In November 2019, the FASB issued ASU 2019-11 to address issues raised by stakeholders during the implementation of ASU 2016-13. Among other narrow-scope improvements, ASU 2019-11 clarifies guidance around how to report expected recoveries and reinforces existing guidance that prohibits organizations from recording negative allowances for AFS debt securities. For entities that have not yet adopted the amendments in ASU 2016-13, the effective dates and transition requirements for the amendments are the same as the effective dates and transition requirements in ASU 2016-13. Thus, ASU 2019-11 will be effective for us on January 1, 2023.

ASU 2019-12 - *Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes.* The guidance issued in this update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. ASU 2019-12 also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. ASU 2019-12 will be effective for us on January 1, 2021, with early adoption permitted, and is not expected to have a significant impact on our financial statements.

NOTE 2 – SECURITIES

In December 2019, the Company reclassified the entire HTM investment portfolio, totaling $83.1 million with unrealized holding gains of $810,000 to the AFS investments category. The reclassification resulted in an increase to accumulated other comprehensive income of $587,000 and to deferred tax liabilities of $223,000. The Bank's primary reasons for the reclassification were to better manage interest rate risks and provide additional on-balance sheet liquidity. Based on accounting rules, the Bank will not be able to designate any securities as HTM securities for a period of time. Management determined that it no longer had the positive intent to hold its investment in securities classified as HTM until maturity and does not intend to hold HTM securities in the future. The Company's HTM portfolio was primarily comprised of asset-backed securities issued by GSEs and U.S. Agencies.

There were no HTM investment securities at December 31, 2019. Amortized cost and fair values of AFS investment securities at December 31, 2019 are summarized as follows:

	December 31, 2019			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale (AFS)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential Mortgage Backed Securities ("MBS")	$ 35,351	$ 754	$ 13	$ 36,092
Residential Collateralized Mortgage Obligations ("CMOs")	145,479	1,839	386	146,932
U.S. Agency	9,671	122	60	9,733
Asset-backed securities issued by Others:				
Residential CMOs	380	3	12	371
Callable GSE Agency Bonds	2,001	1	—	2,002
Certificates of Deposit Fixed	250	—	—	250
U.S. government obligations	1,490	—	1	1,489
Municipal bonds	11,491	—	173	11,318
Total investment securities available-for-sale	$ 206,113	$ 2,719	$ 645	$ 208,187
Equity securities carried at fair value through income				
CRA investment fund	$ 4,669	$ —	$ —	$ 4,669
Non-marketable equity securities				
Other equity securities	$ 209	$ —	$ —	$ 209
Total investment securities	$ 210,991	$ 2,719	$ 645	$ 213,065

Amortized cost and fair values of AFS and HTM investment securities at December 31, 2018 are summarized as follows:

	December 31, 2018			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale (AFS)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential Mortgage Backed Securities ("MBS")	$ 7,641	$ 1	$ 281	$ 7,361
Residential Collateralized Mortgage Obligations ("CMOs")	102,411	199	1,870	100,740
U.S. Agency	12,472	9	606	11,875
Total investment securities available-for-sale	$ 122,524	$ 209	$ 2,757	$ 119,976
Securities held-to-maturity (HTM)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential MBS	$ 25,948	$ 75	$ 756	$ 25,267
Residential CMOs	52,375	64	1,360	51,079
U.S. Agency	10,508	7	404	10,111
Asset-backed securities issued by Others:				
Residential CMOs	482	—	41	441
Callable GSE Agency Bonds	5,009	—	110	4,899
Certificates of deposit fixed	950	—	—	950
U.S. government obligations	999	—	1	998
Total investment securities held-to-maturity	$ 96,271	$ 146	$ 2,672	$ 93,745
Equity securities carried at fair value through income				
CRA investment fund	$ 4,428	$ —	$ —	$ 4,428
Non-marketable equity securities				
Other equity securities	$ 209	$ —	$ —	$ 209
Total investment securities	$ 223,432	$ 355	$ 5,429	$ 218,358

At December 31, 2019, and 2018 securities with an amortized cost of $47.4 million and $41.3 million were pledged to secure certain customer deposits. At December 31, 2018, securities with an amortized cost of $3.3 million were pledged as collateral for advances from the FHLB of Atlanta.

During the year ended December 31, 2019, the Company recognized net gains of $226,000 on the sale of 20 AFS securities with aggregate carrying values of $31.6 million. There were no sales of securities during the year ended December 31, 2018. During the year ended December 31, 2017, the Company recognized net gains on the sale of securities of $175,000. The Company sold three AFS securities with aggregate carrying values of $3.7 million and nine HTM securities with aggregate carrying values of $4.8 million, recognizing gains of $9,000 and $166,000, respectively. The sale of HTM securities was permitted under ASC 320 "Investments - Debt and Equity Securities." The Company disposed of HTM securities using the safe harbor rule that allows for the sale of HTM securities that have principal reductions to less than 15% of original purchased par. ASC 320 10-25-15 indicates that a sale of a debt security after a substantial portion of the principal has been collected is equivalent to holding the security to maturity. In addition, the Company may dispose of HTM securities under ASC 320-10-25-6 due to a significant deterioration in the issues' creditworthiness.

The Company's investment portfolio includes securities that are in an unrealized loss position as of December 31, 2019, the details of which are included in the following table. Although these securities, if sold at December 31, 2019 would result in a pretax loss of $645,000, the Company has no intent to sell the applicable securities at such fair values, and maintains the Company has the ability to hold these securities until all principal has been recovered. It is more likely than not that the Company will not sell any securities at a loss for liquidity purposes. Declines in the fair values of these securities can be traced to general market conditions which reflect the prospect for the economy as a whole. When determining other-than-temporary impairment on securities, the Company considers such factors as adverse conditions specifically related to a certain security or to specific conditions in an industry or geographic area, the time frame securities have been in an unrealized loss position, the Company's ability to hold the security for a period of time sufficient to allow for anticipated recovery in value, whether or not the security has been downgraded by a rating agency, and whether or not the financial condition of the security issuer has severely deteriorated. As of December 31, 2019, the Company considers all securities with unrealized loss positions to be temporarily impaired, and consequently, does not believe it will sustain any material realized losses as a result of the current temporary decline in fair value. No charges related to other-than-temporary impairment were made during for the years ended December 31, 2019, 2018 and 2017.

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at December 31, 2019 and 2018 were as follows:

December 31, 2019	**Less Than 12 Months**		**More Than 12 Months**		**Total**	
(dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Losses**
Asset-backed securities issued by GSEs and U.S. Agencies	$ 15,215	$ 63	$ 39,689	$ 336	$ 54,904	$ 399
U.S. SBA Debentures	—	—	4,744	60	4,744	60
Asset-backed securities issued by Others	—	—	136	12	136	12
Municipal bonds	11,318	173	—	—	11,318	173
U.S. government obligations	1,489	1	—	—	1,489	1
	$ 28,022	$ 237	$ 44,569	$ 408	$ 72,591	$ 645

December 31, 2018	**Less Than 12 Months**		**More Than 12 Months**		**Total**	
(dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Losses**
Asset-backed securities issued by GSEs and U.S. Agencies	$ 30,095	$ 163	$ 54,846	$ 2,594	$ 84,941	$ 2,757
	$ 30,095	$ 163	$ 54,846	$ 2,594	$ 84,941	$ 2,757

At December 31, 2019, and 2018 the AFS investment portfolio had an estimated fair value of $208.2 million and $120.0 million, of which $72.6 million and $84.9 million of the securities had some unrealized losses from their amortized cost, respectively.

AFS asset-backed securities issued by GSEs are guaranteed by the issuer and AFS U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. At December 31, 2019, and 2018 total unrealized losses on the portfolio were $645,000 and $2.8 million of the portfolio amortized cost of $206.1 million and $122.5 million, respectively. At December 31, 2019, and 2018 AFS asset-backed securities issued by GSEs and U.S. Agencies with unrealized losses had an average life of 4.67 years and 4.32 years and an average duration of 4.22 years and 3.83 years, respectively. At December 31, 2019, AFS municipal bonds issued by states, political subdivisions, or agencies had the total amortized cost of $11.5 million with total unrealized losses of $173,000 and had an average life of 9.51 years and an average duration of 8.18 years. Management believes that the securities will either recover in market value or be paid off as agreed.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2018 were as follows:

December 31, 2018	**Less Than 12 Months**		**More Than 12 Months**		**Total**	
(dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Losses**
Asset-backed securities issued by GSEs and U.S. Agencies	$ 6,955	$ 38	$ 70,752	$ 2,483	$ 77,707	$ 2,521
Callable GSE Agency Bonds	—	—	4,899	110	4,899	110
Asset-backed securities issued by Others	—	—	441	41	441	41
	$ 6,955	$ 38	$ 76,092	$ 2,634	$ 83,047	$ 2,672

At December 31, 2018 the HTM investment portfolio had an estimated fair value of $93.7 million, of which $83.0 million of the securities had some unrealized losses from their amortized cost. Of these securities, $82.6 million were asset-backed securities issued by GSEs and U.S. Agencies, and the remaining $441,000 were asset-backed securities issued by others.

HTM asset-backed securities issued by GSEs and GSE agency bonds are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. At December 31, 2018 total unrealized losses on the portfolio were $2.7 million of the portfolio amortized cost of $94.8 million. The securities with unrealized losses had an average life of 4.88 years and an average duration of 4.26 years.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. At December 31, 2018 total unrealized losses on the asset-backed securities issued by others were $41,000 of the portfolio amortized cost of $482,000. HTM asset-backed securities issued by others with unrealized losses had an average life of 3.01 years and an average duration of 2.33 years.

Maturities

The amortized cost and estimated fair value of debt securities at December 31, 2019 by contractual maturity, are shown below. The Company has allocated the AFS securities into the four maturity groups listed below using the expected average life of the individual securities based on statistics provided by industry sources. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

December 31, 2019	**AFS**	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**
Within one year	$ 41,949	$ 42,358
Over one year through five years	80,043	80,855
Over five years through ten years	66,972	67,651
After ten years	17,149	17,323
Total AFS securities	$ 206,113	$ 208,187

NOTE 3 – LOANS

Loans consist of the following:

	December 31, 2019				December 31, 2018			
(dollars in thousands)	PCI	All other loans**	Total	% of Gross Loans	PCI	All other loans**	Total	% of Gross Loans
Commercial real estate	$ 1,738	$ 963,039	$ 964,777	66.34%	$ 1,785	$ 876,231	$ 878,016	65.18%
Residential first mortgages	—	167,710	167,710	11.53%	466	156,243	156,709	11.63%
Residential rentals	295	123,306	123,601	8.50%	897	123,401	124,298	9.23%
Construction and land development	—	34,133	34,133	2.35%	—	29,705	29,705	2.21%
Home equity and second mortgages	391	35,707	36,098	2.48%	72	35,489	35,561	2.64%
Commercial loans	—	63,102	63,102	4.34%	—	71,680	71,680	5.32%
Consumer loans	—	1,104	1,104	0.08%	—	751	751	0.06%
Commercial equipment	—	63,647	63,647	4.38%	—	50,202	50,202	3.73%
Gross loans	2,424	1,451,748	1,454,172	100.00%	3,220	1,343,702	1,346,922	100.00%
Net deferred costs (fees)	—	1,879	1,879	0.13%	—	1,183	1,183	0.09%
Total loans, net of deferred costs	$ 2,424	$ 1,453,627	$ 1,456,051		$ 3,220	$ 1,344,885	$ 1,348,105	
Less: allowance for loan losses	—	(10,942)	(10,942)	-0.75%	—	(10,976)	(10,976)	-0.81%
Net loans	$ 2,424	$ 1,442,685	$ 1,445,109		$ 3,220	$ 1,333,909	$ 1,337,129	

** All other loans include acquired Non-PCI pools.

At December 31, 2019 and 2018, the Bank's allowance for loan losses totaled $10.9 million and $11.0 million, or 0.75% and 0.81%, respectively, of loan balances. Moderate organic loan growth, a continued decline in historical loss rates for the periods used to estimate the allowance, a reduction in specific loan loss allocations and improvements in certain qualitative factors lowered the allowance as a percentage of loans by six basis points at December 31, 2019 compared to December 31, 2018. Improvements to historical charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as delinquency and classified assets, were partially offset by increases in other qualitative factors, such as concentration to capital factors and portfolio growth. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

Net deferred loan costs of $1.9 million at December 31, 2019 included deferred fees paid by customers of $3.3 million offset by deferred costs of $5.2 million. Deferred loan costs include premiums paid for the purchase of residential first mortgages and deferred loan origination costs recorded in accordance with ASC 310-20. Net deferred loan costs of $1.2 million at December 31, 2018 included deferred fees paid by customers of $3.1 million offset by deferred costs of $4.3 million.

Risk Characteristics of Portfolio Segments

Concentrations of Credit - Loans are made primarily within the Company's operating footprint of Southern Maryland and the greater Fredericksburg area of Virginia. Real estate loans can be affected by the condition of the local real estate market. Commercial and industrial loans can be affected by the local economic conditions. The commercial loan portfolio has concentrations in business loans secured by real estate and real estate development loans. At December 31, 2019 and 2018, the Company had no loans outstanding with foreign entities.

The Company manages its credit products and exposure to credit losses (credit risk) by the following specific portfolio segments (classes), which are levels at which the Company develops and documents its allowance for loan loss methodology. These segments are:

Commercial Real Estate ("CRE")

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were 8.9% and 5.9% of the CRE portfolio at December 31, 2019 and 2018, respectively. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

Loans secured by commercial real estate are larger and involve greater risks than one-to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy.

At December 31, 2019 and 2018, the largest outstanding commercial real estate loans were $21.1 million and $21.5 million, respectively, which were secured by commercial real estate and performing according to their terms.

