HCB Financial Corp.

2019

HCB Annual Report

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To Our Shareholders

From the desk of Mark A. Kolanowski

On behalf of our directors and officers, it is my pleasure to present to you the HCB Financial Corp. 2019 Annual Report. Our accomplishments for the year included investing in our future with the completion of two major strategic initiatives. The first was the rebranding of our bank and introducing the Highpoint Community Bank name in late January. This was followed by a core software conversion that was completed in October. We successfully executed these initiatives while simultaneously providing present-day value to our shareholders with increased earnings. For the twelve months ended December 31, 2019, net income was $2,277,745 or $2.14 per common share. This equates to a five percent improvement over our 2018 earnings of $2,166,209 or $2.03 per share.

As you'll see in reviewing our financial highlights, we achieved record balance sheet levels in deposits, loans and shareholder's equity in 2019. During the year, total deposits increased two percent to $265,406,609. Net loans rose eight percent to $218,498,703 and shareholder's equity increased by nine percent to $33,324,266. Total assets stood at $324,290,369, two percent above year-end 2018.

There were several key elements contributing to our strong performance in 2019 that are worth noting. The first is continued quality loan growth, which has allowed us to improve our mix of earning assets on our balance sheet and achieve record-level net interest income in 2019. Next, Highpoint Trust and Wealth Management had another successful year and record earnings. These earnings were an important component to the overall increase in our non-interest income for the year. Finally, we have been successful at containing our other expenses to a modest four percent increase over the prior year while incurring significant one-time expenses related to our rebranding and core conversion projects.

OUR NEW NAME & BRAND ADD TO OUR STRENGTHS FOR TODAY & FOR THE FUTURE.

Aside from our financial achievements, I would be remiss if I did not highlight the benefits that our rebranding and core conversion provide. First, with our rebranding to Highpoint Community Bank, we now have a name that is more inclusive of all the communities we have grown to serve in West Michigan and allows future growth without perceived geographic limitations. We have a name that says with clarity that we are a "community bank," focused on building relationships with our customers and providing them with an exceptional banking experience. Second, our core software conversion provides a wealth of new technology sure to enhance the customer experience in today's banking environment. Additionally, it provides the platform that will allow us to remain competitive with technology in years to come.

There are some important changes within our leadership team that I'd like to bring to your attention, including three officer-level promotions that took place last December. Linda G. Engle was promoted to Vice President, Business Development Officer. Linda holds a bachelor's degree in business administration from Miller College and a master's degree from Davenport University. She joined HCB as a loan officer in 2012 and has been servicing our Marshall market since 2013. Linda now leads a team of business development officers focused on serving our commercial clientele. Rebecca L. Gaylor has been promoted to Cash Management Officer. Becky has a bachelor's degree in science from Grand Valley State University. She joined HCB in 2012 as a part-time teller and has held positions of increased responsibility with us, most recently as branch manager of the Hastings office. In her new role, Becky will be a main point of contact for our commercial customers, supporting their deposit and electronic banking needs. Our third officer promotion in 2019 was elevating Kristen D. Fisher to Senior Branch Manager of our Middleville office. Kristen joined HCB in 2009, also as a part-time teller and earning various promotions leading up to her officer appointment. During that time, Kristen graduated from Davenport University with a bachelor's degree in marketing. Along with oversight of the Middleville office, Kristen will oversee our Interactive Teller Machine (ITM) network and our Customer Call Center. We are very fortunate to have such a talented and capable group of individuals ready to take on new responsibilities and make valuable contributions as leaders in our organization. Also, in December of last year, we recognized the retirement of Neil A. Gardner from our Board of Directors. During his tenure as a senior officer and, in recent years, as a board member, Neil has made an indelible impact on our bank. We thank him for his wisdom, his friendship and his important contributions during his 43-year career with HCB.

Our Annual Meeting will be held on Wednesday, April 15, 2020 at 1:00 p.m. in the Main Office of Highpoint Community Bank. Whether you are able to attend or not, please complete and return the enclosed proxy in advance of the meeting. This will allow us to tally the votes prior to the meeting and proceed without undue delay. Our directors, officers and I look forward to seeing as many of you there as possible.

Yours truly,

Mark A. Kolanowski

Mark A. Kolanowski
President and Chief Executive Officer

Financial Highlights

At Year-End	2019	2018	% Change
Assets	$324,290	$318,733	2%
Deposits	265,407	260,123	2%
Loans, net	218,499	202,704	8%
Investments	67,852	79,654	-15%
Stockholders' Equity	33,324	30,641	9%

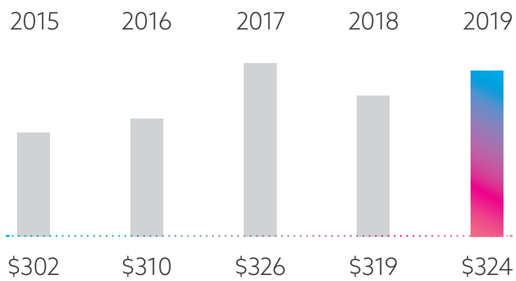
For The Year	2019	2018	% Change
Net income	$2,278	$2,166	5%
Return on average assets	0.71%	0.67%	6%
Return on average equity	7.03%	7.22%	-3%
Net charge-offs to avg loans	0.01%	0.08%	-88%

Per Share			
Dividends per share	$0.78	$0.72	8%
Net income per share	2.14	2.03	5%
Book value at year end	31.26	28.74	9%

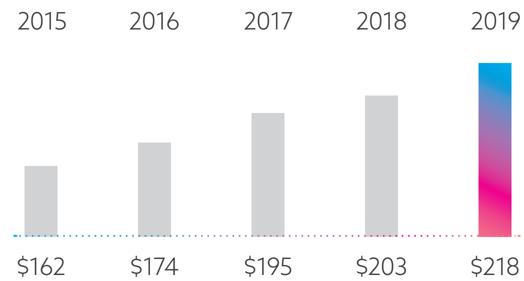
Dollar amounts in thousands, except per-share data

Key Graphs

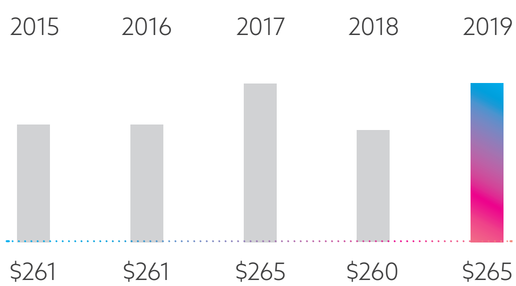
Total Assets (Millions)



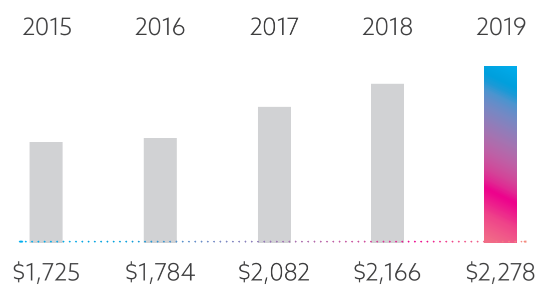
Net Loans (Millions)



