

**Cornerstone Bancorp, Inc. and Subsidiary**

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**Consolidated Financial Report  
December 31, 2019**

# Cornerstone Bancorp, Inc. and Subsidiary

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## Independent Auditor's Report

To the Board of Directors  
Cornerstone Bancorp, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of Cornerstone Bancorp, Inc. and Subsidiary (the "Corporation"), which comprise the consolidated balance sheet 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 consolidated financial statements.

### ***Management's Responsibility for the Consolidated 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 audits 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.

To the Board of Directors  
Cornerstone Bancorp, Inc. and Subsidiary

***Opinion***

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

*Plante & Moran, PLLC*

March 26, 2020

# Cornerstone Bancorp, Inc. and Subsidiary

## Consolidated Balance Sheet

	December 31, 2019	December 31, 2018
<b>Assets</b>		
Cash and cash equivalents	\$ 58,643,841	\$ 45,540,801
Investment securities - Available-for-sale (Note 2)	99,322,987	99,446,645
Other securities	1,122,300	1,148,400
Loans held for sale	2,103,674	1,005,700
Loans, net of allowance for loan losses (Note 3)	463,814,357	413,806,182
Premises and equipment (Note 4)	3,313,990	3,210,222
Accrued interest receivable	1,702,006	1,681,074
Other real estate owned	-	513,625
Other assets	2,951,207	2,541,968
	<u>\$ 632,974,362</u>	<u>\$ 568,894,617</u>
Total assets		
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing deposits	\$ 166,436,734	\$ 147,707,994
Interest-bearing deposits	400,007,158	360,094,842
Total deposits (Note 5)	566,443,892	507,802,836
Securities sold under agreements to repurchase	6,173,381	4,416,601
Junior subordinated debentures (Note 6)	10,310,000	10,310,000
Borrowings under line of credit (Note 10)	8,500,000	2,500,000
Accrued interest payable	169,438	138,670
Other liabilities	3,372,971	1,945,971
	<u>594,969,682</u>	<u>527,114,078</u>
Total liabilities		
<b>Stockholders' Equity</b>		
Preferred Stock - \$0.001 par value:		
Authorized - 500,000 shares	-	-
No shares issued or outstanding at December 31, 2019 or 2018		
Common stock - \$.001 par value:		
Authorized - 1,000,000 shares		
Issued - 994,088 and 751,840 shares at December 31,		
2019 and 2018, respectively	994	752
Outstanding - 994,088 and 706,713 shares at December 31,		
2019 and 2018, respectively	994	752
Additional paid-in capital	34,063,334	20,116,333
Retained earnings	5,504,831	25,157,772
Accumulated other comprehensive income (loss)	96,612	(553,364)
Unearned stock-based compensation	(1,661,091)	-
Treasury stock - 0 and 45,127 shares at December 31,		
2019 and 2018, respectively	-	(2,940,954)
	<u>38,004,680</u>	<u>41,780,539</u>
Total stockholders' equity		
Total liabilities and stockholders' equity	<u>\$ 632,974,362</u>	<u>\$ 568,894,617</u>

# Cornerstone Bancorp, Inc. and Subsidiary

## Consolidated Statement of Income

	Year Ended	
	December 31, 2019	December 31, 2018
<b>Interest Income</b>		
Loans, including fees	\$ 22,572,229	\$ 20,334,668
Investment securities	3,372,698	2,535,285
Total interest income	25,944,927	22,869,953
<b>Interest Expense</b>		
Deposits	4,316,805	2,417,944
Securities sold under agreements to repurchase	24,635	16,347
Borrowings under line of credit	237,085	43,291
Borrowings under term debt	190,757	-
Junior subordinated debentures	581,596	538,402
Total interest expense	5,350,878	3,015,984
<b>Net Interest Income</b> - Before provision for loan losses	20,594,049	19,853,969
<b>Provision for Loan Losses</b> (Note 3)	-	(400,000)
<b>Net Interest Income</b> - After provision for loan losses	20,594,049	20,253,969
<b>Noninterest Income</b>		
Service charges on deposits	568,051	646,557
Trust fees	3,087,158	2,935,593
Gains on sales of loans held for sale	1,406,352	545,465
Other operating	290,091	253,431
Total noninterest income	5,351,652	4,381,046
<b>Noninterest Expenses</b>		
Salaries and employee benefits (Notes 8 and 9)	14,614,184	11,071,719
Occupancy (Note 4)	973,297	991,804
Data processing	1,278,884	1,211,752
Mortgage commissions and third-party fees	722,945	230,775
Legal, audit, and professional fees	416,194	379,289
Other real estate owned	(505,406)	96,165
Regulatory assessments	208,780	315,579
Other operating	1,239,589	1,364,111
Total noninterest expenses	18,948,467	15,661,194
<b>Income</b> - Before income tax expense	6,997,234	8,973,821
<b>Income Tax Expense</b> (Note 7)	1,897,035	2,433,690
<b>Net Income</b>	<b>\$ 5,100,199</b>	<b>\$ 6,540,131</b>