Residential First Mortgages

Residential first mortgage loans are generally long-term loans, amortized on a monthly basis, with principal and interest due each month. The contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank's experience indicates that real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank's residential portfolio has both fixed-rate and adjustable-rate residential first mortgages. During the years ended December 31, 2019 and 2018, the Bank purchased residential first mortgages of $41.0 million and $11.0 million, respectively.

The annual and lifetime limitations on interest rate adjustments may constrain interest rate increases on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank's adjustable rate residential first mortgage portfolio was $52.3 million or 3.6% of total gross loans of $1.45 billion at December 31, 2019 compared to $54.2 million or 4.0% of total gross loans of $1.35 billion at December 31, 2018.

The Bank generally retains the right to service loans sold for a payment based upon a percentage (generally 0.25% of the outstanding loan balance). As of December 31, 2019, and 2018, the Bank serviced $32.9 million and $38.1 million, respectively, in residential mortgage loans for others.

At December 31, 2019, and 2018, the largest outstanding residential first mortgage loans were $3.0 million and $2.1 million, respectively, which were secured by residences located in the Bank's market area. The loans were performing according to terms.

Residential Rentals

Residential rental mortgage loans are amortizing, with principal and interest due each month. The loans are secured by income-producing 1-4 family units and apartments. As of December 31, 2019, and 2018, $97.1 million and $96.6 million, respectively, were 1-4 family units and $26.5 million and $27.7 million, respectively, were apartment buildings or multi-family units. Loans secured by residential rental properties are generally limited to 80% of the lower of the appraised value or sales price at origination and have initial contractual loan payment periods ranging from three to 20 years. The primary security on a residential rental loan is the property and the leases that produce income. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank's adjustable rate residential rental portfolio was $102.2 million or 7.0% of total gross loans of $1.45 billion at December 31, 2019 compared to $97.4 million or 7.2% of total gross loans of $1.35 billion at December 31, 2018.

Loans secured by residential rental properties involve greater risks than 1-4 family residential mortgage loans. Although, there are similar risk characteristics shared with commercial real estate loans, the balances for the loans secured by residential rental properties are generally smaller. Because payments on loans secured by residential rental properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the rental real estate market or the economy than similar owner-occupied properties.

At December 31, 2019 and 2018, the largest outstanding residential rental mortgage loan was $9.7 million and $10.0 million, respectively, which was secured by over 120 single family homes located in the Bank's market area. The loan was performing according to its terms at December 31, 2019 and 2018.

Construction and Land Development

The Bank offers loans for the construction of one-to-four family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building. The Bank's construction and land development portfolio was $34.1 million or 2.4% of total gross loans of $1.45 billion at December 31, 2019 compared to $29.7 million or 2.2% of total gross loans of $1.35 billion at December 31, 2018.

A decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans are inherently riskier than financing owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project's value might be insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

At December 31, 2019 and 2018, the largest outstanding construction and land development loans were $5.3 million and $2.5 million, respectively, which were secured by land in the Bank's market area.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. The Bank's home equity and second mortgage portfolio was $36.1 million or 2.5% of total gross loans of $1.45 billion at December 31, 2019 compared to $35.6 million or 2.6% of total gross loans of $1.35 billion at December 31, 2018. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage.

Commercial Loans

The Bank offers its business customers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The portfolio consists primarily of demand loans and lines of credit. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower's ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank. Commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral would make full-recovery from the sale of collateral unlikely.

The Bank's commercial loan portfolio was $63.1 million or 4.3% of total gross loans of $1.45 billion at December 31, 2019 compared to $71.7 million or 5.3% of total gross loans of $1.35 billion at December 31, 2018. At December 31, 2019 and 2018, the largest outstanding commercial loans were $2.8 million and $4.2 million, respectively, which were secured by commercial real estate (all of which were located in the Bank's market area), cash and investments. These loans were performing according to terms at December 31, 2019 and 2018.

Consumer Loans

Consumer loans consist of loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer's equipment or secured by real property, accounts receivable, or other security as determined by the Bank. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to repay the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

The Bank's commercial equipment portfolio was $63.6 million or 4.4% of total gross loans of $1.45 billion at December 31, 2019 compared to $50.2 million or 3.7% of total gross loans of $1.35 billion at December 31, 2018. At December 31, 2019 and 2018, the largest outstanding commercial equipment loans were $2.1 million and $2.5 million, respectively, which were secured by commercial real estate (located in the Bank's market area), cash and investments. These loans were performing according to terms at December 31, 2019 and 2018.

Non-accrual and Aging Analysis of Current and Past Due Loans

Non-accrual loans as of December 31, 2019 and 2018 were as follows:

	December 31, 2019					
(dollars in thousands)	Non- accrual Delinquent Loans	Number of Loans	Non-accrual Current Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$ 10,562	11	$ 1,687	5	$ 12,249	16
Residential first mortgages	—	—	830	3	830	3
Residential rentals	—	—	937	5	937	5
Construction and land development	—	—	—	—	—	—
Home equity and second mortgages	177	3	271	3	448	6
Commercial loans	1,807	2	1,320	1	3,127	3
Consumer loans	—	—	—	—	—	—
Commercial equipment	241	5	25	1	266	6
	$ 12,787	21	$ 5,070	18	$ 17,857	39

	December 31, 2018					
(dollars in thousands)	Non- accrual Delinquent Loans	Number of Loans	Non-accrual Current Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	8,474	11	6,158	6	14,632	17
Residential first mortgages	146	1	1,228	4	1,374	5
Residential rentals	260	2	703	3	963	5
Construction and land development	—	—	—	—	—	—
Home equity and second mortgages	147	2	—	—	147	2
Commercial loans	866	2	—	—	866	2
Consumer loans	—	—	—	—	—	—
Commercial equipment	1,259	5	41	2	1,300	7
	11,152	23	8,130	15	19,282	38

Non-accrual loans decreased $1.4 million from $19.3 million or 1.43% of total loans at December 31, 2018 to $17.9 million or 1.23% of total loans at December 31, 2019. Non-accrual loans can be current but classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from non-accrual or charged-off loans is reversed against interest income. In accordance with the Company's policy, interest income is recognized on a cash basis or cost-recovery method, until the loan returns to accrual status.

At December 31, 2019, non-accrual loans of $17.9 million included 39 loans, of which $15.0 million, or 84% represented 18 loans and seven customer relationships. At December 31, 2018, non-accrual loans of $19.3 million included 38 loans, of which $15.3 million, or 79% represented 13 loans and four customer relationships. During the year ended December 31, 2019, non-accrual loans decreased $1.4 million primarily as a result of a written off loan relationship. At December 31, 2019, $5.1 million (28%) of non-accrual loans were current with all payments of principal and interest with no impairment and $12.8 million (72%) of non-accrual loans were delinquent with specific valuation reserves $522,000.

Non-accrual loans at December 31, 2019 and 2018 included three and one TDRs totaling $1.4 million and $29,000, respectively. These loans were classified solely as non-accrual for the calculation of financial ratios. Loan delinquency (90 days or greater delinquent and 31-89 days delinquent) increased $1.1 million from $12.2 million, or 0.91% of loans, at December 31, 2018 to $13.3 million, or 0.92% of loans, at December 31, 2019.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $11.7 million and $17.4 million at December 31, 2019 and 2018, respectively. Interest due but not recognized on these balances at December 31, 2019 and 2018 was $318,000 and $456,000, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $6.1 million and $1.9 million at December 31, 2019 and 2018, respectively. Interest due but not recognized on these balances at December 31, 2019 and 2018 was $302,000 and $81,000, respectively.

The Company considers a loan to be past due or delinquent when the terms of the contractual obligation are not met by the borrower. PCI loans are included as a single category in the table below as management believes, regardless of their age, there is a lower likelihood of aggregate loss related to these loan pools. Additionally, PCI loans are discounted to allow for the accretion of income on a level yield basis over the life of the loan based on expected cash flows. Regardless of payment status, as long as cash flows can be reasonably estimated, the associated discount on these loan pools results in income recognition. An analysis of past due loans as of December 31, 2019 and 2018 was as follows:

	December 31, 2019						
(dollars in thousands)	**31-60 Days**	**61-89 Days**	**90 or Greater Days**	**Total Past Due**	**PCI Loans**	**Current**	**Total Loan Receivables**
Commercial real estate	$ —	$ 217	$ 10,563	$ 10,780	$ 1,738	$ 952,259	$ 964,777
Residential first mortgages	—	—	—	—	—	167,710	167,710
Residential rentals	—	—	—	—	295	123,306	123,601
Construction and land dev.	—	—	—	—	—	34,133	34,133
Home equity and second mtg.	98	23	177	298	391	35,409	36,098
Commercial loans	—	—	1,807	1,807	—	61,295	63,102
Consumer loans	—	—	—	—	—	1,104	1,104
Commercial equipment	52	159	231	442	—	63,205	63,647
Total	$ 150	$ 399	$ 12,778	$ 13,327	$ 2,424	$1,438,421	$ 1,454,172

(dollars in thousands)	December 31, 2018						
	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	PCI Loans	Current	Total Loan Receivables
Commercial real estate	$ —	$ 677	$ 8,474	$ 9,151	$ 1,785	$ 867,080	$ 878,016
Residential first mortgages	—	66	146	212	466	156,031	156,709
Residential rentals	13	53	247	313	897	123,088	124,298
Construction and land dev.	—	—	—	—	—	29,705	29,705
Home equity and second mtg.	266	—	147	413	72	35,076	35,561
Commercial loans	—	—	866	866	—	70,814	71,680
Consumer loans	1	4	—	5	—	746	751
Commercial equipment	25	29	1,230	1,284	—	48,918	50,202
Total	$ 305	$ 829	$ 11,110	$ 12,244	$ 3,220	$1,331,458	$ 1,346,922

There were no loans greater than 90 days still accruing interest at December 31, 2019 and 2018, respectively.

Impaired Loans and Troubled Debt Restructures ("TDRs")

Impaired loans, including TDRs, at December 31, 2019 and 2018 were as follows:

(dollars in thousands)	December 31, 2019						
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized
Commercial real estate	$ 20,914	$ 15,919	$ 4,788	$ 20,707	$ 417	$ 21,035	$ 813
Residential first mortgages	1,921	1,917	—	1,917	—	1,962	86
Residential rentals	941	937	—	937	—	967	56
Construction and land dev.	—	—	—	—	—	—	—
Home equity and second mtg.	524	510	—	510	—	519	23
Commercial loans	3,127	1,807	1,320	3,127	210	3,284	152
Consumer loans	—	—	—	—	—	—	—
Commercial equipment	808	585	203	788	201	826	35
Total	$ 28,235	$ 21,675	$ 6,311	$ 27,986	$ 828	$ 28,593	$ 1,165

(dollars in thousands)	December 31, 2018						
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized
Commercial real estate	$ 27,835	$ 24,515	$ 3,025	$ 27,540	$ 326	$ 27,833	$ 1,275
Residential first mortgages	2,527	2,527	—	2,527	—	2,573	126
Residential rentals	1,745	1,745	—	1,745	—	1,792	85
Construction and land dev.	729	729	—	729	—	729	45
Home equity and second mtg.	294	288	—	288	—	291	13
Commercial loans	2,762	1,888	863	2,751	700	2,804	118
Consumer loans	1	—	1	1	1	1	—
Commercial equipment	1,315	1,121	178	1,299	153	1,354	31
Total	$ 37,208	$ 32,813	$ 4,067	$ 36,880	$ 1,180	$ 37,377	$ 1,693

TDRs, included in the impaired loan schedules above, as of December 31, 2019 and 2018 were as follows:

(dollars in thousands)	December 31, 2019		December 31, 2018	
	Dollars	Number of Loans	Dollars	Number of Loans
Commercial real estate	$ 1,420	3	$ 5,612	7
Residential first mortgages	64	1	66	1
Residential rentals	—	—	216	1
Construction and land development	—	—	729	2
Commercial loans	—	—	53	1
Commercial equipment	565	4	29	1
Total TDRs	$ 2,049	8	$ 6,705	13
Less: TDRs included in non-accrual loans	(1,399)	(3)	(29)	(1)
Total performing accrual TDR loans	$ 650	5	$ 6,676	12

TDRs decreased $4.7 million from $6.7 million at December 31, 2018 to $2.0 million at December 31, 2019. TDRs that are included in non-accrual are classified as non-accrual loans solely for the calculation of financial ratios. The Company had specific reserves of $87,000 on three TDRs totaling $88,000 at December 31, 2019 and $165,000 on one TDRs totaling $1.6 million at December 31, 2018. During the year ended December 31, 2019, TDR disposals, which included payoffs and refinancing consisted of seven loans totaling $4.4 million. TDR loan principal curtailment was $236,000 for the year ended December 31, 2019. There was one TDR added during the year ended December 31, 2019 totaling $25,000. During the year ended December 31, 2018, TDR disposals, which included payoffs and refinancing decreased by three loans totaling $3.9 million. TDR loan principal curtailment was $176,000 for the year ended December 31, 2018. There were zero TDRs added during the year ended December 31, 2018.

Performing TDRs as a percentage of outstanding TDRs at December 31, 2019 and 2018 were $650,000 or 31.7%, and $6.7 million or 99.6%, respectively. Interest income in the amount of $92,000 and $348,000 was recognized on outstanding TDR loans for the years ended December 31, 2019 and 2018, respectively. The Bank's TDRs are performing according to the terms of their agreements at market interest rates appropriate for the level of credit risk of each TDR loan. The average contractual interest rate on performing TDRs at December 31, 2019 and 2018 was 4.51% and 5.08%, respectively.