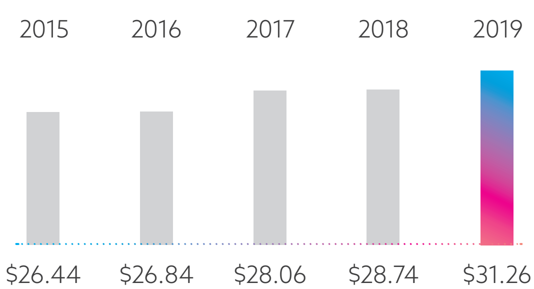
Total Deposits (Millions)



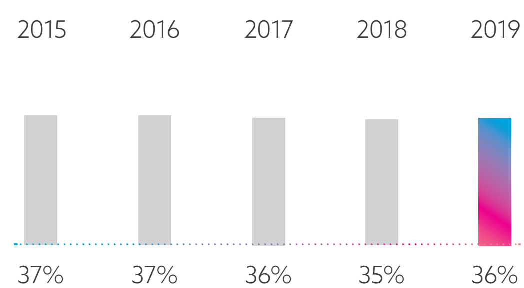
Earnings (Thousands)



Book Value (Per Share, In Dollars)



Dividend Payout Ratio

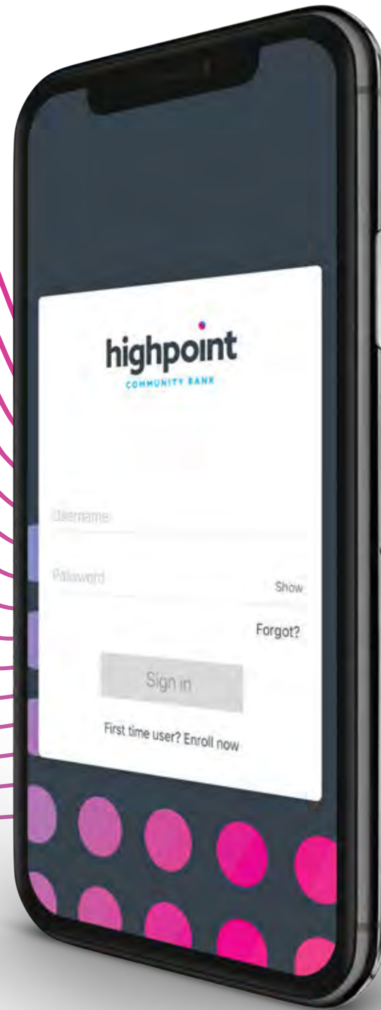


Hello Highpoint!

In 2019, Hastings City Bank became Highpoint Community Bank, which catapulted the organization to new levels.

The feedback from our customers, partners and community was extremely supportive and very positive. The transition is allowing us to serve more communities and enhance our product and service offerings for our customers. Thank you for being part of this exciting change.

WE CONTINUE TO BUILD UPON THE CORE VALUES OF OUR 134 YEAR HISTORY.



The Future of Online Banking

Exciting changes were made to help our customers continue reaching new financial heights.

This past year, we also made a major change to our core processing system. This significant upgrade allows us to provide our customers with even greater services and new technologies. The changes impact your online banking experience, bill pay and other electronic services. The transition was smooth and we are now in a position for better online customer experiences for the future.

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Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
HCB Financial Corp.
Hastings, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of HCB Financial Corp., which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Crowe LLP

Crowe LLP

Grand Rapids, Michigan
February 19, 2020

HCB Financial Corp.
Consolidated Balance Sheets
December 31, 2019 and 2018

	2019	2018
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 18,711,904	$ 16,622,069
	18,711,904	16,622,069
Interest-bearing time deposits in other financial institutions	14,587,000	19,056,000
Securities available for sale	51,654,300	58,931,939
Securities held to maturity (fair value of $30,836 in 2019 and $88,156 in 2018)	30,000	85,186
Restricted investment in Federal Home Loan Bank stock	1,580,800	1,580,800
Loans, net of allowance of $1,308,660 in 2019 and $1,269,122 in 2018	218,498,703	202,704,063
Premises and equipment, net	8,649,832	8,122,329
Other real estate owned, net	-	200,000
Bank owned life insurance	6,795,500	6,620,694
Accrued interest receivable and other assets	3,782,330	4,809,756
Total assets	$ 324,290,369	$ 318,732,836
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$ 55,313,314	$ 51,797,409
Interest-bearing	210,093,295	208,325,398
	265,406,609	260,122,807
Federal Home Loan Bank advances	24,000,000	26,000,000
Accrued interest payable and other liabilities	1,559,494	1,969,093
Total Liabilities	290,966,103	288,091,900
Stockholders' equity:		
Common stock, no par value - 1,500,000 shares authorized; issued and outstanding of 1,066,000 in 2019 and 2018	1,623,800	1,623,800
Capital surplus	2,601,641	2,601,641
Retained earnings	28,225,373	26,779,108
Accumulated other comprehensive income/(loss)	873,452	(363,613)
Total stockholders' equity	33,324,266	30,640,936
Total liabilities and stockholders' equity	$ 324,290,369	$ 318,732,836

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Income
Years ended December 31, 2019 and 2018

	2019	2018
Interest income		
Loans, including fees	**$ 9,683,708**	$ 8,671,539
Investment securities:		
Taxable	**993,347**	1,266,530
Tax-exempt	**453,097**	480,854
Federal funds sold and other	**450,519**	516,258
	11,580,671	10,935,181
Interest expense		
Deposits	**589,763**	268,331
Federal Home Loan Bank advances and other debt	**566,594**	548,167
	1,156,357	816,498
Net interest income	**10,424,314**	10,118,683
Provision for loan losses	**65,000**	60,000
Net interest income after provision for loan losses	**10,359,314**	10,058,683
Other income		
Service charges and fees	**1,611,959**	1,627,126
Wealth Management Income	**531,661**	509,490
Net loss on securities	**(3,223)**	(11,815)
Net gain on sale of loans	**115,278**	113,736
Earnings from bank owned life insurance	**174,806**	188,070
Other income	**279,080**	266,188
	2,709,561	2,692,795
Other expenses		
Salaries and employee benefits	**5,702,631**	5,629,288
Occupancy and equipment	**1,396,402**	1,317,285
Data processing	**1,858,272**	1,588,832
Professional fees	**445,379**	498,246
FDIC Insurance	**42,331**	93,004
Other operating expenses	**1,261,115**	1,213,614
	10,706,130	10,340,269
Income before federal income taxes	**2,362,745**	2,411,209
Federal income taxes	**85,000**	245,000
Net income	**$ 2,277,745**	$ 2,166,209
Basic and Diluted earnings per share	**$ 2.14**	$ 2.03

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Comprehensive Income
Years ended December 31, 2019 and 2018

	2019	2018
Net income	**$ 2,277,745**	$ 2,166,209
Available-for-sale securities		
Unrealized holding gains (losses) arising during the year	**1,593,128**	(821,976)
Reclassification adjustment for net realized losses included in net income (A)	**(3,223)**	(4,515)
Defined Benefit Plans		
Net unrealized loss on defined benefit plan	**(24,000)**	(24,000)
Other comprehensive income (loss) before income tax	**1,565,905**	(850,491)
Income tax (expense) benefit related to other comprehensive income (loss) (B)	**(328,840)**	178,603
Other comprehensive income (loss)	**1,237,065**	(671,888)
Comprehensive Income	**$ 3,514,810**	$ 1,494,321