# Cornerstone Bancorp, Inc. and Subsidiary

## Consolidated Statement of Comprehensive Income

	Year Ended	
	December 31, 2019	December 31, 2018
<b>Net Income</b>	\$ 5,100,199	\$ 6,540,131
<b>Other Comprehensive Income (Loss):</b>		
Unrealized holding gains on investment securities - Available-for-sale	1,413,108	126,558
Unrealized holding losses on interest rate swap	(503,951)	(246,233)
Tax effect	(259,181)	34,101
<b>Other Comprehensive Income (Loss) - Net of tax</b>	<u>649,976</u>	<u>(85,574)</u>
<b>Comprehensive Income</b>	<u>\$ 5,750,175</u>	<u>\$ 6,454,557</u>

# Cornerstone Bancorp, Inc. and Subsidiary

## Consolidated Statement of Stockholders' Equity

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Stock- Based Compensation	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
<b>Balance - January 1, 2018</b>	\$ 752	\$ 19,900,245	\$ 29,203,336	\$ -	\$ (467,790)	\$ (3,515,942)	\$ 45,120,601
Net income	-	-	6,540,131	-	-	-	6,540,131
Other comprehensive loss, net	-	-	-	-	(85,574)	-	(85,574)
Dividends paid	-	-	(10,585,695)	-	-	-	(10,585,695)
Redemption - 2,210 shares of common stock	-	-	-	-	-	(190,060)	(190,060)
Issuance - 15,252 shares of treasury stock	-	216,088	-	-	-	765,048	981,136
<b>Balance - December 31, 2018</b>	752	20,116,333	25,157,772	-	(553,364)	(2,940,954)	41,780,539
Cumulative effect of the adoption of new lease accounting standard	-	-	(18,185)	-	-	-	(18,185)
<b>Balance - January 1, 2019</b>	752	20,116,333	25,139,587	-	(553,364)	(2,940,954)	41,762,354
Net income	-	-	5,100,199	-	-	-	5,100,199
Other comprehensive income, net	-	-	-	-	649,976	-	649,976
Dividends paid	-	-	(24,734,955)	-	-	-	(24,734,955)
Grant - 35,259 shares of restricted common stock	35	1,868,692	-	(1,868,727)	-	-	-
Issuance - 206,989 shares of common stock	207	12,627,532	-	-	-	-	12,627,739
Issuance - 45,127 shares of treasury stock	-	(549,223)	-	-	-	2,940,954	2,391,731
Stock compensation expense	-	-	-	207,636	-	-	207,636
<b>Balance - December 31, 2019</b>	<b>994</b>	<b>\$ 34,063,334</b>	<b>\$ 5,504,831</b>	<b>\$ (1,661,091)</b>	<b>\$ 96,612</b>	<b>\$ -</b>	<b>\$ 38,004,680</b>