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the years ended December 31, 2019, 2018 and 2017, respectively. An allocation of the allowance to one category of loans does not prevent the Company from using that allowance to absorb losses in a different category.

Year Ended	December 31, 2019				
(dollars in thousands)	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$ 6,882	$ (148)	$ 15	$ 649	$ 7,398
Residential first mortgages	755	—	—	(291)	464
Residential rentals	498	(53)	46	(94)	397
Construction and land development	310	(329)	—	292	273
Home equity and second mortgages	133	(28)	6	38	149
Commercial loans	1,482	(1,127)	40	691	1,086
Consumer loans	6	(5)	2	7	10
Commercial equipment	910	(685)	102	838	1,165
	$ 10,976	$ (2,375)	$ 211	$ 2,130	$ 10,942
Purchase Credit Impaired**	$ —	$ —	$ —	$ —	$ —

** There is no allowance for loan loss on the PCI portfolios. A more detailed rollforward schedule will be presented if an allowance is required.

Year Ended	December 31, 2018				
(dollars in thousands)	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$ 6,451	$ (268)	$ 10	$ 689	$ 6,882
Residential first mortgages	1,144	(115)	—	(274)	755
Residential rentals	512	(84)	—	70	498
Construction and land development	462	—	—	(152)	310
Home equity and second mortgages	162	(7)	18	(40)	133
Commercial loans	1,013	(94)	189	374	1,482
Consumer loans	7	(2)	—	1	6
Commercial equipment	764	(647)	56	737	910
	$ 10,515	$ (1,217)	$ 273	$ 1,405	$ 10,976

Year Ended	December 31, 2017				
(dollars in thousands)	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$ 5,212	$ (217)	$ 63	$ 1,393	$ 6,451
Residential first mortgages	1,406	—	—	(262)	1,144
Residential rentals	362	(42)	—	192	512
Construction and land development	941	(26)	—	(453)	462
Home equity and second mortgages	138	(14)	1	37	162
Commercial loans	794	(13)	1	231	1,013
Consumer loans	3	(2)	—	6	7
Commercial equipment	1,004	(168)	62	(134)	764
	$ 9,860	$ (482)	$ 127	$ 1,010	$ 10,515

The following tables detail loan receivable and allowance balances disaggregated on the basis of the Company's impairment methodology at December 31, 2019 and 2018, respectively.

	December 31, 2019				December 31, 2018			
(dollars in thousands)	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Purchase Credit Impaired	Total	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Purchase Credit Impaired	Total
Loan Receivables:								
Commercial real estate	$ 20,707	$ 942,332	$ 1,738	$ 964,777	$ 27,540	$ 848,691	$ 1,785	$ 878,016
Residential first mortgages	1,917	165,793	—	167,710	2,527	153,716	466	156,709
Residential rentals	937	122,369	295	123,601	1,745	121,656	897	124,298
Construction and land development	—	34,133	—	34,133	729	28,976	—	29,705
Home equity and second mortgages	510	35,197	391	36,098	288	35,201	72	35,561
Commercial loans	3,127	59,975	—	63,102	2,751	68,929	—	71,680
Consumer loans	—	1,104	—	1,104	1	750	—	751
Commercial equipment	788	62,859	—	63,647	1,299	48,903	—	50,202
	$ 27,986	$ 1,423,762	$ 2,424	$ 1,454,172	$ 36,880	$ 1,306,822	$ 3,220	$ 1,346,922
Allowance for loan losses:								
Commercial real estate	$ 417	$ 6,981	$ —	$ 7,398	$ 326	$ 6,556	$ —	$ 6,882
Residential first mortgages	—	464	—	464	—	755	—	755
Residential rentals	—	397	—	397	—	498	—	498
Construction and land development	—	273	—	273	—	310	—	310
Home equity and second mortgages	—	149	—	149	—	133	—	133
Commercial loans	210	876	—	1,086	700	782	—	1,482
Consumer loans	—	10	—	10	1	5	—	6
Commercial equipment	201	964	—	1,165	153	757	—	910
	$ 828	$ 10,114	$ —	$ 10,942	$ 1,180	$ 9,796	$ —	$ 10,976

Credit Quality Indicators

Credit quality indicators as of December 31, 2019 and 2018 were as follows:

Credit Risk Profile by Internally Assigned Grade

	Commercial Real Estate		Construction and Land Dev.		Residential Rentals	
(dollars in thousands)	12/31/2019	12/31/2018	12/31/2019	12/31/2018	12/31/2019	12/31/2018
Unrated	$ 102,695	$ 112,280	$ 2,075	$ 2,172	$ 38,139	$ 37,478
Pass	840,403	741,037	32,058	26,805	84,811	85,551
Special mention	—	—	—	—	—	—
Substandard	21,679	24,699	—	728	651	1,269
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	$ 964,777	$ 878,016	$ 34,133	$ 29,705	$ 123,601	$ 124,298

(dollars in thousands)	Commercial Loans 12/31/2019	Commercial Loans 12/31/2018	Commercial Equipment 12/31/2019	Commercial Equipment 12/31/2018	Total Commercial Portfolios 12/31/2019	Total Commercial Portfolios 12/31/2018
Unrated	$ 16,754	$ 19,157	$ 26,045	$ 15,373	$ 185,708	$ 186,460
Pass	43,221	49,828	37,399	33,685	1,037,892	936,906
Special mention	—	—	—	—	—	—
Substandard	3,127	2,695	203	1,144	25,660	30,535
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	$ 63,102	$ 71,680	$ 63,647	$ 50,202	$ 1,249,260	$ 1,153,901

(dollars in thousands)	Non-Commercial Portfolios ** 12/31/2019	Non-Commercial Portfolios ** 12/31/2018	Total All Portfolios 12/31/2019	Total All Portfolios 12/31/2018
Unrated	$ 164,991	$ 146,889	$ 350,699	$ 333,349
Pass	38,718	44,441	1,076,610	981,347
Special mention	—	—	—	—
Substandard	1,203	1,691	26,863	32,226
Doubtful	—	—	—	—
Loss	—	—	—	—
Total	$ 204,912	$ 193,021	$ 1,454,172	$ 1,346,922

** Non-commercial portfolios are generally evaluated based on payment activity but may be risk graded if part of a larger commercial relationship or are credit impaired (e.g., non-accrual loans, TDRs).

Credit Risk Profile Based on Payment Activity (Non-Commercial Portfolios)

(dollars in thousands)	Residential First Mortgages 12/31/2019	Residential First Mortgages 12/31/2018	Home Equity and Second Mtg. 12/31/2019	Home Equity and Second Mtg. 12/31/2018	Consumer Loans 12/31/2019	Consumer Loans 12/31/2018
Performing	$ 167,710	$ 156,563	$ 35,921	$ 35,414	$ 1,104	$ 751
Nonperforming	—	146	177	147	—	—
Total	$ 167,710	$ 156,709	$ 36,098	$ 35,561	$ 1,104	$ 751

A risk grading scale is used to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Loans are graded at inception, annually thereafter when financial statements are received and at other times when there is an indication that a credit may have weakened or improved. Only commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are subject to being risk rated.

Home equity and second mortgages and consumer loans are evaluated for creditworthiness in underwriting and are monitored based on borrower payment history. Residential first mortgages are evaluated for creditworthiness during credit due diligence before being purchased. Residential first mortgages, home equity and second mortgages and consumer loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are TDRs or nonperforming loans with an Other Assets Especially Mentioned (“OAEM”) or higher risk rating due to a delinquent payment history.

Management reviews credit quality indicators as part of its individual loan reviews on a quarterly basis. The overall quality of the Bank's loan portfolio is assessed using the Bank's risk grading scale, the level and trends of net nonperforming loans and delinquencies, the performance of TDRs and the general economic conditions in the Company's geographical market. This review process is assisted by frequent internal reporting of loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Credit quality indicators and allowance factors are adjusted based on management's judgment during the monthly and quarterly review process. Loans subject to risk ratings are graded on a scale of one to ten. The Company considers loans rated substandard, doubtful and loss as classified assets for regulatory and financial reporting.

Ratings 1 thru 6 - Pass

Ratings 1thru 6 have asset risks ranging from excellent low risk to adequate. The specific rating assigned considers customer history of earnings, cash flows, liquidity, leverage, capitalization, consistency of debt service coverage, the nature and extent of customer relationship and other relevant specific business factors such as the stability of the industry or market area, changes to management, litigation or unexpected events that could have an impact on risks.

Rating 7 - OAEM (Other Assets Especially Mentioned) – Special Mention

These credits, while protected by the financial strength of the borrowers, guarantors or collateral, have reduced quality due to economic conditions, less than adequate earnings performance or other factors which require the lending officer to direct more than normal attention to the credit. Financing alternatives may be limited and/or command higher risk interest rates. OAEM loans are the first adversely classified assets on our watch list. These relationships will be reviewed at least quarterly.

Rating 8 - Substandard

Substandard assets are assets that are inadequately protected by the sound worth or paying capacity of the borrower or of the collateral pledged. These assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. The loans may have a delinquent history or combination of weak collateral, weak guarantor strength or operating losses. When a loan is assigned to this category the Bank may estimate a specific reserve in the loan loss allowance analysis. These assets listed may include assets with histories of repossessions or some that are non-performing bankruptcies. These relationships will be reviewed at least quarterly.

Rating 9 - Doubtful

Doubtful assets have many of the same characteristics of Substandard with the exception that the Bank has determined that loss is not only possible but is probable and the risk is close to certain that loss will occur. When a loan is assigned to this category the Bank will identify the probable loss and the loan will receive a specific reserve in the loan loss allowance analysis. These relationships will be reviewed at least quarterly.

Rating 10 – Loss

Once an asset is identified as a definite loss to the Bank, it will receive the classification of "loss." There may be some future potential recovery; however, it is more practical to write off the loan at the time of classification. Losses will be taken in the period in which they are determined to be uncollectable.

Purchased Credit-Impaired Loans and Acquired Loans

PCI loans had an unpaid principal balance of $2.9 million and $3.9 million and a carrying value of $2.4 million and $3.2 million at December 31, 2019 and December 31, 2018, respectively. PCI loans represented 0.13% and 0.19% of total assets at December 31, 2019 and December 31, 2018, respectively. Determining the fair value of the PCI loans at the time of acquisition required the Company to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest considering prepayment assumptions. For such loans, the excess of cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called accretable yield. At acquisition, the difference between contractually required payments and the cash flows expected to be collected reflects estimated credit losses and is called the nonaccretable difference. In accordance with U.S. GAAP, there was no carryover of previously established allowance for loan losses from acquisition. In conjunction with the acquisition of County First, the PCI loan portfolio was accounted for at fair value as follows:

(dollars in thousands)	January 1, 2018
Contractual principal and interest at acquisition	$ 6,126
Nonaccretable difference	(1,093)
Expected cash flows at acquisition	5,033
Accretable yield	(516)
Basis in PCI loans at acquisition - estimated fair value	$ 4,517

A summary of changes in the accretable yield for PCI loans for the year ended December 31, 2019 follows:

	Years Ended December 31,	
(dollars in thousands)	2019	2018
Accretable yield, beginning of period	$ 733	$ —
Additions	—	516
Accretion	(354)	(230)
Reclassification from (to) nonaccretable difference	330	134
Other changes, net	(32)	313
Accretable yield, end of period	$ 677	$ 733

Accounting standards require a periodic recast of the expected cash flows on the PCI loan portfolio. The recast was performed during the second and fourth quarters of 2019 and the fourth quarter of 2018 and resulted in a reclassification of $330,000 and $134,000, respectively, from the credit (nonaccretable) portion of the discount to the liquidity (accretable) portion of the discount. Also, based on the recast, future expected cash flows, not related to the reclassification, decreased $32,000 for the year ended December 31, 2019 and increased $313,000 for the year ended December 31, 2018.

The following is a summary of acquired and non-acquired loans as of December 31, 2019 and 2018:

BY ACQUIRED AND NON-ACQUIRED	December 31, 2019	%	December 31, 2018	%
Acquired loans - performing	$ 74,654	5.13%	$ 103,667	7.70%
Acquired loans - purchase credit impaired ("PCI")	2,424	0.17%	3,220	0.24%
Total acquired loans	77,078	5.30%	106,887	7.94%
Non-acquired loans**	1,377,094	94.70%	1,240,035	92.06%
Gross loans	1,454,172	100.00%	1,346,922	100.00%
Net deferred costs (fees)	1,879	0.13%	1,183	0.09%
Total loans, net of deferred costs	$ 1,456,051		$ 1,348,105	

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

At December 31, 2019 acquired performing loans, which totaled $74.7 million, included a $1.2 million net acquisition accounting fair market value adjustment, representing a 1.55% discount and PCI loans which totaled $2.4 million, included a $516,000 adjustment, representing a 17.55% discount.

At December 31, 2018 acquired performing loans, which totaled $103.7 million, included a $1.9 million net acquisition accounting fair market value adjustment, representing a 1.76% discount and PCI loans which totaled $3.2 million, included a $696,000 adjustment, representing a 17.77% discount.

Related Party Loans

Included in loans receivable were loans made to executive officers and directors or their related interests. These loans were made in the ordinary course of business at substantially the same terms and conditions as those prevailing at the time for comparable transactions with persons not affiliated with the Bank and are not considered to involve more than the normal risk of collectability. For the years ended December 31, 2019, 2018 and 2017, all loans to directors and executive officers of the Bank performed according to original loan terms. Activity in loans outstanding to executive officers and directors are summarized as follows:

	At and For the Years Ended December 31,		
(dollars in thousands)	2019	2018	2017
Balance, beginning of period	$ 24,852	$ 26,476	$ 26,464
Loans and additions	1,845	46	3,699
Change in Directors' status	(10,452)	575	—
Repayments	(7,575)	(2,245)	(3,687)
Balance, end of period	$ 8,670	$ 24,852	$ 26,476

In addition, the Bank had outstanding loans of $5.4 million, $9.2 million and $10.4 million, respectively, for the years ended December 31, 2019, 2018 and 2017 to charitable and community organizations in which the Bank's executive officers and directors volunteer.