(A) - Included in net gain (loss) on securities

(B) - Federal Income Tax expense in 2019 and 2018 includes ($677) and ($948) related to reclassification adjustments

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2019 and 2018

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2018	$ 1,623,800	$ 2,601,641	$ 25,380,419	$ 308,275	$ 29,914,135
Net income	-	-	2,166,209	-	2,166,209
Other comprehensive income (loss)	-	-	-	(671,888)	(671,888)
Dividends declared - $.72 per share	-	-	(767,520)	-	(767,520)
Balance at December 31, 2018	1,623,800	2,601,641	26,779,108	(363,613)	30,640,936
Net income	**-**	**-**	**2,277,745**	**-**	**2,277,745**
Other comprehensive income (loss)	**-**	**-**	**-**	**1,237,065**	**1,237,065**
Dividends declared - $.78 per share	**-**	**-**	**(831,480)**	**-**	**(831,480)**
Balance at December 31, 2019	**$ 1,623,800**	**$ 2,601,641**	**$ 28,225,373**	**$ 873,452**	**$ 33,324,266**

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
Cash flows from operating activities		
Net income	**$ 2,277,745**	$ 2,166,209
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**65,000**	60,000
Depreciation	**602,381**	493,166
Net amortization of securities	**100,117**	156,969
Earnings on bank owned life insurance, net	**(174,806)**	(172,705)
Loans originated for sale	**(4,099,500)**	(4,264,885)
Proceeds from sale of loans	**4,214,778**	4,378,621
Net gain on sales of other real estate	**(37,527)**	-
Net gain on sales of loans	**(115,278)**	(113,736)
Net loss on securities	**3,223**	4,515
Net loss on disposal of assets	**13,572**	-
Proceeds from AMT refund	**1,116,643**	-
Net change in:		
Accrued interest receivable and other assets	**(418,057)**	213,522
Accrued interest payable and other liabilities	**(433,599)**	539,887
Net cash from operating activities	**3,114,692**	3,461,563
Cash flows from (for) investing activities		
Net change in interest-bearing deposits in other financial institutions	**4,469,000**	9,125,000
Activity in available-for-sale securities:		
Sales	**1,007,380**	6,840,783
Maturities, prepayments, calls	**9,758,157**	6,975,378
Purchases	**(2,001,333)**	(2,455,000)
Activity in held-to-maturity securities:		
Maturities, prepayments, calls	**1,969,086**	1,906,863
Purchases	**(1,913,900)**	(1,667,000)
Loan originations and payments, net	**(2,433,130)**	(7,524,537)
Purchase of mortgage loans	**(13,426,510)**	-
Purchases of premises and equipment, net	**(1,143,856)**	(639,648)
Proceeds from sales of other real estate owned	**237,527**	-
Proceeds from sales of assets	**400**	-
Net cash from (for) investing activities	**(3,477,179)**	12,561,839
Cash flows from (for) financing activities		
Net change in deposits	**5,283,802**	(4,683,837)
Proceeds from Federal Home Loan Bank advances	**7,000,000**	12,000,000
Repayments of Federal Home Loan Bank advances	**(9,000,000)**	(16,000,000)
Cash dividends paid	**(831,480)**	(746,200)
Net cash from (for) financing activities	**2,452,322**	(9,430,037)
Net change in cash and cash equivalents	**2,089,835**	6,593,365
Cash and cash equivalents at beginning of year	**16,622,069**	10,028,704
Cash and cash equivalents at end of year	**$ 18,711,904**	$ 16,622,069
Supplemental disclosures of cash flow information		
Cash paid for interest	**$ 1,114,763**	$ 815,439
Cash paid for income taxes	**-**	-
Supplemental non-cash disclosures		
Dividends declared and not paid	**$ 287,820**	$ 287,820
Transfer of loans to other real estate owned	**-**	200,000

See accompanying notes

HCB Financial Corp.
Notes to Consolidated Financial Statements
December 31, 2019 and 2018

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: HCB Financial Corp. (the Company) is a bank holding company headquartered in Hastings, Michigan. The Company's wholly owned subsidiary, Highpoint Community Bank, (the Bank) operates seven full-service banking offices in and around Barry County. The Bank offers a variety of deposit and lending services.

Principles of Consolidation: The consolidated financial statements include the accounts and operations of HCB Financial Corp. and its wholly owned subsidiaries, Highpoint Community Bank, Citybanc Insurance Services, HCB Real Estate Holdings, LLC and Court Street Financial, Inc. All significant inter-company balances and transactions have been eliminated in consolidation.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through February 19, 2020, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions and for interest bearing time deposits with other financial institutions.

Cash and Cash Equivalents: The Company maintains deposit accounts with other financial institutions which generally exceed federally insured limits or are uninsured.

Interest-Bearing Time Deposits in other Financial Institutions: Interest-bearing time deposits in other financial institutions consist of fully insured certificates of deposits with $4,913,000 maturing within 1 year, $8,930,000 maturing within 2-5 years and $744,000 maturing within 6-10 years.

Restricted Investments: The Bank is a member of the Federal Home Loan Bank (FHLB) System and is required to invest in capital stock of the FHLB of Indianapolis. The amount of the required investment is determined and adjusted periodically by the FHLB.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts are amortized on the level yield method. Gains and losses on sales are based on the amortized cost of the security sold. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least an annual basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets.

Interest income is reported on the interest method. Interest income on loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received, for loans placed on nonaccrual, is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans held for sale are reported at the lower of cost or market, on an aggregate basis. Mortgage loans held for sale are generally sold with servicing rights retained; the carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Commercial and commercial real estate loans are individually evaluated for impairment if outstanding loans to a borrower are, in aggregate, over $150,000 and the risk rating assigned to a loan is a non-pass rating. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are also considered impaired and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The general component of the Allowance for Loan Losses covers non-impaired loans and large groups of homogeneous loans and is based on historical loss experience, over the last three years, adjusted for current risk factors. The following portfolio segments have been identified and the risk factors listed below are considered in determining the allowance for loan loss:

Residential real estate loans are evaluated for impairment using various economic indicators. Environmental factors that may impact collateral value on residential real estate loans include data on average local home sales, national and local economic conditions, and local employment rates. These factors are used to calculate an adjustment for current economic conditions. Other residential real estate loans with additional risk factors are loans where the payment is more than 30 days past due.

Commercial loans are evaluated for impairment using the following risk classification codes assigned to commercial credits internally:

- Risk Ratings 1-5 are considered to be within an acceptable risk tolerance to the bank.
- Risk Rating 6 is considered special mention. Typically, these loans are inadequately protected by the current net worth or paying capacity of the obligor, even though the value of underlying collateral may be sufficient to protect against loss. These loans are included on the watch list.
- Risk Rating 7 is considered substandard. Typically, these loans have well-defined weaknesses, normal repayment is in jeopardy.
- Risk Rating 8 is considered impaired non-accrual. All the weaknesses of a 7 rating exist plus the loan is in non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.
- Risk Rating 9 is considered doubtful. All the weaknesses of an 8 rating exist, however, these weaknesses now make collection or liquidation in full, based on existing conditions, improbable.
- Risk Rating 10 is considered loss. The bank recognizes loss credits by recording the charge-off in a timely manner.