# Cornerstone Bancorp, Inc. and Subsidiary

## Consolidated Statement of Cash Flows

	Year Ended	
	December 31, 2019	December 31, 2018
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 5,100,199	\$ 6,540,131
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization on premises and equipment	268,961	216,548
Provision for loan losses	-	(400,000)
Amortization and accretion on securities - Net	699,805	901,247
(Gains) losses on sale of other real estate owned	(23,162)	7,492
Gains on sales of loans held for sale	(1,406,352)	(545,465)
Originations of loans held for sale	(81,417,313)	(35,519,988)
Proceeds from sale of loans held for sale	81,633,690	35,624,620
Deferred income tax expense (benefit)	71,836	(433,838)
Stock-based compensation	207,636	-
Changes in operating assets and liabilities that provided (used) cash:		
Accrued interest receivable	(20,932)	(4,326)
Other assets	(180,243)	340,394
Accrued interest payable	30,768	95,090
Other liabilities	344,851	381,550
Net cash provided by operating activities	5,309,744	7,203,455
<b>Cash Flows from Investing Activities</b>		
Activity in available-for-sale investment securities:		
Maturities, prepayments, and calls	29,828,225	42,292,297
Purchases	(28,991,264)	(10,112,976)
Redemption (purchase) of Federal Home Loan Bank stock	26,100	(40,000)
Net increase in loans	(49,916,174)	(44,164,725)
Proceeds from sale of other real estate owned	536,787	232,508
Additions to premises and equipment	(372,729)	(181,784)
Net cash used in investing activities	(48,889,055)	(11,974,680)
<b>Cash Flows from Financing Activities</b>		
Net change in deposits	58,641,056	36,035,401
Net change in securities sold under agreements to repurchase	1,756,780	(2,531,631)
Borrowings under line of credit	6,000,000	2,500,000
Borrowings under term note	14,235,000	-
Repayments of borrowings under term note	(14,235,000)	-
Dividends paid on common stock	(24,734,955)	(10,585,695)
Issuance of common stock	12,627,739	-
Redemption of treasury stock	-	(190,060)
Issuance of treasury stock	2,391,731	981,136
Net cash provided by financing activities	56,682,351	26,209,151
<b>Net Change in Cash and Cash Equivalents</b>	13,103,040	21,437,926
<b>Cash and Cash Equivalents - Beginning of year</b>	45,540,801	24,102,875
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 58,643,841</b>	<b>\$ 45,540,801</b>
<b>Supplemental Cash Flow and Noncash Information</b>		
Cash paid for:		
Interest	5,320,110	2,920,894
Income taxes	1,850,000	2,625,000
Noncash transactions		
Net transfer of loans to other real estate owned	-	134,608
Loans held-for-sale transferred to loans, net	92,001	660,031

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 1 - Nature of Business and Significant Accounting Policies

**Nature of Operations** - Cornerstone Bancorp, Inc. (the "Corporation") and its wholly owned subsidiary, Cornerstone National Bank & Trust Company (the "Bank"), provide a variety of financial services to individuals and businesses in the Chicago metropolitan area through their main office in Palatine, Illinois, and branch offices in Crystal Lake, Lake Zurich, and Naperville Illinois. Their primary deposit products are demand deposits, savings, money market, and term certificate accounts, and their primary lending products are commercial and commercial mortgage loans. The Corporation has a mortgage banking operation in which residential mortgage loans are originated and sold to the secondary market.

**Use of Estimates** - In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenue 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 and the valuation of investment securities.

**Basis of Presentation and Consolidation** - The consolidated financial statements include the accounts of the Corporation and the Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents** - For the purpose of the consolidated statement of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold which have original maturities within 90 days.

**Investment Securities** - Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale 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 Corporation 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.

**Other Securities** - Other securities consist of Federal Home Loan Bank and Federal Reserve Bank Stock. These investments are restricted as to redemption and are carried at cost.

**Loans Held for Sale** - Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income. For the years ended December 31, 2019 and 2018, the majority of such loans were sold to three investors.

**Loans** - The Corporation grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans in the Chicago metropolitan area. The ability of the Corporation's debtors to honor their contracts is partially dependent upon the real estate and general economic conditions in this area.

# Cornerstone Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements  
December 31, 2019 and 2018

## Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Loans that management 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 chargeoffs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to the related loan yield using the interest method.

The accrual of interest on loans is 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 collected for loans that are placed on nonaccrual 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. 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 are considered delinquent when customers fail to make their payments in accordance with the contractual loan agreement. If a loan matures and principal remains outstanding, the loan is considered delinquent until the loan is paid off or renewed.

Gross loans are reported at the Corporation's recorded investment. The recorded investment is the borrower's principal balance less partial charge-offs, if any.

**Allowance for Loan Losses** - The allowance for loan losses (the "allowance") is established as 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 uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. The general component covers nonimpaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Specific reserves are measured on a

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

loan-by-loan basis for impaired loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer loans for impairment disclosures.

Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as a Troubled Debt Restructure (TDR). A loan is a TDR when the Corporation, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower by modifying or renewing a loan under terms that the Corporation would not otherwise consider. To make this determination, the Corporation must determine whether (a) the borrower is experiencing financial difficulties and (b) the Corporation granted the borrower a concession. This determination requires consideration of all of the facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean the borrower is experiencing financial difficulties.

**Premises and Equipment** - Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets, ranging from 3 years to 40 years.

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

**Securities Sold Under Agreements to Repurchase** - Securities sold under agreements to repurchase, which are classified as secure borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Corporation may be required to provide additional collateral based on the fair value of the underlying securities.

**Treasury Stock** - Treasury stock represents shares of the Corporation that were repurchased. These shares are carried at cost and are reissued using the first-in-first-out method.

**Income Taxes** - Deferred income 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 various temporary differences between the book and tax basis of the various consolidated balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

At December 31, 2019 and 2018, the Corporation evaluated tax positions taken for filing with the Internal Revenue Service and all state jurisdictions in which it operates. The Corporation believes that income tax filing positions will be sustained under examination and does not anticipate any adjustments that would result in a material adverse effect on the Corporation's financial condition, results of operations, or cash flows. Accordingly, the Corporation has not recorded any reserves or related accruals for interest and penalties for uncertain tax positions at December 31, 2019 and 2018.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Comprehensive Income** - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and certain interest rate swap agreements, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income. At December 31, 2019, the components of accumulated other comprehensive income consist of net unrealized holding gains on securities available-for-sale of \$885,368, unrealized holding losses on interest rate swap contracts of \$750,184, and a net income tax expense of \$38,572.

**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 Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Advertising Costs** - All advertising costs incurred by the Corporation are expensed in the period in which they are incurred.

**Off-Balance-Sheet Instruments** - In the ordinary course of business, the Corporation has entered into commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

**Equity Compensation Plans** - The Corporation measures the cost of employee services received in exchange for equity awards, including stock options and restricted stock awards. Compensation related to stock options is based on the estimated grant date fair value of the awards. Compensation related to restricted stock awards is based on the market price of the Company's common stock at the date of grant. Compensation cost is recognized over the required service period, generally defined as the vesting period.

**Trust Assets** - Assets held by the Corporation in a fiduciary, agency, or custody capacity for its trust department customers are not included in the accompanying consolidated financial statements since such items are not assets of the Corporation. The Corporation charges client fees based on a percentage of the market value of assets held in client accounts. As the Corporation's services are performed over time on an ongoing basis, its clients obtain the benefits of such services as they are performed. Therefore, the Corporation satisfies its performance obligations and records income during the year as services are rendered.

**Subsequent Events** - The consolidated financial statements and related disclosures include evaluation of events up through and including March 26, 2020, which is the date the consolidated financial statements were available to be issued. As part of this evaluation, the COVID-19 pandemic arose with a related monetary easing by the Federal Reserve and is considered an event that has prospective financial reporting implications. Therefore, no financial implications are reflected in the December 31, 2019 financial statements. However, while it is not yet possible to estimate the impact on future earnings, certain estimates such as the allowance for loan losses, fair value of financial instruments, and the fair value of investment securities, are particularly susceptible to adjustment and these adjustments could be significant.