Loan Participations

The Bank sells portions of commercial, commercial real estate and commercial construction loans to other lenders. The Bank's sold participated loans with other lenders at December 31, 2019 and 2018 were $14.9 million and $24.6 million, respectively. The Bank may also buy loans, portions of loans, or participation certificates from other lenders to limit overall exposure. The Bank only purchases loans or portions of loans after reviewing loan documents, underwriting support, and completing other procedures, as necessary.

The Bank's purchased participation loans from other lenders at December 31, 2019 and 2018 were $3.4 million and $11.9 million, respectively. Purchased participation loans are subject to the same regulatory and internal policy requirements as other loans in the Bank's portfolio.

NOTE 4 – GOODWILL AND OTHER INTANGIBLE ASSETS

The Company recognized core deposit intangible assets of $3.6 million with the acquisition of County First Bank. Core deposit intangible is amortized on an accelerated basis over its estimated life of 8 years. Amortization expense related to intangible assets totaled $688,000 and $784,000 for the years ended December 31, 2019 and 2018.

Goodwill and other intangible assets are presented in the tables below.

(dollars in thousands)	As of December 31, 2019	As of December 31, 2018
Goodwill	$ 10,835	$ 10,835

	As of December 31, 2019			As of December 31, 2018		
(dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Intangible Asset	Gross Carrying Amount	Accumulated Amortization	Net Intangible Asset
Core deposit intangibles	$ 3,590	$ (1,472)	$ 2,118	$ 3,590	$ (784)	$ 2,806

Estimated amortization expense for other intangible for each of the next five years:

(dollars in thousands)	
2020	$ 591
2021	495
2022	398
2023	302
2024	205
Thereafter	127
	$ 2,118

Based upon an annual impairment analysis performed during the fourth quarter of 2019 and 2018, it was determined that goodwill is not impaired as of December 31, 2019 and 2018. The Company has not identified any triggering events since the impairment evaluation that would indicate potential impairment.

Core deposit intangibles are evaluated for impairment if events and circumstances indicate a potential for impairment. No impairment charges were recorded for other intangible assets in any of the periods presented.

NOTE 5 - PREMISES AND EQUIPMENT AND LEASE COMMITMENTS

A summary of the cost and accumulated depreciation of premises and equipment at December 31, 2019 and 2018 follows:

(dollars in thousands)	December 31, 2019	December 31, 2018
Land	$ 4,406	$ 4,358
Building and improvements	25,001	25,198
Furniture and equipment	10,149	9,715
Automobiles	256	303
Total cost	39,812	39,574
Less accumulated depreciation	18,150	16,652
Premises and equipment, net	$ 21,662	$ 22,922

Operating Leases

Certain Bank facilities are leased under various operating leases. A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On January 1, 2019, the Company adopted ASU No. 2016-02 “Leases” (Topic 842) and all subsequent ASUs that modified Topic 842. For the Company, Topic 842 primarily affected the accounting treatment for operating lease agreements in which the Company is the lessee. All of the leases in which the Company is the lessee are for branches and office space. All of these leases are classified as operating leases, and therefore, were previously not recognized on the Company’s consolidated balance sheet. With the adoption of Topic 842, operating lease agreements are required to be recognized on the consolidated balance sheet as a right-of-use-asset with a corresponding lease liability.

At December 31, 2019, the Company had lease liabilities totaling $8.5 million and right of use assets totaling $8.4 million related to these leases. Remaining lease terms range from 2 months to 25 years. The right of use assets and lease liabilities are impacted by the length of the lease term and the discount rate used to present value the minimum lease payments. The Company's lease agreements often include one or more options to renew at the Company's discretion. If at lease inception, the Company considers the exercising of a renewal option to be reasonably certain, the Company will include the extended term in the calculation of the right of use asset and lease liability. Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, the Company utilizes its incremental borrowing rate at lease inception over a similar term. For operating leases existing prior to January 1, 2019, the FHLB fixed advance rate which corresponded with the remaining lease term as of January 1, 2019 was used.

For the year ended December 31, 2019, the weighted average remaining lease term for operating leases was 18.8 years and the weighted average discount rate used in the measurement of operating leases was 3.50%. Operating lease cost for the year ended December 31, 2019 was $854,000 and cash paid for amounts included in the measurement of lease liabilities was $740,000.

The Company elected to apply certain practical expedients provided under ASU 2016-02 whereby management did not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. The Company accounted for lease and non-lease components separately because such amounts are readily determinable under the lease contracts. ASC 842 allows a lessee to make an accounting policy election whereby short-term leases are not recognized on the balance sheet. However, the Company did not have any short-term leases upon adoption or during the year.

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

(dollars in thousands)		
Lease payments due:		
Within one year	$	697
After one but within two years		670
After two but within three years		602
After three but within four years		612
After four but within five years		620
After five years		8,773
Total undiscounted cash flows	$	11,974
Discount on cash flows		3,479
Total lease liability	$	8,495

Certain Bank facilities are leased under various operating leases. Rent expense was $854,000, $974,000 and $761,000 for the years ended December 31, 2019, 2018 and 2017, respectively. Future minimum rental commitments under non-cancellable operating leases are as follows at December 31, 2019:

(dollar in thousands)		
2020	$	697
2021		670
2022		602
2023		612
2024		620
Thereafter		8,773
Total	$	11,974

As of December 31, 2019, the Company had a small office condo held for sale with a fair value of $430,000 that was recorded as a non-recurring Level 3 asset. The Company recorded an impairment of $1,000 based on fair value of the of the property during the fourth quarter of 2019. During 2017, the Company sold property for net proceeds of $392,000 with a gain on sale of $47,000.

NOTE 6 - OTHER REAL ESTATE OWNED ("OREO")

OREO assets are presented net of the allowance for losses. The Company considers OREO as classified assets for regulatory and financial reporting. OREO carrying amounts reflect management's estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs. An analysis of the activity follows.

	Years Ended December 31,	
(dollars in thousands)	2019	2018
Balance at beginning of year	$ 8,111	$ 9,341
Additions of underlying property	3,567	307
Disposals of underlying property	(3,004)	(1,005)
Valuation allowance	(901)	(532)
Balance at end of period	$ 7,773	$ 8,111

During the year ended December 31, 2019, additions of $3.6 million consisted of $3.4 million for commercial real estate acquired at foreclosure on a $3.8 million classified loan relationship recorded at the estimated fair value at the date of foreclosure less selling costs, establishing a new cost basis and $146,000 for residential lots. The Company disposed of commercial real estate for proceeds of $3.1 million and recognized a gain of $190,000. Residential lots were sold for $63,000 with a loss of $2,000 along with sales of commercial equipment for $35,000 for the year ended December 31, 2019. The Bank provided $280,000 in financing for the sale of a commercial building during the first quarter of 2019. The transaction qualified for full accrual sales treatment under ASC Topic 610-20 "Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets".

During the year ended December 31, 2018, additions of $307,000 consisted of $165,000 of capitalized costs to improve a development project and $142,000 for commercial real estate. The Company disposed of commercial real estate for proceeds of $807,000 and gains of $4,000 along with residential lots for proceeds of $190,000 and a loss of $12,000 for the year ended December 31, 2018.

The Company had no impaired loans secured by residential real estate for which formal foreclosure proceedings were in process at December 31, 2019 and 2018.

Additions to the valuation allowances of $901,000, $532,000 and $600,000 were recorded to adjust properties to current appraised values for the years ended December 31, 2019, 2018 and 2017, respectively. OREO carrying amounts reflect management's estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs. Expenses applicable to OREO assets included the following.

	Years Ended December 31,		
(dollars in thousands)	2019	2018	2017
Valuation allowance	$ 901	$ 532	$ 600
Losses (gains) on dispositions	(188)	8	(43)
Operating expenses	250	117	146
	$ 963	$ 657	$ 703

NOTE 7 - DEPOSITS

Deposits consist of the following:

(dollars in thousands)	December 31, 2019	December 31, 2018
Noninterest-bearing demand	$ 241,174	$ 209,378
Interest-bearing:		
Demand	523,802	437,169
Money market deposits	283,438	266,160
Savings	69,254	69,893
Certificates of deposit	394,169	447,029
Total interest-bearing	1,270,663	1,220,251
Total Deposits	$ 1,511,837	$ 1,429,629

As of December 31, 2019, and 2018, there were $7.5 million and $7.9 million, respectively in deposit accounts held by executive officers and directors of the Bank and Company.

The aggregate amount of certificates of deposit in denominations of $250,000 or more at December 31, 2019, and 2018 was $86.6 million and $117.2 million, respectively.

At December 31, 2019 the scheduled contractual maturities of certificates of deposit are as follows:

(dollars in thousands)	December 31, 2019
Within one year	$ 309,043
Year 2	56,755
Year 3	15,830
Year 4	7,035
Year 5	5,506
	$ 394,169

The FDIC's examination policies require that the Company monitor all customer deposit concentrations at or above 2% of total deposits. At December 31, 2019, the Bank had two customer deposit relationships that exceeded 2% of total deposits, totaling $297.1 million which represented 19.6% of total deposits of $1,511.8 million. At December 31, 2018, the Bank had one customer deposit relationship that exceeded 2% of total deposits, totaling $158.8 million which represented 11.1% of total deposits of $1,429.6 million. The reported concentrations at December 31, 2019 and 2018 were with local municipal agencies.

NOTE 8 - SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The Bank's long-term debt and short-term borrowings consist of advances from the FHLB of Atlanta. The Bank classifies debt based upon original maturity and does not reclassify debt to short-term status during its life. Long-term debt and short-term borrowings include fixed-rate long-term advances, short-term advances, daily advances, fixed-rate convertible advances, and variable-rate convertible advances.

Rates and maturities on long-term advances and short-term borrowings were as follows:

	Fixed-Rate	Fixed-Rate Convertible	Variable Convertible
December 31, 2019			
Highest rate	2.92%	n/a	n/a
Lowest rate	1.00%	n/a	n/a
Weighted average rate	2.26%	n/a	n/a
Matures through	2036	n/a	n/a
December 31, 2018			
Highest rate	2.92%	n/a	n/a
Lowest rate	1.00%	n/a	n/a
Weighted average rate	2.63%	n/a	n/a
Matures through	2036	n/a	n/a

Average rates of long-term debt and short-term borrowings were as follows:

	At or for the Year Ended December 31,	
(dollars in thousands)	2019	2018
Long-term debt		
Long-term debt outstanding at end of period	$ 40,370	$ 20,436
Weighted average rate on outstanding long-term debt	2.31%	2.84%
Maximum outstanding long-term debt of any month end	55,392	55,493
Average outstanding long-term debt	32,702	35,684
Approximate average rate paid on long-term debt	2.27%	2.39%
Short-term borrowings		
Short-term borrowings outstanding at end of period	$ 5,000	$ 35,000
Weighted average rate on short-term borrowings	1.81%	2.51%
Maximum outstanding short-term borrowings at any month end	59,500	74,000
Average outstanding short-term borrowings	30,965	42,286
Approximate average rate paid on short-term borrowings	2.50%	1.81%

The Bank's fixed-rate debt generally consists of advances with monthly interest payments and principal due at maturity.

The Bank's fixed-rate convertible long-term debt is callable by the issuer, after an initial period ranging from six months to five years. The instruments are callable at the end of the initial period. As of December 31, 2019, and 2018, all fixed-rate convertible debt has passed its call date. All advances have a prepayment penalty, determined based upon prevailing interest rates.

Variable convertible advances have an initial variable rate based on a discount to LIBOR. As of December 31, 2019, there were no remaining fixed or variable convertible advances.

During the year ended December 31, 2019, the Bank paid off $15.1 million of maturing long-term debt and added five long-term fixed-rate advances totaling $35.0 million with one $15.1 million advance called in November 2019, $10.0 million maturing in 2020 at 1.85%, $3.0 million in 2021 at 1.70%, $2.0 million in 2022 at 1.69%, and $5.0 million in 2024 at 1.67%. During the year ended December 31, 2018, the Bank paid off $55.1 million of maturing long-term debt and added two $10.0 million fixed-rate advances maturing in 2020 at 2.81% and 2021 at 2.92%, respectively.

At December 31, 2019 and 2018, $40.4 million or 100% and $20.4 million or 100%, respectively, of the Bank's long-term debt was fixed for rate and term, as the conversion optionality of the advances have either been exercised or expired. The contractual maturities of long-term debt were as follows at December 31, 2019 and 2018:

	December 31, 2019			
(dollars in thousands)	Fixed-Rate	Fixed-Rate Convertible	Variable Convertible	Total
Due in 2020	$ 20,000	$ —	$ —	$ 20,000
Due in 2021	13,000	—	—	13,000
Due in 2022	2,188	—	—	2,188
Due in 2023	—	—	—	—
Due in 2024	5,000	—	—	5,000
Thereafter	182	—	—	182
	$ 40,370	$ —	$ —	$ 40,370

The Bank also has daily advances outstanding and short-term advances with terms of less than one year, which are classified as short-term borrowings. Daily advances are repayable at the Bank's option at any time and are re-priced daily. There were no daily advances as of December 31, 2019 and December 31, 2018. The Bank had short-term advances of $5.0 million and $35.0 million, respectively, at December 31, 2019 and 2018.