These risk codes are reviewed and adjusted as appropriate in several circumstances. A formal loan review process is conducted on loans above various dollar thresholds based on the type of collateral securing the credit. The loan reviewer will either affirm that the risk rating is appropriate or recommend a change. Risk codes are also adjusted upon loan renewals, additional requests, and upon receipt of knowledge that an event has caused a change in apparent risk of an individual credit. In addition, business loan charge-offs are evaluated annually to assess the likelihood of deteriorating to charge-off before the determination that an allocated reserve is required. That additional loss factor is applied to non-impaired loans with a 5 and 6 rating. Any loans that are not individually evaluated for impairment are assigned an additional risk factor if they become past due by 30 days or more.

Consumer loans are both secured and unsecured and an additional risk factor is applied to loans that are past due by 30 days or more.

Bank-Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts that are probable at settlement.

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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing Rights: Servicing rights represent the fair value of retained servicing rights on loans sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the assets, using groupings of the underlying loans as to interest rates and then, secondarily, as to prepayment characteristics. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment is reported as a valuation allowance to the extent that fair value is less than the capitalized amount.

Servicing fee income, which is reported on the income statement as other income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees total $125,000 and $133,000 for the years ended December 31, 2019 and 2018, respectively. Late fees and ancillary fees related to loan servicing are not material.

Premises and Equipment: Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed principally using the straight-line method over the estimated lives of the related assets. Expenditures for normal repair and maintenance are charged to expenses as incurred.

Other Real Estate Owned: Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Long-Term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Post Retirement Benefit: The Bank sponsors a post retirement benefit plan that provides medical and life insurance benefits to eligible retirees, who retired prior to 2004, for life. At year-end 2019, the plan provided benefits to 10 participants. At year-end 2019 and 2018, the accrued benefit obligation recognized in the consolidated balance sheet and the unrecognized actuarial gain were $175,261 and $16,050 and $210,827 and $40,050, respectively. Additional disclosures related to the post retirement health care plan are not material to the financial statements.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period, which were 1,066,000 for both 2019 and 2018. There were no potentially dilutive common stock equivalents for 2019 or 2018.

Off-Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and changes in the funded status of the Company's post retirement benefit plans, which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Revenue Recognition: Effective January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (ASC Topic 606), and subsequent related Updates (collectively, ASU 2014-09). ASU 2014-09 modified the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of non-financial assets, unless those contracts are within the scope of other guidance. The Company determined that all interest revenues from loans and investments should be excluded from ASU 2014-09, as guidance from ASC Topic 310, Receivables (ASC Topic 310), and ASC Topic 320, Investments-Debt and Equity Securities (ASC Topic 320), respectively, address these revenues. Non-interest revenues from loan fees, bank-owned life insurance (BOLI), and gains and losses were also excluded, as guidance from ASC Topic 310, ASC Topic 325, and ASC Topic 360, Property, Plant, and Equipment, respectively, address these revenues. The Company’s principal revenue streams that are within the scope of ASC 606 include service charges and fees and trust income. These revenues are generally recognized immediately upon the completion of the service or over time as services are performed. Any services performed over time generally require that the Company renders services each period, for example monthly, therefore the Company measures progress in completing these services based upon the passage of time.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards:

Leases: Effective January 1, 2019, the Company was required to adopt ASU 2016-02 (Topic 842). This standard requires lessees to recognize a lease liability and a right of use asset for all leases, other than short-term leases. As the Company determined it had no leases affected by this standard, its adoption did not have any impact on the Company's financial condition on January 1, 2019.

Reclassifications: Certain items in the prior year financial statements were reclassified to conform to the current presentation.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 2 - SECURITIES

The fair value of available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

Available-for-sale

2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	$ 5,538,564	$ 99,705	$ -	$ 5,638,269
State and municipal	34,038,901	968,544	31,883	34,975,562
Mortgage-backed, residential	7,003,931	39,145	16,932	7,026,144
Corporate	3,983,319	31,027	21	4,014,325
Asset-backed securities	-	-	-	-
Total	$ 50,564,715	$ 1,138,421	$ 48,836	$ 51,654,300
2018				
U.S. Government and federal agency	$ 7,033,714	$ 14,545	$ 94,049	$ 6,954,210
State and municipal	41,498,195	351,614	514,937	41,334,872
Mortgage-backed, residential	6,651,089	16,284	178,504	6,488,869
Corporate	4,228,480	-	95,257	4,133,223
Asset-backed securities	20,781	-	16	20,765
Total	$ 59,432,259	$ 382,443	$ 882,763	$ 58,931,939

The carrying amount, unrecognized gains and losses, and fair value of securities held-to-maturity were as follows:

Held-to-maturity

2019	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
State and municipal	$ 30,000	$ 836	$ -	$ 30,836
2018				
State and municipal	$ 85,186	$ 2,970	$ -	$ 88,156

The fair value of debt securities and carrying amount, if different, at year-end 2019 by contractual maturity were as follows: Securities not due at a single maturity date, primarily consisting of mortgage-backed securities, are shown separately.

	Held-to-maturity		Available-for-sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 30,000	$ 30,836	$ 6,233,053	$ 6,247,809
Due after one through five years	-	-	31,998,529	32,592,796
Due after five through ten years	-	-	5,329,202	5,787,551
Due after ten years	-	-	-	-
Mortgage-backed, residential	-	-	7,003,931	7,026,144
	$ 30,000	$ 30,836	$ 50,564,715	$ 51,654,300

NOTE 2 - SECURITIES (Continued)

Securities pledged at year-end 2019 and 2018 had a carrying amount of $3,863,000 and $4,165,000 respectively, and were pledged to secure public deposits and other purposes as required or permitted by law.

Securities with unrealized losses at year-end 2019 and 2018, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2019						
U.S. Govt. and federal agency	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
State and municipal	**918,415**	**5,585**	**4,847,082**	**26,298**	**5,765,497**	**31,883**
Mortgage-backed, residential	**2,202,185**	**15,344**	**387,968**	**1,588**	**2,590,153**	**16,932**
Corporate	**-**	**-**	**499,897**	**21**	**499,897**	**21**
Asset-backed securities	**-**	**-**	**-**	**-**	**-**	**-**
	$ 3,120,600	**$ 20,929**	**$ 5,734,947**	**$ 27,907**	**$ 8,855,547**	**$ 48,836**
2018						
U.S. Govt. and federal agency	$ 497,815	$ 2,473	$ 4,890,867	$ 91,576	$ 5,388,682	$ 94,049
State and municipal	6,842,726	25,887	20,691,332	489,050	27,534,058	514,937
Mortgage-backed, residential	-	-	5,866,301	178,504	5,866,301	178,504
Corporate	249,672	323	3,883,551	94,934	4,133,223	95,257
Asset-backed securities	-	-	20,765	16	20,765	16
	$ 7,590,213	$ 28,683	$ 35,352,816	$ 854,080	$ 42,943,029	$ 882,763

Unrealized losses have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is not likely that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline.