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**Recent Accounting Pronouncements** – In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the current revenue recognition requirements in Topic 605, *Revenue Recognition*. The ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of this standard on January 1, 2019 did not have a significant impact on the Corporation's consolidated financial statements, as the majority of the Corporation's revenue sources are scoped out of the standard, including revenue generated from financial instruments, such as loans, letters of credit, and investment securities. Descriptions of the Corporation's significant revenue generating activities that are within the scope of Topic 606, which are presented in the consolidated statement of income as components of noninterest income, are service charges on deposits, trust income, and other miscellaneous fee income.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosures related to certain financial instruments, including requiring equity investments to be accounted for at fair value with changes recorded through earnings, the use of the exit price when measuring fair value, and disaggregation of financial assets and liabilities by category for disclosure purposes. The Corporation adopted this standard as of January 1, 2019. The ASU eliminated the ability to carry equity investments at cost. The impact of adopting this provision of the ASU did not have a significant impact on the consolidated financial statements. In addition, the adoption of this standard resulted in the Corporation's use of an exit price rather than an entrance price to determine the fair value of loans and deposits not already measured at fair value on a nonrecurring basis in the consolidated balance sheet disclosures included as Note 13 to the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which superseded the current lease requirements in ASC 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases are classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Previously, leases were classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows remains generally consistent with the previous guidance. In July 2018, the FASB issued ASU 2018-11, *Leases: Targeted Improvements*, which provided additional guidance on the transition method, including application as a cumulative-effect adjustment to equity and practical expedients to use when accounting for lease components. The new lease guidance was effective for the Corporation's year ending December 31, 2019 and was applied using a modified retrospective transition method to the beginning of the most recent period presented. As a result of adopting this standard on January 1, 2019, the Corporation recorded a lease obligation for the operating leases described in Note 4 in the amount of \$578,198, with a corresponding right to use asset in the amount of \$560,013, in other liabilities and other assets, respectively, in the consolidated financial statements. The difference of \$18,185 was recorded to equity as of January 1, 2019 as a cumulative effect of the adoption of an accounting principle.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*. The ASU includes increased disclosures and various changes to the accounting and measurement of financial assets including the Corporation's loans and available-for-sale debt securities. Each financial asset presented on the balance sheet would have a unique allowance for credit losses valuation account that is deducted from the amortized cost basis to present the net carrying value at the amount expected to be collected on the financial asset. The amendments in this ASU also eliminate the probable initial recognition threshold in current GAAP and, instead, reflect an entity's current estimate of all expected credit losses using reasonable and supportable forecasts. The new credit loss guidance will be effective for the Corporation's year ending December 31, 2023. Upon adoption the ASU will be applied using a modified retrospective transition method to the beginning of the first reporting period in which the guidance is effective. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Early adoption for all institutions is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. This standard is expected to have a significant effect on the Corporation's consolidated financial statements. The Corporation is assessing the impact of ASU 2016-13 on its accounting and disclosures and has determined that a loss rate model will be used for calculation of future risk assessments upon the ASU's adoption in 2023. The Corporation has accumulated historical data by loan pools and collateral classifications and anticipates calculation of estimates in 2020 through 2022 on a test basis to confirm model processes and to determine financial statement impact prior to adoption in 2023.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815)*, to permit entities to better portray the economic results of their hedging strategies in their financial statements. In addition, the amendments make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. One of the targeted improvements of the ASU eliminates the Corporation's requirement to measure and reclassify ineffective portions of a cash flow hedge to earnings. The amendment is effective for fiscal years beginning after December 15, 2019, with early adoption permitted, including adoption in an interim period. The Corporation has chosen to early adopt this amendment in connection with the interest rate swap that commenced in July 2018 with no material impact on its results of operation, financial position, or liquidity.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 2 - Investment Securities

The amortized cost and estimated fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities Available-for-Sale</b>				
U.S. government agencies	\$ 17,075,570	\$ 162,988	\$ -	\$ 17,238,558
Mortgage-backed securities and collateralized mortgage obligations	10,808,235	168,990	(18,176)	10,959,049
State and municipal securities	50,210,812	432,226	(11,719)	50,631,319
Corporate debt securities	19,331,993	191,269	(40,210)	19,483,052
Community reinvestment fund	1,011,009	-	-	1,011,009
Total	<u>\$ 98,437,619</u>	<u>\$ 955,473</u>	<u>\$ (70,105)</u>	<u>\$ 99,322,987</u>
	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Securities Available-for-Sale</b>				
U.S. government agencies	\$ 22,052,842	\$ 70,178	\$ (75,103)	\$ 22,047,917
Mortgage-backed securities and collateralized mortgage obligations	2,461,904	683	(67,594)	2,394,993
State and municipal securities	61,415,533	80,397	(463,718)	61,032,212
Corporate debt securities	13,044,106	-	(52,235)	12,991,871
Community reinvestment fund	1,000,000	-	(20,348)	979,652
Total	<u>\$ 99,974,385</u>	<u>\$ 151,258</u>	<u>\$ (678,998)</u>	<u>\$ 99,446,645</u>