Under the terms of an Agreement for Advances and Security Agreement with Blanket Floating Lien (the "Agreement"), the Bank maintains collateral with the FHLB consisting of one-to four-family residential first mortgage loans, second mortgage loans, commercial real estate and securities. The Agreement limits total advances to 30% of assets, which were $538.8 million and $506.2 million at December 31, 2019 and 2018, respectively.

At December 31, 2019, $578.7 million of loans and securities were pledged or in safekeeping at the FHLB. Loans and securities are subject to collateral eligibility rules and are adjusted for market value and collateral value factors to arrive at lendable collateral values. At December 31, 2019, FHLB lendable collateral was valued at $458.1 million. At December 31, 2019, the Bank had total lendable pledged collateral at the FHLB of $304.6 million of which $216.3 million was available to borrow in addition to outstanding advances of $45.4 million and letter of credit of $43.0 million. Unpledged lendable collateral was $153.5 million, bringing total available borrowing capacity to $369.8 million at December 31, 2019.

At December 31, 2018, $589.2 million of loans and securities were pledged or in safekeeping at the FHLB. Loans and securities are subject to collateral eligibility rules and are adjusted for market value and collateral value factors to arrive at lendable collateral values. At December 31, 2018, FHLB lendable collateral was valued at $466.0 million. At December 31, 2018, the Bank had total lendable pledged collateral at the FHLB of $298.6 million of which $213.1 million was available to borrow in addition to outstanding advances of $55.4 million. Unpledged lendable collateral was $167.4 million, bringing total available borrowing capacity to $380.5 million at December 31, 2018.

The Bank has established a short-term credit facility with the Federal Reserve Bank of Richmond under its Borrower in Custody program. The Bank had segregated collateral sufficient to draw $7.7 million and $5.7 million under this agreement at December 31, 2019 and 2018, respectively. In addition, the Bank has established unsecured short-term credit facilities with other commercial banks totaling $32.0 million and $22.0 million at December 31, 2019 and 2018. Additionally, the Bank has a $40.0 million repurchase credit facility. The repurchase facility requires the pledging of securities as collateral. No amounts were outstanding under the Borrower in Custody or the unsecured and secured commercial lines at December 31, 2019 and 2018.

NOTE 9 - GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES ("TRUPs")

On June 15, 2005, Tri-County Capital Trust II ("Capital Trust II"), a Delaware business trust formed, funded and wholly owned by the Company, issued $5.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I ("Capital Trust I"), a Delaware business trust formed, funded and wholly owned by the Company, issued $7.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company's $217,000 capital contribution for Capital Trust I's common securities, to purchase $7.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

NOTE 10 – SUBORDINATED NOTES

On February 6, 2015 the Company issued $23.0 million of unsecured 6.25% fixed-to-floating-rate subordinated notes due February 15, 2025 ("subordinated notes"). The subordinated notes qualified as Tier 2 regulatory capital and replaced SBLF Tier 1 capital. The subordinated notes were not listed on any securities exchange or included in any automated dealer quotation system and there was no market for the notes. The notes were unsecured obligations and were subordinated in right of payment to all existing and future senior debt, whether secured or unsecured. The notes were not guaranteed obligations of any of the Company's subsidiaries. Interest accrued at a fixed per annum rate of 6.25% from and including the issue date to but excluding February 15, 2020. The subordinated notes were able to be redeemed in whole or in part on February 15, 2020. The redemption price was equal to 100% of the principal amount of the subordinated notes to be redeemed plus accrued and unpaid interest to the date of redemption.

On December 31, 2019, the Company issued a total of 312,747 shares of its common stock, par value $0.01 in a private placement offering. The Company received net proceeds of $10.6 million after deal expenses. On February 15, 2020, the Company used the proceeds and a cash dividend from the Bank to redeem the Company's outstanding $23.0 million of 6.25% fixed to floating rate subordinate notes.

NOTE 11 - REGULATORY CAPITAL

As of December 31, 2015, the Bank was a member of the Federal Reserve System and its primary federal regulator was the Federal Reserve Board. On April 18, 2016, Community Bank of the Chesapeake, cancelled its stock in the Federal Reserve Bank of Richmond. This terminated its status as a member of the Federal Reserve System. As of that date, the Bank's primary regulator became the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to regulation, supervision and regular examination by the Maryland Commissioner of Financial Regulation (the "Commissioner") and the FDIC.

The Company continues to be subject to regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA").

The Company and Bank are subject to the Basel III Capital Rules with full compliance with all of the final rule's requirements. In July 2013, the final rules were published (the "Basel III Capital Rules") establishing a comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The rules included a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, required a minimum ratio ("Min. Ratio") of Total Capital to risk-weighted assets of 8.0%, and required a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer ("CCB") was also established above the regulatory minimum capital requirements. This capital conservation buffer began its phase-in period beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revised the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets.

As of December 31, 2019, and 2018, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the new Basel III Capital Rules. Management believes, as of December 31, 2019 and 2018, that the Company and the Bank met all capital adequacy requirements to which they were subject.

The Company's and the Bank's regulatory capital amounts and ratios are presented in the following table.

Regulatory Capital and Ratios		**The Company**		**The Bank**	
(dollars in thousands)		**December 31, 2019**	**December 31, 2018**	**December 31, 2019**	**December 31, 2018**
Common Equity		$ 181,494	$ 154,482	$ 202,604	$ 185,073
Goodwill		(10,835)	(10,835)	(10,835)	(10,835)
Core Deposit intangible (net of deferred tax liability)		(1,534)	(2,034)	(1,534)	(2,034)
AOCI (Gains) Losses		(1,504)	1,847	(1,504)	1,847
Common Equity Tier 1 Capital		167,621	143,460	188,731	174,051
TRUPs		12,000	12,000	—	—
Tier 1 Capital		179,621	155,460	188,731	174,051
Allowable Reserve for Credit Losses and Other Tier 2 Adjustments		10,993	11,027	10,993	11,027
Subordinated Notes		23,000	23,000	—	—
Tier 2 Capital		$ 213,614	$ 189,487	$ 199,724	$ 185,078
Risk-Weighted Assets ("RWA")		$ 1,508,352	$ 1,384,807	$ 1,506,766	$ 1,383,048
Average Assets ("AA")		$ 1,782,834	$ 1,635,594	$ 1,781,415	$ 1,632,846
2019 Regulatory Min. Ratio + CCB (1)					
Common Tier 1 Capital to RWA	*7.00%*	11.11%	10.36%	12.53%	12.58%
Tier 1 Capital to RWA	*8.50*	11.91	11.23	12.53	12.58
Tier 2 Capital to RWA	*10.50*	14.16	13.68	13.26	13.38
Tier 1 Capital to AA (Leverage) (2)	*n/a*	10.08	9.50	10.59	10.66

(1) These are the fully phased-in ratios as of January 1, 2019 that include the minimum capital ratio ("Min. Ratio") + the capital conservation buffer ("CCB"). The phase-in period is more fully described in the footnote above.

(2) Tier 1 Capital to AA (Leverage) has no capital conservation buffer defined. PCA well capitalized is defined as 5.00%.

On February 15, 2020, the Company used the proceeds from a private placement offering and a cash dividend from the Bank to redeem the Company's outstanding $23.0 million of 6.25% fixed to floating rate subordinate notes. If the redemption of the subordinated notes had been effective as of December 31, 2019, this would have resulted in the Company's regulatory Tier 2 Risk-Based Capital decreasing to 12.64% If the redemption of the subordinated notes had been effective as of December 31, 2019, this would have resulted in the Bank's regulatory capital ratios decreasing to 11.66% for Common Tier 1 Capital and Tier 1 Capital, 12.39% for Tier 2 Risk-Based Capital and 9.86% for Leverage Capital.

NOTE 12 - ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2019, 2018 and 2017. The Company's comprehensive gains and losses and reclassification adjustments were solely for securities for the years ended December 31, 2019, 2018 and 2017. Reclassification adjustments are recorded in non-interest income.

Years Ended	**December 31, 2019**			**December 31, 2018**			**December 31, 2017**		
(dollars in thousands)	**Before Tax**	**Tax Effect**	**Net of Tax**	**Before Tax**	**Tax Effect**	**Net of Tax**	**Before Tax**	**Tax Effect**	**Net of Tax**
Net unrealized holding gains (losses) arising during period	$ 3,587	$ 987	$ 2,600	$ (879)	$ (242)	$ (637)	$ (103)	$ (41)	$ (62)
Reclassification adjustment for HTM to AFS securities	810	223	587	—	—	—	—	—	—
Reclassification adjustments	226	62	164	—	—	—	(8)	(3)	(5)
Other comprehensive income (loss)	$ 4,623	$ 1,272	$ 3,351	$ (879)	$ (242)	$ (637)	$ (111)	$ (44)	$ (67)

The following table presents the changes in each component of accumulated other comprehensive (loss) income, net of tax, for the years ended December 31, 2019, 2018 and 2017.

	Year Ended Year Ended December 31,		
	2019	**2018**	**2017**
(dollars in thousands)	**Net Unrealized Gains And Losses**	**Net Unrealized Gains And Losses**	**Net Unrealized Gains And Losses**
Beginning of period	$ (1,847)	$ (1,191)	$ (928)
Other comprehensive income (loss)			
Other comprehensive gains (losses), net of tax before reclassifications	2,600	(637)	(62)
Amounts reclassified for reclassification of HTM to AFS securities	587	—	—
Amounts reclassified from accumulated other comprehensive gain (loss)	164	—	(5)
Net other comprehensive income (loss)	$ 3,351	$ (637)	$ (67)
Reclassification due to Accounting Standard Updates (ASU 2016-01 & 2018-02)	—	(19)	(196)
End of period	$ 1,504	$ (1,847)	$ (1,191)

Following our adoption of ASU 2016-01 - *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* on January 1, 2018, the Company accounts for its investment in equity securities with a readily determinable fair value with unrealized gains and losses included in earnings. $19,000 was reclassified from AOCI into Retained Earnings.

The FASB issued ASU 2018-02 allowing companies to reclassify stranded tax effects resulting from the Tax Cuts and Job Act from accumulated other comprehensive income (loss) to retained earnings. The Company early adopted this guidance during the quarter ended December 31, 2017 and utilizing the portfolio method reclassified $196,000 from accumulated other comprehensive loss to retained earnings to eliminate the stranded tax effects.

NOTE 13 - EARNINGS PER SHARE

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may have been issued by the Company related to outstanding stock options and were determined using the treasury stock method. The Company has not granted any stock options since 2007 and all outstanding options expired on July 17, 2017.

As of December 31, 2019, 2018 and 2017, there were no options which were excluded from the calculation as their effect would be anti-dilutive, because the exercise price of the options was greater than the average market price of the common shares. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Years Ended December 31,		
(dollars in thousands)	2019	2018	2017
Net Income	$ 15,272	$ 11,228	$ 7,208
Average number of common shares outstanding	5,560,588	5,550,510	4,627,776
Dilutive effect of common stock equivalents	—	—	1,452
Average number of shares used to calculate diluted EPS	5,560,588	5,550,510	4,629,228
Earnings Per Common Share			
Basic	$ 2.75	$ 2.02	$ 1.56
Diluted	2.75	2.02	1.56

NOTE 14 - INCOME TAXES

Allocation of federal and state income taxes between current and deferred portions is as follows:

	Years Ended December 31,		
	2019	2018	2017
Current			
Federal	$ 4,234	$ 2,810	$ 5,584
State	2,179	1,653	1,686
	6,413	4,463	7,270
Deferred			
Federal	(547)	(202)	1,894
State	(201)	(88)	(7)
	(748)	(290)	1,887
Income tax expense	$ 5,665	$ 4,173	$ 9,157

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	2019		2018		2017	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
Expected income tax expense at federal tax rate	$ 4,397	21.00 %	$ 3,234	21.00 %	$ 5,728	35.00 %
State taxes net of federal benefit	1,745	8.33 %	1,281	8.32 %	1,096	6.70 %
Nondeductible expenses	103	0.49 %	85	0.55 %	255	1.56 %
Nontaxable income	(277)	(1.31%)	(248)	(1.61%)	(376)	(2.30%)
Provisional deferred tax adjustment related to reduction in U.S. federal statutory income tax rate	—	0.00 %	—	— %	2,740	16.74 %
Other	(303)	(1.45%)	(179)	(1.16%)	(286)	(1.75%)
	$ 5,665	27.06 %	$ 4,173	27.10 %	$ 9,157	55.95 %

Income tax expense for 2017 was impacted by the adjustment of our deferred tax assets and liabilities related to the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. As a result of the new law, we recognized a provisional net tax expense of $2.7 million.

The net deferred tax assets in the accompanying balance sheets include the following components:

	2019	2018
Deferred tax assets		
Allowance for loan losses	$ 3,011	$ 3,020
Deferred compensation	3,239	2,676
Lease liability	2,338	—
OREO valuation allowance & expenses	457	355
Unrealized loss on investment securities	—	724
Depreciation	50	—
Other	189	144
	9,284	6,919
Deferred tax liabilities		
Fair value adjustments for acquired assets and liabilities	115	65
FHLB stock dividends	109	109
Unrealized gain on investment securities	585	—
Right of use asset	2,307	—
Depreciation	—	52
	3,116	226
	$ 6,168	$ 6,693

The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the law (i) established a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminated the corporate alternative minimum tax and allowed the use of any such carryforwards to offset regular tax liability for any taxable year, (iii) limited the deduction for net interest expense incurred by U.S. corporations, (iv) allowed businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminated or reduced certain deductions related to meals and entertainment expenses, (vi) modified the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limited the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changed U.S. tax law related to foreign operations, however, such changes do not currently impact the Company.