Sales of available-for-sale securities were as follows:

	2019	2018
Proceeds	**$ 1,007,380**	$ 6,840,783
Gross gains	**-**	9,710
Gross losses	**(3,223)**	(14,225)

In 2018, the Company also realized a $7,300 loss on the sale of time deposits in other financial institutions.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS

Loans at year-end were as follows:

	2019	2018
Residential real estate:		
Residential mortgages	**$ 79,467,120**	$ 65,075,708
Home equity loans	**12,220,093**	14,749,043
Commercial:		
Real estate secured	**56,888,099**	56,850,924
Non-real estate secured	**20,840,297**	20,295,699
Municipal loans	**38,857,352**	36,133,311
Consumer	**11,534,402**	10,868,500
Subtotal	**219,807,363**	203,973,185
Allowance for loan losses	**(1,308,660)**	(1,269,122)
	$ 218,498,703	$ 202,704,063

Mortgage loans serviced for others are not reported as assets. Such loans aggregated to $46,365,000 and $51,211,000 at year-end 2019 and 2018, respectively. Capitalized mortgage servicing rights were $286,000 and $345,000 at year-end 2019 and 2018, respectively.

Certain directors and executive officers of the Company, including their associates, were loan customers of the Bank during 2019 and 2018. The outstanding loan balances for these persons at December 31, 2019 and 2018 amounted to $1,852,000 and $1,823,000, respectively. During 2019, new loans to these persons amounted to $457,000 and payments amounted to $428,000, compared to new loans of $457,000 and payments of $723,000 during 2018.

Activity in the allowance for loan losses for 2019 and 2018, by portfolio segment, was as follows:

December 31, 2019	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Beginning balance	**$ 383,013**	**$ 773,114**	**$ 112,995**	**$ 1,269,122**
Provision for loan losses	**(6,069)**	**68,865**	**2,204**	**65,000**
Loans charged-off	**-**	**(7,994)**	**(24,828)**	**(32,822)**
Recoveries	**-**	**150**	**7,210**	**7,360**
Ending balance:	**$ 376,944**	**$ 834,135**	**$ 97,581**	**$ 1,308,660**

December 31, 2018	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Beginning balance	$ 421,541	$ 899,105	$ 54,373	$ 1,375,019
Provision for loan losses	(38,528)	16,250	82,278	60,000
Loans charged-off	-	(142,821)	(27,488)	(170,309)
Recoveries	-	580	3,832	4,412
Ending balance:	$ 383,013	$ 773,114	$ 112,995	$ 1,269,122

NOTE 3 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2019 and 2018:

December 31, 2019	**Residential Real Estate**	**Commercial**	**Consumer**	**Total**
Allowance for loan losses:				
Individually evaluated for impairment	**$ 252,135**	**$ 172,865**	**$ 49,795**	**$ 474,795**
Collectively evaluated for impairment	**124,809**	**661,270**	**47,786**	**833,865**
Ending allowance balance attributable to loans:	**$ 376,944**	**$ 834,135**	**$ 97,581**	**$ 1,308,660**
Loan balances:				
Individually evaluated for impairment	**$ 723,005**	**$ 284,010**	**$ 53,550**	**$ 1,060,565**
Collectively evaluated for impairment	**90,964,208**	**116,301,738**	**11,480,852**	**218,746,798**
Total ending loan balances:	**$ 91,687,213**	**$ 116,585,748**	**$ 11,534,402**	**$ 219,807,363**
December 31, 2018				
Allowance for loan losses:				
Individually evaluated for impairment	$ 255,378	$ 208,794	$ 61,562	$ 525,734
Collectively evaluated for impairment	127,635	564,320	51,433	743,388
Ending allowance balance attributable to loans:	$ 383,013	$ 773,114	$ 112,995	$ 1,269,122
Loan balances:				
Individually evaluated for impairment	$ 772,655	$ 337,989	$ 75,084	$ 1,185,728
Collectively evaluated for impairment	79,052,096	112,941,945	10,793,416	202,787,457
Total ending loan balances:	$ 79,824,751	$ 113,279,934	$ 10,868,500	$ 203,973,185

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2019 and 2018:

December 31, 2019

	Unpaid Principal Balance	**Recorded Investment**	**Allowance for Loan Losses Allocated**	**Average Recorded Investment**	**Interest Income Recognized**	**Cash Basis Interest Recognized**
With no related allowance recorded:						
Residential real estate						
Residential mortgages	**$ 107,824**	**$ 107,824**	**$ -**	**$ 108,639**	**$ 6,207**	**$ 6,351**
Home equity loans	**81,625**	**81,625**	**-**	**83,081**	**4,014**	**3,759**
Commercial						
Real estate secured	**-**	**-**	**-**	**-**	**-**	**-**
Non-real estate secured	**-**	**-**	**-**	**-**	**-**	**-**
Consumer	**3,612**	**3,612**	**-**	**4,564**	**25**	**24**
Subtotal	**193,061**	**193,061**	**-**	**196,284**	**10,246**	**10,134**
With related allowance recorded:						
Residential real estate						
Residential mortgages	**533,556**	**533,556**	**252,135**	**538,838**	**25,269**	**25,594**
Home equity loans	**-**	**-**	**-**	**-**	**-**	**-**
Commercial						
Real estate secured	**284,010**	**284,010**	**172,865**	**293,505**	**17,346**	**17,227**
Non-real estate secured	**-**	**-**	**-**	**-**	**-**	**-**
Consumer	**49,938**	**49,938**	**49,795**	**45,992**	**341**	**340**
Subtotal	**867,504**	**867,504**	**474,795**	**878,335**	**42,956**	**43,161**
Total	**$ 1,060,565**	**$ 1,060,565**	**$ 474,795**	**$ 1,074,619**	**$ 53,202**	**$ 53,295**

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS (Continued)

December 31, 2018	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential real estate						
Residential mortgages	$ 139,459	$ 139,459	$ -	$ 141,837	$ 7,749	$ 7,870
Home equity loans	85,616	85,616	-	84,536	3,818	4,065
Commercial						
Real estate secured	-	-	-	-	-	-
Non-real estate secured	-	-	-	-	-	-
Consumer	12,287	12,287	-	16,966	85	67
Subtotal	237,362	237,362	-	243,339	11,652	12,002
With related allowance recorded:						
Residential real estate						
Residential mortgages	547,580	547,580	255,378	554,215	26,491	26,548
Home equity loans	-	-	-	-	-	-
Commercial						
Real estate secured	337,989	337,989	208,794	347,761	17,879	18,108
Non-real estate secured	-	-	-	-	-	-
Consumer	62,797	62,797	61,562	65,143	184	180
Subtotal	948,366	948,366	525,734	967,119	44,554	44,836
Total	$ 1,185,728	$ 1,185,728	$ 525,734	$ 1,210,458	$ 56,206	$ 56,838

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the recorded investment in non-accrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2019 and December 31, 2018

	2019		2018	
	Non-Accrual	Loans Past Due Over 90 Days Still Accruing	Non-Accrual	Loans Past Due Over 90 Days Still Accruing
Residential real estate				
Residential mortgages	$ -	$ -	$ 46,619	$ -
Home equity loans	-	-	-	-
Commercial				
Real estate secured	-	-	29,172	-
Non-real estate secured	-	-	-	-
Municipal loans	-	-	-	-
Consumer	-	-	-	-
	$ -	$ -	$ 75,791	$ -

NOTE 3 - LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2019 and 2018:

December 31, 2019	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due
Residential real estate				
Residential mortgages	$ 340,770	$ -	$ 340,770	$ 79,126,350
Home equity loans	-	-	-	12,220,093
Commercial				
Real estate secured	17,265	-	17,265	56,870,834
Non-real estate secured	-	-	-	20,840,297
Municipal loans	-	-	-	38,857,352
Consumer	37,266	-	37,266	11,497,136
	$ 395,301	$ -	$ 395,301	$ 219,412,062
December 31, 2018				
Residential real estate				
Residential mortgages	$ -	$ 46,619	$ 46,619	$ 65,029,089
Home equity loans	12,423	-	12,423	14,736,620
Commercial				
Real estate secured	120,000	29,172	149,172	56,701,752
Non-real estate secured	-	-	-	20,295,699
Municipal loans	-	-	-	36,133,311
Consumer	13,935	-	13,935	10,854,565
	$ 146,358	$ 75,791	$ 222,149	$ 203,751,036

Troubled Debt Restructurings:

The Company has allocated $475,000 and $487,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2019 and 2018. Of these reserves, $420,000 and $431,000 represent reserves on collateral dependent troubled debt restructures. The outstanding balance of such loans was $679,000 and $754,000 at year-end 2019 and 2018. The Company committed to lending no additional amounts, as of December 31, 2019 and 2018 respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The modifications of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the market rate for new debt with similar risk, capitalization of interest due or a nominal principal advance to enhance collectability of the debt.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 12 months to 30 years.

During 2019 there were no new troubled debt restructurings. During 2018, 1 consumer loan and 1 home equity loan were modified. The pre-modification outstanding recorded investment on these modified loans were $105,000 and the post modification outstanding recorded investment was $143,000. This troubled debt restructuring increased the allowance for loan losses by $52,000 and resulted in a charge-off of $0 during the year ending December 31, 2018.

There were no troubled debt restructurings in payment default within twelve months following the modification during the year ending December 31, 2019 or December 31, 2018. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 3 - LOANS (Continued)

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes credit relationships with an outstanding balance greater than $150,000 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed annually, at renewals, and when new information on a credit is learned. The Company uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention are included on the watch list, have identifiable weaknesses and are reviewed quarterly for impairment. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Not rated loans that are past due 30-89 days are also included in this category.

Substandard: Loans classified as substandard are considered very high risk, included on watch list, have well-defined weaknesses, normal repayment is in jeopardy and they are reviewed quarterly for impairment. Not rated loans that are more than 89 days past due are included in this category.

Impaired Non-Accrual: Loans classified as impaired non-accrual are very high risk and are in non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as impaired non-accrual, plus significant weaknesses making full collection through payment or liquidation questionable and improbable. The bank had no doubtful loans in 2019 and 2018.

Loans not meeting the criteria above, that are analyzed individually as part of the above described process, are considered to be pass rated loans. Municipal loans are primarily short-moderate term loans to municipalities related to maintenance or improvement projects that are funded by approved special tax assessments. The Company reviews updated financial information on long-term issues periodically. Groups of homogeneous loans and municipal loans are not rated and are listed as pass.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

December 31, 2019	Pass	Special Mention	Substandard	Impaired Non-Accrual	Total
Residential real estate					
Residential mortgages	**$ 78,484,970**	**$ 982,150**	**$ -**	**$ -**	**$ 79,467,120**
Home equity loans	**12,138,468**	**81,625**	**-**	**-**	**12,220,093**
Commercial					
Real estate secured	**55,926,935**	**677,154**	**284,010**	**-**	**56,888,099**
Non-real estate secured	**20,800,502**	**-**	**39,795**	**-**	**20,840,297**
Municipal loans	**38,857,352**	**-**	**-**	**-**	**38,857,352**
Consumer	**11,443,586**	**90,816**	**-**	**-**	**11,534,402**
Total	**$ 217,651,813**	**$ 1,831,745**	**$ 323,805**	**$ -**	**$ 219,807,363**

December 31, 2018	Pass	Special Mention	Substandard	Impaired Non-Accrual	Total
Residential real estate					
Residential mortgages	$ 64,342,049	$ 687,040	$ -	$ 46,619	$ 65,075,708
Home equity loans	14,651,004	98,039	-	-	14,749,043
Commercial					
Real estate secured	56,392,935	120,000	308,817	29,172	56,850,924
Non-real estate secured	20,288,996	6,703	-	-	20,295,699
Municipal loans	36,133,311	-	-	-	36,133,311
Consumer	10,779,482	89,018	-	-	10,868,500
Total	$ 202,587,777	$ 1,000,800	$ 308,817	$ 75,791	$ 203,973,185

NOTE 4 - PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	2019	2018
Land	**$ 1,785,136**	$ 1,785,136
Buildings	**9,702,736**	9,586,460
Furniture and equipment	**4,208,237**	3,462,043
	15,696,109	14,833,639
Less: Accumulated depreciation	**(7,046,277)**	(6,711,310)
	$ 8,649,832	$ 8,122,329

NOTE 5 - DEPOSITS

Time deposits of $250,000 or more were $4,334,000 and $1,369,000 at year-end 2019 and 2018, respectively. Scheduled maturities of all time deposits for the next five years and thereafter are as follows:

2020	$ 15,305,811
2021	6,065,141
2022	1,313,499
2023	1,130,074
2024	430,374
Thereafter	98,531

The Company held deposits of approximately $2,487,000 and $2,546,000 for related parties at December 31, 2019 and 2018, respectively.

NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES

Advances from the Federal Home Loan Bank were $24,000,000 and $26,000,000 at year-end 2019 and 2018, respectively. The weighted average fixed interest rate of outstanding advances was 1.92% and 2.20% at year-end 2019 and 2018, respectively.

Advances are payable at maturity dates, or prior with penalty for prepayment. The advances were collateralized by $60,368,000 and $55,536,000 of first mortgage loans under a blanket lien arrangement at year-end 2019 and 2018, respectively.

Scheduled maturities and required payments over the next five years and thereafter:

2020	$ -
2021	-
2022	5,000,000
2023	-
2024	-
Thereafter	19,000,000

$19,000,000 of advances are “Putable” advances which provide the Federal Home Loan Bank (“FHLB”) the option to convert the entire advance to an Adjustable Rate Advance at certain dates beginning in 2021. The advances are fixed rate advances until that time. If the FHLB exercises its option, the Company may pay off the advance without penalty. These advances have final maturity dates in 2026, 2028 and 2029.

The Company's Federal Home Loan Bank Overdraft Line of Credit had a balance of $0 at year-end 2019 and 2018.

NOTE 7 - RETIREMENT PLAN

The Bank sponsors a 401(k) savings plan that allows eligible employees to contribute a percentage of their annual compensation. The Bank matches a portion of the participant's contribution, up to plan-specified maximums. The Bank contributed $75,000 and $73,000 to the plan during 2019 and 2018, respectively. The Bank may also elect to make a profit-sharing contribution to the Plan.

Additionally, retirement benefits are provided to substantially all employees under a discretionary profit-sharing and employee stock ownership plan (ESOP). The Bank recognized expense of $210,000 and $210,000 during 2019 and 2018, respectively, related to the profit-sharing plan, which includes contributions to the ESOP of $130,000 and $130,000 in 2019 and 2018, respectively.

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 8 - FEDERAL INCOME TAXES

The provision for income taxes is summarized as follows:

	Year ended December 31	
	2019	**2018**
Current	**$ (59,000)**	$ 153,000
Deferred	**144,000**	92,000
Benefit due to enactment of federal tax reform	**-**	-
	$ 85,000	$ 245,000

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Bank's deferred tax assets and liabilities are as follows:

	December 31	
	2019	**2018**
Deferred income tax assets:		
Allowance for loan losses in excess of deductible amounts	**$ 212,000**	$ 204,000
Post retirement benefits	**37,000**	44,000
Accrued liabilities	**70,000**	89,000
Unrealized losses on securities	**-**	105,000
Net operating loss carryforward	**32,000**	-
Other	**13,000**	12,000
	364,000	454,000
Deferred income tax liabilities:		
Prepaid expenses	**(51,000)**	(43,000)
Book-tax basis differences on property and equipment	**(436,000)**	(273,000)
Unrealized gains on securities	**(229,000)**	-
Mortgage servicing rights	**(60,000)**	(72,000)
Other	**(19,000)**	(24,000)
	(795,000)	(412,000)
Net deferred income tax assets/(liabilities)	**$ (431,000)**	$ 42,000

At December 31, 2019 and December 31, 2018 there were no unrecognized tax benefits recorded. The Bank does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months. There were no interest or penalties recorded during 2019 or 2018. The Company is subject to U.S. federal income tax and is no longer subject to examination by taxing authorities for years before 2016.

At December 31, 2019 and December 31, 2018, the Company has $1,117,000 and $2,238,000 of alternative minimum tax credit (AMTC) carryforwards which do not expire and are now carried as tax receivables on the balance sheet since, under the new federal law, the Company expects to recover the entire amount by 2022 via reduction of regular tax liability or refund. Pursuant to the new tax law, the Company expects to receive a refund of AMTC of approximately $558,000 in 2020. For tax year 2019, the Company generated a net operating loss of $152,000 which has an unlimited carryforward period and can offset 80% of taxable income annually.

A reconciliation of the difference between federal income taxes and the amount computed by applying the statutory rate are as follows:

	Year ended December 31	
	2019	**2018**
Taxes at statutory rate	**$ 496,000**	$ 506,000
Effect of tax-exempt interest	**(312,000)**	(297,000)
Effect of BOLI income	**(37,000)**	(36,000)
Other	**(62,000)**	72,000
	$ 85,000	$ 245,000

NOTE 9 - LOAN COMMITMENTS AND STANDBY LETTERS OF CREDIT

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

At December 31, 2019 and 2018, the Bank had commitments to fund loans to customers and available unused lines of credit of $15,625,000 and $21,547,000, respectively. Commitments under outstanding standby letters of credit amounted to $728,000 and $337,000 at December 31, 2019 and 2018, respectively.

NOTE 10 – REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. The table below presents capital adequacy information assuming full phase-in of these new requirements, which includes the full 2.50% capital conservation buffer which was required as of January 1, 2019. Management believes, as of December 31, 2019 and December 31 2018, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2019 and 2018, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (000's omitted) and ratios at year-end are presented below:

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
2019						
Total capital to risk-weighted assets:	**$ 33,745**	**17.46%**	**$ 20,298**	**10.50%**	**$ 19,332**	**10.00%**
Tier 1 (Core) Capital to risk-weighted assets:	**32,436**	**16.78**	**16,432**	**8.50**	**15,465**	**8.00**
Common Tier 1 to risk-weighted assets (CET1):	**32,436**	**16.78**	**13,532**	**7.00**	**12,566**	**6.50**
Tier 1 (Core) Capital to average assets:	**32,436**	**9.94**	**21,203**	**4.00**	**16,310**	**5.00**
2018						
Total capital to risk-weighted assets:	$ 32,263	17.34%	$ 19,531	10.50%	$ 18,601	10.00%
Tier 1 (Core) Capital to risk-weighted assets:	30,994	16.66	15,811	8.50	14,881	8.00
Common Tier 1 to risk-weighted assets (CET1):	30,994	16.66	13,021	7.00	12,091	6.50
Tier 1 (Core) Capital to average assets:	30,994	9.73	20,697	4.00	15,920	5.00

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 11 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: The fair value for securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and Treasury curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations. The Company had no securities designated as Level 3 securities at year-end 2019 and 2018.

Impaired Loans: The fair value of collateral dependent impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate valuations. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate valuations which are updated no less frequently than annually. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Valuations for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties), certified residential appraisers, state licensed appraisers or licensed realtors (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, an administrator level or higher reviews the assumptions and approaches utilized in the valuation as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent valuation to determine what additional adjustment should be made to the valuation to arrive at fair value. The most recent analysis performed indicated that a discount of 20% should be applied.

NOTE 11 - FAIR VALUE (Continued)

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at December 31 using:

2019	**Carrying Value**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and federal agency	**$ 5,638,269**	**$ -**	**$ 5,638,269**	**$ -**
State and municipal	**34,975,562**	**-**	**34,975,562**	**-**
Mortgage-backed, residential	**7,026,144**	**-**	**7,026,144**	**-**
Corporate	**4,014,325**	**-**	**4,014,325**	**-**
Asset-backed securities	**-**	**-**	**-**	**-**
Available-for-sale securities	**$ 51,654,300**	**$ -**	**$ 51,654,300**	**$ -**
2018				
U.S. Government and federal agency	$ 6,954,210	$ -	$ 6,954,210	$ -
State and municipal	41,334,872	-	41,334,872	-
Mortgage-backed, residential	6,488,869	-	6,488,869	-
Corporate	4,133,223	-	4,133,223	-
Asset-backed securities	20,765	-	20,765	-
Available-for-sale securities	$ 58,931,939	$ -	$ 58,931,939	$ -

Assets measured at fair value on a non-recurring basis are summarized below:

December 31, 2019	**Level 1**	**Level 2**	**Level 3**
Impaired Loans			
Residential mortgages	**$**	**$ -**	**$ - 154,779**
Commercial			
Real estate secured	**-**	**-**	**104,388**
Non-real estate secured	**-**	**-**	**-**
Total impaired loans	**-**	**-**	**259,167**
Other Real Estate Owned			
Commercial real estate	**-**	**-**	**-**
Total impaired loans / other real estate owned	**$ -**	**$ -**	**$ 259,167**

HCB Financial Corp.
Notes to Consolidated Financial Statements
(Continued)

NOTE 11 - FAIR VALUE (Continued)

December 31, 2018	Level 1	Level 2	Level 3
Impaired Loans			
Residential real estate			
Residential mortgages	$ -	$ -	$ 164,811
Commercial			
Real estate secured	-	-	129,195
Non-real estate secured	-	-	-
Total impaired loans	-	-	294,006
Other Real Estate Owned			
Commercial real estate	-	-	-
Total impaired loans / other real estate owned	$ -	$ -	$ 294,006

As discussed previously, the fair values of impaired loans carried at fair value are determined by third party appraisals. Management makes adjustments to these appraised values based on the age of the appraisal. Quantitative information about level 3 fair value measurements is presented if there are large or complex classes of financial instruments measured at fair value on a non-recurring basis. No such information is deemed significant for 2019 or 2018.