As stated above, as a result of the enactment of the Tax Cuts and Jobs Act on December 22, 2017, we calculated deferred tax assets and liabilities based upon the U.S. statutory federal income tax rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. We analyzed certain aspects of the new law and refined our calculations based on this analysis and tax positions taken, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. We recognized a provisional net tax expense related to the calculation of our deferred tax assets and liabilities totaling $2.7 million.

The FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income," which allows companies to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act from AOCI to retained earnings. The Company early adopted this standard for the quarter ended December 31, 2017. See Notes 1 and 12 for further information.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 (SAB 118). SAB 118 indicated that a reporting entity must record a reasonable estimate in the first period in which it is possible to determine a reasonable estimate. Under SAB 118, reasonable estimates are considered "provisional amounts" that have to be updated when additional information becomes available and the evaluation and computation of the additional information is complete. A reporting entity must act in good faith and update provisional amounts as soon as more information becomes available, evaluated and prepared, during a measurement period that cannot exceed one year from the enactment date. Initial reasonable estimates and subsequent changes to provisional amounts should be reported in income tax expense or benefit from continuing operations in the period in which they are determined. See Note 1 for further information.

Retained earnings at December 31, 2019 and 2018 included approximately $1.2 million of bad debt deductions allowed for federal income tax purposes (the "base year tax reserve") for which no deferred income tax has been recognized. If, in the future, this portion of retained earnings is used for any purpose other than to absorb bad debt losses, it would create income for tax purposes only and income taxes would be imposed at the then prevailing rates. The unrecorded income tax liability on the above amount was approximately $330,000 at December 31, 2019 and 2018.

The Company does not have uncertain tax positions that are deemed material and did not recognize any adjustments for unrecognized tax benefits. The Company's policy is to recognize interest and penalties on income taxes as a component of tax expense. The Company is no longer subject to U.S. Federal tax examinations by tax authorities for years before 2016.

NOTE 15 - STOCK-BASED COMPENSATION

The Company has stock-based incentive arrangements to attract and retain key personnel. In May 2015, the 2015 Equity Compensation Plan (the "2015 plan") was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service-based awards is recognized over the vesting period. Performance-based awards are recognized based on a vesting schedule and the probability of achieving goals specified at the time of the grant. The 2015 plan replaced the 2005 Equity Compensation Plan.

Stock-based compensation expense totaled $329,000, $474,000 and $515,000 for the years ended December 31, 2019, 2018 and 2017, respectively, which consisted of grants of restricted stock and restricted stock units.

The Company has not granted any stock options since 2007 and all outstanding options expired on July 17, 2017. The fair value of the Company's outstanding employee stock options was estimated on the date of grant using the Black-Scholes option pricing model. The Company estimated expected market price volatility and expected term of the options based on historical data and other factors. The exercise price for options granted is set at the discretion of the committee administering the Plan but is not less than the market value of the shares as of the date of grant. An option's maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize option activity and outstanding and exercisable options at and for the year ended December 31, 2017.

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2017	15,081	$ 27.70	$ —	—
Exercised	(14,231)	27.70	134	—
Expired	(350)	27.70	—	—
Forfeited	(500)	27.70	—	—
Outstanding at December 31, 2017	—	$ —	$ —	—
Exercisable at December 31, 2017	—	$ —	$ —	—

The Company has outstanding restricted stock in accordance with the Plan. As of December 31, 2019 and 2018, unrecognized stock compensation expense was $304,000 and $430,000, respectively. The following tables summarize the unvested restricted stock awards outstanding at December 31, 2019 and 2018 respectively.

	2019		2018		2017	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of year	25,473	$ 28.76	32,809	$ 22.61	47,881	$ 20.41
Granted	6,524	31.82	10,662	36.43	6,752	30.20
Vested	(17,557)	25.83	(17,607)	21.85	(21,738)	20.13
Cancelled	—	—	(391)	27.69	(86)	20.75
Nonvested at end of year	14,440	$ 25.79	25,473	$ 28.76	32,809	$ 22.61

NOTE 16 - EMPLOYEE BENEFIT PLANS

The Company has an Employee Stock Ownership Plan ("ESOP") that covers substantially all its employees. Employees qualify to participate after one year of service and vest in allocated shares after three years of service. The ESOP acquires stock of the Company by purchasing shares. Dividends on ESOP shares are recorded as a reduction of retained earnings. Contributions are made at the discretion of the Board of Directors. ESOP contributions recognized for the years ended December 31, 2019, 2018 and 2017 totaled $229,000, $124,000 and $242,000, respectively. As of December 31, 2019 and 2018, the ESOP held 156,451 and 161,173 allocated shares and 17,581 and 21,091 unallocated shares. The approximate market values of the shares were $6.2 million and $5.3 million, respectively as of December 31, 2019 and 2018. The estimated value was determined using the Company's closing stock price of $35.57 and $29.24 per share as of December 31, 2019 and 2018, respectively. In addition, salary and employee benefit expense for the years ended December 31, 2019 and December 31, 2018 included an increase of $3,000 and a decrease of $33,000 for the net change of fair market value of leveraged ESOP shares allocated.

The ESOP has promissory notes with the Company for the purchase of TCFC common stock for the benefit of the participants in the Plan of $602,000 and $718,000 at December 31, 2019 and 2018, respectively. Loan terms are at prime rate plus one-percentage point and amortize over seven (7) years. As principal is repaid, common shares are allocated to participants based on the participant account allocation rules described in the Plan. The Bank is a guarantor of the ESOP debt with the Company. During the year ended December 31, 2019, $155,000 or 4,815 ESOP shares were allocated with the payment of promissory notes. This was offset by the purchase of 3,271 shares of the Company's common shares for $39,000 with promissory notes by the ESOP and $63,000 in cash during the first and third quarters of 2019, respectively. During the year ended December 31, 2018, $174,000 or 6,061 ESOP shares were allocated with the payment of promissory notes. This was offset by the purchase of 4,244 shares of the Company's common shares for $137,000 with promissory notes by the ESOP during the third and fourth quarters of 2018.

The Company also has a 401(k) plan. The Company matches a portion of the employee contributions. This ratio is determined annually by the Board of Directors. In 2019, 2018 and 2017, the Company matched one-half of the first 8% of the employee's

contribution. Employees who have completed six months of service are covered under this defined contribution plan. Employee's vest in the Company's matching contributions after three years of service. For the years ended December 31, 2019, 2018 and 2017, the expense recorded for this plan totaled $488,000, $405,000 and $298,000, respectively.

The Company maintains a nonqualified deferred compensation plan for the Board of Directors and certain key employees under which each participant may elect to defer all or any portion of board fees or salary otherwise payable. Deferred amounts under this plan will be distributed to participants following termination of service or on a specified date in either lump sum or over a period of one to ten years, as elected by the participant. As of December 31, 2019, and 2018, the liability related to this plan was $2.2 million and $2.1 million, respectively.

The Company has a separate nonqualified retirement plan for non-employee directors. Directors are eligible for a maximum benefit of $3,500 a year for ten years following retirement from the Board of Community Bank of the Chesapeake. The maximum benefit is earned at 15 years of service as a non-employee director. Full vesting occurs after two years of service. Expense recorded for this plan was $26,000, $35,000 and $29,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

In addition, the Company has established individual supplemental retirement plans and life insurance benefits for certain key executives and officers of the Bank. The retirement plans provide retirement income payments for 15 years from the date of the employee's expected retirement at age 65. The retirement benefit amount for each agreement is set at the discretion of the Board of Directors and vests from the date of the agreement until the expected retirement date. Expense recorded for the plans totaled $885,000, $1,109,000 and $637,000 for 2019, 2018 and 2017, respectively.

NOTE 17 -RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2019 and 2018, these reserve balances amounted to $6.0 million and $1.3 million, respectively.

NOTE 18 - COMMITMENTS AND CONTINGENCIES

The Bank is 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 are commitments to extend credit. These instruments may, but do not necessarily, involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheets. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet loans receivable.

As of December 31, 2019, and 2018, the Bank had outstanding loan commitments, consisting of commitments issued to originate loans, of approximately $96.6 million and $56.8 million, respectively, excluding undisbursed portions of loans in process.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are issued primarily to support construction borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash or a secured interest in real estate as collateral to support those commitments for which collateral is deemed necessary. Standby letters of credit outstanding amounted to $22.3 million and $21.2 million at December 31, 2019 and 2018, respectively. In addition to the commitments noted above, customers had approximately $230.5 million and $211.5 million available under lines of credit at December 31, 2019 and 2018, respectively.

NOTE 19 - FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, *"Fair Value Measurements"* and FASB ASC Topic 825, *"The Fair Value Option for Financial Assets and Financial Liabilities"*, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, AFS investment securities) or on a nonrecurring basis (for example, impaired loans).

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

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. AFS securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities 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 the fair value. These hierarchy levels are:

Level 1 inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's quarterly valuation process. Transfers in and out of level 3 during a quarter are disclosed. There were no transfers between Level 1, 2 or 3 during the years ended December 31, 2019 and December 31, 2018.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

AFS investment securities are recorded at fair value on a recurring basis. Standard inputs include quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities ("GSEs"), municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2019 and 2018, substantially all impaired loans were evaluated based upon the fair value of the collateral.

In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the loan as nonrecurring Level 2. When the fair value of the impaired loan is derived from an appraisal, the Company records the loan as nonrecurring Level 3. Fair value is re-assessed at least quarterly or more frequently when circumstances occur that indicate a change in the fair value. The fair values of impaired loans that are not measured based on collateral values are measured using discounted cash flows and considered to be Level 3 inputs.

Premises and Equipment Held For Sale

Premises and equipment are adjusted to fair value upon transfer of the assets to premises and equipment held for sale. Subsequently, premises and equipment held for sale are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the asset as nonrecurring Level 2. When the fair value of premises and equipment is derived from an appraisal or a cash flow analysis, the Company records the asset as nonrecurring Level 3.

As of December 31, 2019, the Company had a small office condo held for sale with a fair value of $430,000 that was recorded as a non-recurring Level 3 asset.

Other Real Estate Owned ("OREO")

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value and fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the foreclosed asset as nonrecurring Level 2. When the fair value is derived from an appraisal, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of December 31, 2019 and December 31, 2018 measured at fair value on a recurring basis.

(dollars in thousands)	December 31, 2019			
Description of Asset	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
AFS securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$ 36,092	$ —	$ 36,092	$ —
MBS	146,932	—	146,932	—
U.S. Agency	9,733	—	9,733	—
Asset-backed securities issued by others:				
Residential CMOs	371	—	371	—
Callable GSE Agency Bonds	2,002	—	2,002	—
Certificates of Deposit Fixed	250	—	250	—
U.S. government obligations	1,489	—	1,489	—
Municipal bonds	11,318	—	11,318	—
Total AFS securities	$ 208,187	$ —	$ 208,187	$ —
Equity securities carried at fair value through income				
CRA investment fund	$ 4,669	$ —	$ 4,669	$ —
Non-marketable equity securities				
Other equity securities	$ 209	$ —	$ 209	$ —

(dollars in thousands)	December 31, 2018			
Description of Asset	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
AFS securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$ 100,740	$ —	$ 100,740	$ —
MBS	7,361	—	7,361	—
U.S. Agency	11,875	—	11,875	—
Total AFS securities	$ 119,976	$ —	$ 119,976	$ —
Equity securities carried at fair value through income				
CRA investment fund	$ 4,428	$ —	$ 4,428	$ —

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of December 31, 2019 and 2018 are included in the tables below.

(dollars in thousands)	December 31, 2019			
Description of Asset	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Loans with impairment				
Commercial real estate	$ 4,371	$ —	$ —	$ 4,371
Commercial loans	1,110	—	—	1,110
Commercial equipment	2	—	—	2
Total loans with impairment	$ 5,483	$ —	$ —	$ 5,483
Premises and equipment held for sale	$ 430	$ —	$ —	$ 430
Other real estate owned	$ 7,773	$ —	$ —	$ 7,773

(dollars in thousands)	December 31, 2018			
Description of Asset	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Loans with impairment				
Commercial real estate	$ 2,699	$ —	$ —	$ 2,699
Commercial loans	163	—	—	163
Commercial equipment	25	—	—	25
Total loans with impairment	$ 2,887	$ —	$ —	$ 2,887
Other real estate owned	$ 8,111	$ —	$ —	$ 8,111

Loans with impairment have unpaid principal balances of $6.3 million and $4.1 million at December 31, 2019 and 2018, respectively, and include impaired loans with a specific allowance.

The following tables provide information describing the unobservable inputs used in Level 3 fair value measurements.

December 31, 2019

(dollars in thousands)

Description of Asset	Fair Value		Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Loans with impairment	$	5,483	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (13%)
Premises and equipment held for sale	$	430	Third party appraisals, in-house real estate evaluations of fair value and contracts to sell.	Management discount for property type and current market conditions	0%-50% (n/a%)
Other real estate owned	$	7,773	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (18%)

December 31, 2018

(dollars in thousands)

Description of Asset	Fair Value		Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Loans with impairment	$	2,887	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (29%)
Other real estate owned	$	8,111	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (14%)

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Therefore, any aggregate unrealized gains or losses should not be interpreted as a forecast of future earnings or cash flows. Furthermore, the fair values disclosed should not be interpreted as the aggregate current value of the Company.

Valuation Methodology

During the three months ended March 31, 2018, the Company implemented "*ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*." ASU 2016-01 requires public business entities to use the exit prices when measuring the fair value of financial instruments for disclosure purposes. The other requirements of ASU 2016-01 are described in Note 1. Fair values at December 31, 2019 and December 31, 2018 were measured using an "exit price" notion.

The exit price notion uses a similar approach as the Company's previous methodology for valuations that used discounted cash flows, but also incorporates other factors, such as enhanced credit risk, illiquidity risk and market factors that sometimes exist in exit prices in dislocated markets. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The implementation of ASU 2016-01 was most impactful to the Company's loan portfolio because the Company's other financial instruments have one or several other compensating factors (e.g., quoted market prices, lower credit risk, limited liquidity risk, short durations, etc.).

Investment securities - Fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

FHLB stock – Fair values are at cost, which is the carrying value of the securities.

Accrued Interest Receivable – Carrying amount is the estimated fair value.

Investment in bank owned life insurance ("BOLI") – Fair values are at cash surrender value.

Loans receivable – The fair values for non-impaired loans are estimated using discounted cash flow analysis, applying interest rates currently being offered for loans with similar terms and credit quality. Internal prepayment risk models are used to adjust contractual cash flows.

Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. After evaluating the underlying collateral, the fair value is determined by allocating specific reserves from the allowance for loan losses to the impaired loans.

Deposits - The fair value of checking accounts, saving accounts and money market accounts were the amount payable on demand at the reporting date.

Time certificates - The fair value was determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

Long-term debt and short-term borrowings - These were valued using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar borrowings.

Guaranteed preferred beneficial interest in junior subordinated securities (TRUPs) - These were valued using discounted cash flows. The discount rate was equal to the rate currently offered on similar borrowings.

Subordinated notes - These were valued using discounted cash flows. The discount rate was equal to the rate currently offered on similar borrowings.

Off-balance sheet instruments - The Company charges fees for commitments to extend credit. Interest rates on loans for which these commitments are extended are normally committed for periods of less than one month. Fees charged on standby letters of credit and other financial guarantees are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused. It is impractical to assign any fair value to these commitments.

The Company's estimated fair values of financial instruments are presented in the following tables.

December 31, 2019			Fair Value Measurements		
(dollars in thousands) **Description of Asset**	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets					
Investment securities - AFS	$ 208,187	$ 208,187	$ —	$ 208,187	$ —
Investment securities - HTM					
Equity securities carried at fair value through income	4,669	4,669	0	4,669	—
Non-marketable equity securities in other financial institutions	209	209	—	209	—
FHLB Stock	3,447	3,447	—	3,447	—
Loans Receivable	1,445,109	1,424,506	—	—	1,424,506
Accrued Interest Receivable	5,019	5,019	—	5,019	—
Investment in BOLI	37,180	37,180	—	37,180	—
Liabilities					
Savings, NOW and money market accounts	$ 1,117,668	$ 1,117,668	$ —	$ 1,117,668	$ —
Time deposits	394,169	396,492	—	396,492	—
Short-term borrowings	5,000	5,007	—	5,007	—
Long-term debt	40,370	40,588	—	40,588	—
TRUPs	12,000	10,129	—	10,129	—
Subordinated notes	23,000	23,031	—	23,031	—

December 31, 2018			Fair Value Measurements		
(dollars in thousands) **Description of Asset**	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets					
Investment securities - AFS	$ 119,976	$ 119,976	$ —	$ 119,976	$ —
Investment securities – HTM	96,271	93,745	999	92,746	—
Equity securities carried at fair value through income	4,428	4,428	—	4,428	—
Non-marketable equity securities in other financial institutions	209	209	—	209	—
FHLB Stock	3,821	3,821	—	3,821	—
Loans Receivable	1,337,129	1,298,465	—	—	1,298,465
Accrued Interest Receivable	4,957	4,957	—	4,957	—
Investment in BOLI	36,295	36,295	—	36,295	—
Liabilities					
Savings, NOW and money market accounts	$ 982,600	$ 982,600	$ —	$ 982,600	$ —
Time deposits	447,029	446,683	—	446,683	—
Short-term borrowings	35,000	35,016	—	35,016	—
Long-term debt	20,436	20,568	—	20,568	—
TRUPs	12,000	10,924	—	10,924	—
Subordinated notes	23,000	23,085	—	23,085	—

At December 31, 2019 and 2018, the Company had outstanding loan commitments of $96.6 million and $47.3 million, respectively, and standby letters of credit of $22.3 million and $21.2 million respectively. Additionally, at December 31, 2019 and 2018, customers had $230.5 million and $211.5 million, respectively, available and unused on lines of credit, which include lines of credit for commercial customers, home equity loans as well as builder and construction lines. Based on the short-term lives of these instruments, the Company does not believe that the fair value of these instruments differs significantly from their carrying values.

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2019 and 2018, respectively. Although management is not aware of any factors that would significantly affect the estimated fair value

amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amount presented herein.

NOTE 21 - CONDENSED FINANCIAL STATEMENTS – PARENT COMPANY ONLY

Balance Sheets

(dollars in thousands)	December 31, 2019	December 31, 2018
Assets		
Cash - noninterest bearing	$ 3,268	$ 4,246
Cash - interest bearing	10,759	—
Investment in wholly owned subsidiaries	202,976	185,445
Other assets	1,214	1,387
Total Assets	$ 218,217	$ 191,078
Liabilities and Stockholders' Equity		
Current liabilities	$ 1,351	$ 1,224
Guaranteed preferred beneficial interest in junior subordinated debentures	12,372	12,372
Subordinated notes - 6.25%	23,000	23,000
Total Liabilities	36,723	36,596
Stockholders' Equity		
Common stock	59	56
Additional paid in capital	95,474	84,397
Retained earnings	85,059	72,594
Accumulated other comprehensive loss	1,504	(1,847)
Unearned ESOP shares	(602)	(718)
Total Stockholders' Equity	181,494	154,482
Total Liabilities and Stockholders' Equity	$ 218,217	$ 191,078

Condensed Statements of Income

(dollars in thousands)	Years Ended December 31, 2019	2018	2017
Interest and Dividend Income			
Dividends from subsidiary	$ 4,500	$ 6,000	$ 7,500
Interest income	65	65	64
Interest expense	2,023	1,984	1,865
Net Interest Income	2,542	4,081	5,699
Miscellaneous expenses	(2,408)	(2,818)	(2,968)
Income before income taxes and equity in undistributed net income of subsidiary	134	1,263	2,731
Federal and state income tax benefit	954	1,078	1,583
Equity in undistributed net income of subsidiary	14,184	8,887	2,894
Net Income	$ 15,272	$ 11,228	$ 7,208

Condensed Statements of Cash Flows

(dollars in thousands)	Years Ended December 31, 2019	2018	2017
Cash Flows from Operating Activities			
Net income	$ 15,272	$ 11,228	$ 7,208
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed earnings of subsidiary	(14,184)	(8,887)	(2,894)
Stock based compensation	329	474	515
Decrease (increase) in other assets	163	3,109	(2,446)
(Increase) decrease in deferred income tax benefit	11	(6)	(29)
Increase (decrease) in current liabilities	126	(168)	327
Net Cash Provided by Operating Activities	1,717	5,750	2,681
Cash Flows from Investing Activities			
Cash paid to acquire County First Bank	—	(2,120)	—
Net Cash Provided by Investing Activities	—	(2,120)	—
Cash Flows from Financing Activities			
Dividends paid	(2,668)	(2,163)	(1,804)
Proceeds from public offering	10,632	—	—
Exercise of stock options	—	—	155
Net change in unearned ESOP shares	116	37	(586)
Repurchase of common stock	(17)	(70)	—
Net Cash Used in Financing Activities	8,063	(2,196)	(2,235)
Increase in Cash	9,780	1,434	446
Cash at Beginning of Year	4,246	2,812	2,366
Cash at End of Year	$ 14,026	$ 4,246	$ 2,812

NOTE 22 - QUARTERLY FINANCIAL COMPARISON (Unaudited)

(dollars in thousands)	2019 Fourth Quarter	2019 Third Quarter	2019 Second Quarter	2019 First Quarter
Interest and dividend income	$ 18,279	$ 18,259	$ 18,118	$ 17,797
Interest expense	4,566	4,734	4,859	4,760
Net interest income	13,713	13,525	13,259	13,037
Provision for loan losses	805	450	375	500
Net interest income after provision	12,908	13,075	12,884	12,537
Noninterest income	2,213	1,239	1,253	1,061
Noninterest expense	9,488	9,224	9,116	8,405
Income before income taxes	5,633	5,090	5,021	5,193
Provision for income taxes	1,558	1,397	1,394	1,316
Net Income Available to Common Stockholders	$ 4,075	$ 3,693	$ 3,627	$ 3,877
Earnings Per Common Share [(1)]				
Basic	$ 0.73	$ 0.66	$ 0.65	$ 0.70
Diluted	$ 0.73	$ 0.66	$ 0.65	$ 0.70

(dollars in thousands)	2018 Fourth Quarter	2018 Third Quarter	2018 Second Quarter	2018 First Quarter
Interest and dividend income	$ 17,043	$ 16,484	$ 15,754	$ 15,892
Interest expense	4,217	3,724	3,343	3,002
Net interest income	12,826	12,760	12,411	12,890
Provision for loan losses	465	40	400	500
Net interest income after provision	12,361	12,720	12,011	12,390
Noninterest income	1,067	1,069	901	1,031
Noninterest expense	8,240	8,491	9,750	11,668
Income before income taxes	5,188	5,298	3,162	1,753
Provision for income taxes	1,371	1,441	828	533
Net Income Available to Common Stockholders	$ 3,817	$ 3,857	$ 2,334	$ 1,220
Earnings Per Common Share [(1)]				
Basic	$ 0.69	$ 0.70	$ 0.42	$ 0.22
Diluted	$ 0.69	$ 0.70	$ 0.42	$ 0.22

(dollars in thousands)	2017 Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest and dividend income	$ 13,573	$ 13,680	$ 13,395	$ 12,922
Interest expense	2,800	2,672	2,462	2,248
Net interest income	10,773	11,008	10,933	10,674
Provision for loan losses	30	224	376	380
Net interest income after provision	10,743	10,784	10,557	10,294
Noninterest income	993	1,157	1,043	848
Noninterest expense	7,739	7,442	7,521	7,352
Income before income taxes	3,997	4,499	4,079	3,790
Provision for income taxes	4,456	1,717	1,536	1,448
Net Income (Loss) Available to Common Stockholders	$ (459)	$ 2,782	$ 2,543	$ 2,342
Earnings Per Common Share [1]				
Basic	$ (0.10)	$ 0.60	$ 0.55	$ 0.51
Diluted	$ (0.10)	$ 0.60	$ 0.55	$ 0.51

(1) Earnings per share are based upon quarterly results and, when added, may not total the annual earnings per share amounts.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Not applicable

Item 9A. Controls and Procedures

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15 (e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management's annual report on internal control over financial reporting is provided at Item 8 in this Form 10-K.

(c) Changes to Internal Control Over Financial Reporting

Except as indicated herein, there were no changes in the Company's internal control over financial reporting during the three months ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

Effective January 1, 2019, the Board of Directors amended and restated Community Bank of the Chesapeake's Executive Incentive Compensation Plan to: (i) provide that "Retirement Date" is defined as when a participant terminates employment with the Bank or an affiliate other than Cause, Death or disability on or after the attainment of 65; (ii) implement the use of scorecards for each participant that are to be used by the compensation committee to determine the amount of incentive award to be awarded to plan participants; (iii) include a disability clause that provides that the compensation committee will pro-rate the plan participant's incentive award for the participants' service during the performance period and distribute the incentive award to the participant's beneficiary; and (iv) to add a requirement that the compensation committee set the incentive award opportunity on an annual basis for the Chief Executive Officer of the Bank.

The foregoing description is qualified in its entirety by reference to the text of the Community Bank of the Chesapeake Executive Incentive Compensation Plan, as amended and restated effective January 1, 2019, which is filed as Exhibit 10.78 hereto and incorporated herein by reference.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

For information concerning the Company's directors, the information contained under the section captioned *"Items to be voted on by Stockholders- Item 1 – Election of Directors"* in the Company's definitive proxy statement for the Annual Meeting of Stockholders to be held on May 20, 2020 (the "Proxy Statement"), which will be filed with the SEC within 120 days after December 31, 2019, is incorporated herein by reference. For information concerning the executive officers of the Company, the information contained under the section captioned "Corporate Governance - Executive Officers" in the Proxy Statement is incorporated herein by reference.

For information regarding compliance with Section 16(a) of the Exchange Act, the cover page of this Annual Report on Form 10-K and the information contained under the section captioned *"Other Information Relating to Directors and Executive Officer Section 16(a) Beneficial Ownership Reporting Compliance"* in the Proxy Statement are incorporated herein by reference.

For information concerning the Company's code of ethics, the information contained under the section captioned *"Corporate Governance – Code of Ethics"* in the Proxy Statement is incorporated by reference. A copy of the code of ethics and business conduct is filed as Exhibit 14 hereto and is available to stockholders within the "Investor Relations" section of the Bank's website under the tabs "Investor Resources", "Proxy and Annual Report, Committee Charters and Code of Ethics", and Code of Ethics.

For information regarding the audit committee and its composition and the audit committee financial expert, the section captioned *"Corporate Governance – Committees of the Board of Directors – Audit Committee"* in the Proxy Statement is incorporated by reference.

Item 11. Executive Compensation

For information regarding executive compensation, the information contained under the sections captioned *"Executive Compensation" and "Directors' Compensation"* in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Security Ownership of Certain Owners

The information required by this item is incorporated herein by reference to the section captioned *"Principal Holders of Voting Securities"* in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned *"Principal Holders of Voting Securities"* in the Proxy Statement.

(c) Changes in Control

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may, at a subsequent date, result in a change in control of the registrant.

(d) Equity Compensation Plan Information

The Company's Tri-County 2005 Equity Compensation Plan was terminated in May 2015 and replaced with the 2015 Equity Compensation Plan (the "2015 Plan"). The 2015 Plan was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. There were no outstanding options issued under any plan as of December 31, 2019.