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, a level 3 value, had a carrying amount of $679,000 prior to a valuation allowance of $420,000 at December 31, 2019, resulting in an additional allocation for loan losses of $0 for the year ending December 31, 2019. At December 31, 2018, impaired loans had a carrying amount of $755,000, prior to a valuation allowance of $461,000, resulting in a reduction of allocation for loan losses of $0 for the year ending December 31, 2018.

NOTE 11 - FAIR VALUE (Continued)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:
Carrying amount is the estimated fair value for cash and cash equivalents, interest-bearing deposits, short-term borrowings and accrued interest receivable and payable. The methods for determining the fair values for securities were described previously. For fixed and variable rate loans, fair value is based upon the exit price notion where projected cash flows are discounted using interest rates and credit adjustments from a market participants' perspective. For interest-bearing deposits and for deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material.

The carrying amounts, estimated fair values of financial instruments and fair value level are summarized as follows:

		2019		2018	
	Fair Value Level	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Assets:					
Cash and cash equivalents	1	**$ 18,711,904**	**$ 18,712,000**	$ 16,622,069	$ 16,622,000
Interest-bearing deposits	2	**14,587,000**	**14,732,000**	19,056,000	18,783,000
Securities - held-to-maturity	2	**30,000**	**31,000**	85,186	88,000
Securities - available-for-sale	2	**51,654,300**	**51,654,000**	58,931,939	58,932,000
Federal Home Loan Bank stock	N/A	**1,580,800**	**NA**	1,580,800	NA
Loans, net	3	**218,498,703**	**217,538,000**	203,447,451	197,524,000
Accrued interest receivable	2	**1,357,230**	**1,357,000**	1,264,885	1,265,000
Liabilities:					
Deposits (Non Time Deposits)	1	**$ 241,063,179**	**$ 241,063,000**	$ 243,510,467	$ 243,510,000
Time Deposits	2	**24,343,430**	**23,980,000**	16,612,340	16,602,000
Federal Home Loan Bank advances	2	**24,000,000**	**23,834,000**	26,000,000	25,880,000
Accrued interest payable	2	**88,281**	**88,000**	46,687	47,000

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Directors & Officers

Directors

Front: Joan M. Heffelbower, Archie A. Warner, Barbara L. Hunt
Back: W. Scott McKeown, Brian N. Calley, Matthew R. Garber, Mark A. Kolanowski, Joseph J. Babiak, James H. Fisher

Joseph J. Babiak
President and C.E.O.
Hastings Mutual Insurance Company

Brian N. Calley
President
Small Business Association of Michigan

James H. Fisher
Of Counsel, Dickinson Wright

Matthew R. Garber
Physician and Director of Hospitalist Program
Spectrum Health Pennock

Joan M. Heffelbower
Retired, Chief Financial Officer
Highpoint Community Bank

Barbara L. Hunt
Accounting Manager
Bethany Christian Services

Mark A. Kolanowski
President and C.E.O.
Highpoint Community Bank

W. Scott McKeown
Partner
McKeown & Kraai, PLC

Archie A. Warner
President and C.E.O.
Harder and Warner Landscaping, Inc.
Harder and Warner Nursery, Inc.

Officers

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President and C.E.O.

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Randoulph L. Teegardin
Senior Vice President,
Wealth Management

Richard L. Zwiernikowski, Jr.
Senior Vice President
and Chief Financial Officer

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Vice President, Credit Manager

Amanda M. Belcher-Currier
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Compliance Officer

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Vice President,
Retail Bank Services

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Vice President, Retail Lending

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Business Development Director

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Vice President,
Marketing Director

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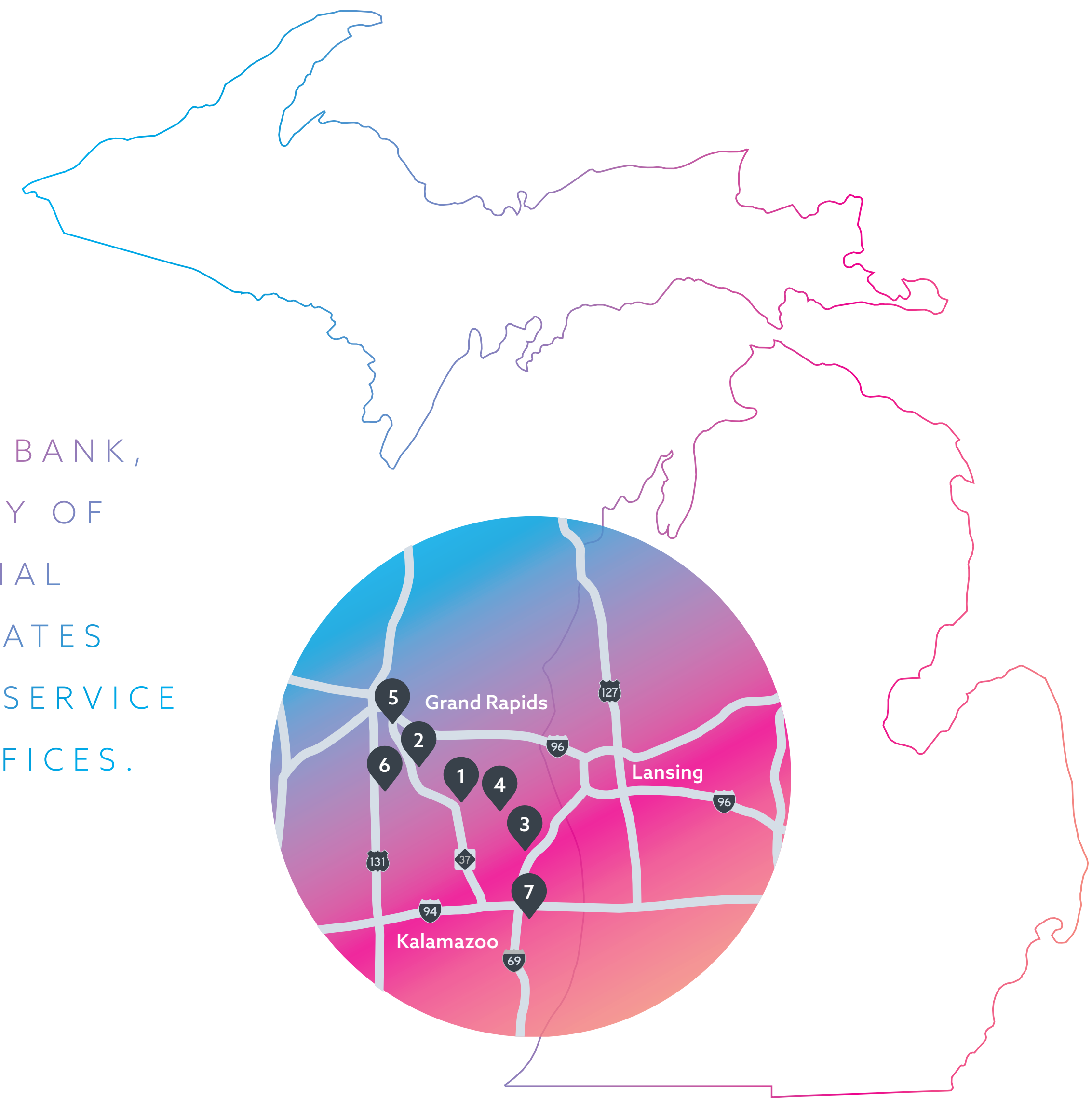

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