Item 13. Certain Relationships, Related Transactions and Director Independence

The information regarding certain relationships and related transactions, the section captioned *"Other Information Relating to Directors and Executive Officers – Policies and Procedures for Approval and Related Parties Transactions and Relationships and Transactions with the Company and the Bank"* in the Proxy Statement is incorporated herein by reference.

For information regarding director independence, the section captioned *"Proposal 1 – Election of Directors"* in the Proxy Statement is incorporated by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is incorporated herein by reference to the section captioned *"Audit Related Matters – Audit Fees"* and *"— an Pre-Approval of Services by the Independent Registered Public Accounting Firm"* in the Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) List of Documents Filed as Part of this Report

(1) *Financial Statements*. The following consolidated financial statements and notes related thereto are incorporated by reference from Item 8 hereof:

Reports of Independent Registered Public Accounting Firms	70
Consolidated Balance Sheets as of December 31, 2019 and 2018	72
Consolidated Statements of Income for the Years Ended December 31, 2019, 2018 and 2017	73
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2019, 2018 and 2017	74
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2019, 2018 and 2017	75
Consolidated Statements of Cash Flows for the Years Ended December 31, 2019, 2018 and 2017	76
Notes to Consolidated Financial Statements	78

(2) *Financial Statement Schedules*. All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) *Exhibits*. The following is a list of exhibits filed as part of this Annual Report on Form 10-K and is also the Exhibit Index.

Exhibit No	Description	Incorporated by Reference to
2.1	Agreement and Plan of Merger dated as of July 31, 2017 by and among The Community Financial Corporation, Community Bank of the Chesapeake and County First Bank	Exhibit 2.1 to the Form 8-K as filed on August 1, 2017
3.1	Articles of Incorporation as Amended and Restated of The Community Financial Corporation	Exhibit 3.1 to the Form S-4 (Registration No. 333-220455).
3.2	Amended and Restated Bylaws of The Community Financial Corporation	Exhibit 3.1 to the Form 8-K as filed on March 25, 2016
4.1	Amended and Restated Articles Supplementary establishing Senior Non-cumulative Perpetual Preferred Stock, Series C, of Tri-County Financial Corporation	Exhibit 3.1 to the Form 8-K as filed on September 23, 2011.
4.2	Form of Subordinated Indenture between The Community Financial Corporation and Wilmington Trust, National Association, as Trustee	Exhibit 4.1 to the Form 8-K as filed on February 4, 2015
4.3	Form of First Supplemental Indenture between The Community Financial Corporation and Wilmington Trust, National Association, as Trustee	Exhibit 4.2 to the Exhibit 4.2 to the Form 8-K as filed on February 4, 2015
4.4	Form of Global Note to represent the 6.25% Fixed to Floating Rate Subordinated Notes due 2025 (included in Exhibit 4.3)	Form 8-K as filed on February 4, 2015
4.5	Description of securities registered pursuant to Section 12 of the Securities and Exchange Act of 1934	Filed herewith
10.4*	Community Bank of the Chesapeake Executive Incentive Compensation Plan, as amended and restated	Exhibit 10.1 to the Form 8-K as filed on February 10, 2016
10.5*	Community Bank of the Chesapeake Retirement Plan for Directors, as amended and restated	Exhibit 10.5 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.6*	Split Dollar Agreement with Michael L. Middleton	Exhibit 10.8 to the Form 10-K for the year ended December 31, 2000 as filed on March 30, 2001

10.7*	Split Dollar Agreement with William J. Pasenelli dated April 12, 2001	Exhibit 10.10 to the Form 10-K for the year ended December 31, 2001 as filed on April 1, 2002.
10.8*	Salary Continuation Agreement with Michael L. Middleton, dated September 6, 2003	Exhibit 10.13 to the Form 10-K for the year ended December 31, 2003 as filed on March 26, 2004
10.9*	First Amendment to the Salary Continuation Agreement, dated September 6, 2003, with Michael L. Middleton	Exhibit 10.20 to the Form 10-K for the year ended December 31, 2008 as filed on March 9, 2009
10.10*	Tri-County Financial Corporation 2005 Equity Compensation Plan	Appendix A to the Definitive Proxy Statement as filed on April 11, 2005
10.11*	Amendment No. 1 to the Tri-County Financial Corporation 2005 Equity Compensation Plan	Exhibit 10 to the Form 10-Q for the quarter ended September 30, 2007 as filed on November 13, 2007
10.12*	Community Bank of the Chesapeake Executive Deferred Compensation Plan, as amended and restated	Exhibit 10.12 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.26*	Form of Letter Agreement between Tri-County Financial Corporation and each of Michael L. Middleton, Gregory C. Cockerham and William J. Pasenelli	Exhibit 10.3 to the Form 8-K as filed on September 23, 2011
10.32*	The Community Financial Corporation 2015 Equity Compensation Plan	Appendix A to the Definitive Proxy Statement as filed on March 25, 2015
10.37*	Split Dollar Agreement with Todd L. Capitani dated March 3, 2011	Exhibit 10.37 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.38*	Split Dollar Agreement with James Burke dated March 15, 2011	Exhibit 10.38 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.42*	Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with Michael L. Middleton	Exhibit 10.42 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.43*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and Michael L. Middleton dated January 12, 2004	Exhibit 10.43 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.44*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and William J. Pasenelli dated January 12, 2004	Exhibit 10.44 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.45*	Split Dollar Agreement with William J. Pasenelli dated March 15, 2011	Exhibit 10.45 to the Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016
10.47*	Agreement dated March 25, 2016, by and between Community Financial Corporation and Basswood Capital Management, LLC	Exhibit 10.1 to the Form 8-K as filed on March 25, 2016
10.48*	Split Dollar Agreement with Gregory C. Cockerham dated April 5, 2011	Exhibit 10.48 to the Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017
10.49*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and Gregory C. Cockerham dated January 12, 2004	Exhibit 10.49 to the Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017

10.54*	Split Dollar Agreement with James F. Di Misa dated March 15, 2011	Exhibit 10.54 to the Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017
10.55*	Employment Agreement by and among Community Bank of the Chesapeake, William J. Pasenelli and The Community Financial Corporation, as guarantor	Exhibit 10.1 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.56*	Employment Agreement by and among Community Bank of the Chesapeake, Todd L. Capitani and The Community Financial Corporation, as guarantor	Exhibit 10.2 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.57*	Employment Agreement by and among Community Bank of the Chesapeake, James M. Burke and The Community Financial Corporation, as guarantor	Exhibit 10.3 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.58*	Employment Agreement by and among Community Bank of the Chesapeake, Gregory C. Cockerham and The Community Financial Corporation, as guarantor	Exhibit 10.4 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.59*	Employment Agreement by and among Community Bank of the Chesapeake, James F. Di Misa and The Community Financial Corporation, as guarantor	Exhibit 10.5 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.61*	Salary Continuation Agreement between William J. Pasenelli and Community Bank of the Chesapeake, dated September 6, 2003, as amended on December 22, 2008 and amended and restated in its entirety on April 30, 2018	Exhibit 10.7 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.62*	Salary Continuation Agreement between Gregory C. Cockerham and Community Bank of the Chesapeake, dated September 6, 2003, as amended on December 22, 2008 and amended and restated in its entirety on April 30, 2018	Exhibit 10.8 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.63*	Salary Continuation Agreement between William J. Pasenelli and Community Bank of the Chesapeake, dated August 21, 2006, as amended on April 13, 2007, December 30, 2007 and amended and restated in its entirety on April 30, 2018	Exhibit 10.9 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.64*	Salary Continuation Agreement between James M. Burke and Community Bank of the Chesapeake, dated August 21, 2006 and amended and restated in its entirety on April 30, 2018	Exhibit 10.10 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.65*	Salary Continuation Agreement between Gregory C. Cockerham and Community Bank of the Chesapeake, dated August 21, 2006, as amended on April 13, 2007, December 30, 2007 and amended and restated in its entirety on April 30, 2018	Exhibit 10.11 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.66*	Salary Continuation Agreement between James F. Di Misa and Community Bank of the Chesapeake, dated August 21, 2006 and amended and restated in its entirety on April 30, 2018	Exhibit 10.12 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.67*	Amended and Restated Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, First Amendment to the Supplemental Executive Retirement Plan dated January 1, 2011 and amended and restated in its entirety on April 30, 2018 with William J. Pasenelli	Exhibit 10.13 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018

10.68*	Amended and Restated Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, First Amendment to the Supplemental executive Retirement Plan dated January 1, 2011 and amended and restated in its entirety on April 30, 2018 with Todd L. Capitani	Exhibit 10.14 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.69*	Amended and Restated Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, First Amendment to the Supplemental Executive Retirement Plan dated January 1, 2011 and amended and restated on April 30, 2018 with James M. Burke	Exhibit 10.15 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.70*	Amended and Restated Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, First Amendment to the Supplemental Executive Retirement Plan dated January 1, 2011 and amended and restated in its entirety on April 30, 2018 with Gregory C. Cockerham	Exhibit 10.16 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.71*	Amended and Restated Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, First Amendment to the Supplemental Executive Retirement Plan dated January 1, 2011 and amended and restated on April 30, 2018 with James F. Di Misa	Exhibit 10.17 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.72*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with William J. Pasenelli	Exhibit 10.18 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.73*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with Todd L. Capitani	Exhibit 10.19 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.74*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with James M. Burke	Exhibit 10.20 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.75*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with Gregory C. Cockerham	Exhibit 10.21 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.76*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with James F. Di Misa	Exhibit 10.22 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.77*	Amended and Restated Supplemental Executive Retirement Plan agreement, dated November 1, 2014 as amended and restated on April 30, 2018, with Christy Lombardi	Exhibit 10.23 to the Form 10-Q for the quarter ended March 31, 2018 as filed on May 10, 2018
10.78*	Community Bank of the Chesapeake Executive Incentive Compensation Plan, as amended and restated effective January 1, 2019	Exhibit 10.78 to the Form 10-K for the year ended December 31, 2018 as filed on March 7, 2019
10.79*	Consulting Agreement, effective April 1, 2019, by and between Community Bank of the Chesapeake and James F. Di Misa	Exhibit 10.2 to the Form 8-K as filed on April 5, 2019

10.80*	Amendment 1 to the Consulting Agreement by and between Community Bank of the Chesapeake and James F. Di Misa, effective December 19, 2019	Exhibit 10.1 to the Form 8-K as filed on December 23, 2019
10.81*	Amended and Restated Employment Agreement by and among Community Bank of the Chesapeake, Christy Lombardi and The Community Financial Corporation, as guarantor	Exhibit 10.1 to the Form 8-K as filed on April 5, 2019
10.82*	Change in Control Agreement by and among Community Bank of the Chesapeake, John Chappelle and The Community Financial Corporation, as guarantor	Filed herewith
10.83*	Change in Control Agreement by and among Community Bank of the Chesapeake, B. Scot Ebron and The Community Financial Corporation, as guarantor	Filed herewith
10.84*	Change in Control Agreement by and among Community Bank of the Chesapeake, Lacey Pierce and The Community Financial Corporation, as guarantor	Filed herewith
10.85*	Change in Control Agreement by and among Community Bank of the Chesapeake, Patrick Pierce and The Community Financial Corporation, as guarantor	Filed herewith
10.86*	Change in Control Agreement by and among Community Bank of the Chesapeake, Talal Tay and The Community Financial Corporation, as guarantor	Filed herewith
14.0	Code of Ethics	Exhibit 14 to the Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017
21.0	List of Subsidiaries	Filed herewith
23.1	Consent of Dixon Hughes Goodman LLP	Filed herewith
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	Filed herewith
32.0	Section 1350 Certification of Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer	Filed herewith
101.0	The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Changes in Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes in the Consolidated Financial Statements.	

(*) Management contract or compensating arrangement.

(b) Exhibits. The exhibits required by Item 601 of Regulation S-K are either filed as part of this Annual Report on Form 10-K or incorporated by reference herein.

(c) Financial Statements and Schedules Excluded From Annual Report. There are no other financial statements and financial statement schedules which were excluded from this Annual Report pursuant to Rule 14a-3(b)(1) which are required to be included herein.

Item 16. Form 10-K Summary

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE COMMUNITY FINANCIAL CORPORATION

Date: March 4, 2020

By: /s/ William J. Pasenelli

William J. Pasenelli
President and Chief Executive Officer
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Michael L. Middleton

Michael L. Middleton
Director, Chairman of the Board
President and Chief Executive Officer
Date: March 4, 2020

By: /s/ William J. Pasenelli

William J. Pasenelli
Director, Vice-Chairman of the Board
(Principal Executive Officer)
Date: March 4, 2020

By: /s/ Todd L. Capitani

Todd L. Capitani
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)
Date: March 4, 2020

By: /s/ Austin J. Slater, Jr.

Austin J. Slater, Jr.
Director
Date: March 4, 2020

By: /s/Louis P. Jenkins, Jr

Louis P. Jenkins, Jr.
Director
Date: March 4, 2020

By: /s/ Kathryn M. Zabriskie

Kathryn M. Zabriskie
Director
Date: March 4, 2020

By: /s/ Mary Todd Peterson

Mary Todd Peterson
Director
Date: March 4, 2020

By: /s/ Joseph V. Stone, Jr.

Joseph V. Stone, Jr.
Director
Date: March 4, 2020

By: /s/ Edward Lawrence Sanders, III

Edward Lawrence Sanders, III
Director
Date: March 4, 2020

By: /s/ M. Arshed Javaid

M. Arshed Javaid
Director
Date: March 4, 2020

By: /s/ Kimberly C. Briscoe-Tonic

Kimberly C. Briscoe-Tonic
Director
Date: March 4, 2020

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