At December 31, 2019 and 2018, securities with a carrying value of approximately \$13,708,000 and \$12,714,000, respectively, were pledged to secure repurchase agreements, borrowings, public deposits and for other purposes required or permitted by law.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 2 - Investment Securities (Continued)

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2019 are as follows:

	December 31, 2019	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 28,248,777	\$ 28,303,157
Due after one year through five years	51,777,380	52,454,500
Due after five years through ten years	6,592,218	6,595,272
Total	86,618,375	87,352,929
Community reinvestment fund	1,011,009	1,011,009
Mortgage-backed securities and collateralized mortgage obligations	10,808,235	10,959,049
Total	\$ 98,437,619	\$ 99,322,987

There were no sales of investments in 2019 or 2018.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 2 - Investment Securities (Continued)

Information pertaining to securities with gross unrealized losses at December 31, 2019 and 2018, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

	December 31, 2019			
	<12 Months		>12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	\$ -	\$ -	\$ -	\$ -
Mortgage-backed securities and collateralized mortgage obligations	-	-	(18,176)	848,723
State and municipal securities	(6,643)	2,895,825	(5,076)	3,689,747
Corporate debt securities	(40,210)	5,120,990	-	-
Community reinvestment fund	-	-	-	-
Total	<u>\$ (46,853)</u>	<u>\$ 8,016,815</u>	<u>\$ (23,252)</u>	<u>\$ 4,538,470</u>

  

	December 31, 2018			
	<12 Months		>12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	\$ (428)	\$ 983,872	\$ (74,675)	\$ 9,944,740
Mortgage-backed securities and collateralized mortgage obligations	(1,539)	186,784	(66,055)	2,181,708
State and municipal securities	(24,913)	6,547,766	(438,805)	41,622,458
Corporate debt securities	(12,293)	974,828	(39,942)	12,017,043
Community reinvestment fund	(20,348)	979,652	-	-
Total	<u>\$ (59,521)</u>	<u>\$ 9,672,902</u>	<u>\$ (619,477)</u>	<u>\$ 65,765,949</u>

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, the Corporation has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is primarily due to increased market interest rates. The fair value is expected to recover as the bonds approach their maturity date.

Other securities, totaling \$1,122,300 and \$1,148,400 at December 31, 2019 and 2018, consist of restricted Federal Home Loan Bank and Federal Reserve Bank stock. These stocks are carried at cost, which approximates fair value.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans

A summary of the balances of loans follows:

	December 31	
	2019	2018
Mortgage loans on real estate:		
1-4 family residential	\$ 63,483,729	\$ 57,846,627
Commercial	235,769,207	212,425,254
Construction and land development	3,709,748	3,959,642
Vacant land and farm land	2,171,515	2,104,314
Multi-family residential	34,214,380	26,297,944
Total mortgage loans on real estate	339,348,579	302,633,781
Commercial and industrial loans	128,049,960	115,662,782
Consumer loans	2,126,874	1,433,453
Cash secured loans	1,881,773	1,606,912
Total loans	471,407,186	421,336,928
Less allowance for loan losses	7,075,503	6,989,739
Net deferred loan fees	517,326	541,007
Total loans, net	\$ 463,814,357	\$ 413,806,182

In the ordinary course of business, the Bank has granted loans to principal officers and directors and their affiliates amounting to approximately \$14,836,000 at December 31, 2019 and \$801,000 at December 31, 2018.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

Activity in the allowance for loan losses for 2019 and 2018 is summarized as follows:

	Year Ended December 31, 2019				Ending Balance
	Beginning Balance	Charge-Offs	Recoveries	Provision	
Allowance for loan losses:					
Commercial and industrial	\$ 1,538,789	\$ -	\$ 85,264	\$ (311,472)	\$ 1,312,581
Consumer	19,652	(5,258)	5,258	41,480	61,132
Construction and land development	63,771	-	-	(3,026)	60,745
Commercial real estate	4,030,474	-	500	97,802	4,128,776
1-4 family residential	840,250	-	-	1,462	841,712
Multi-family residential	349,763	-	-	67,652	417,415
Vacant land and farm land	34,300	-	-	(9,376)	24,924
Unallocated	112,740	-	-	115,478	228,218
Total	<u>\$ 6,989,739</u>	<u>\$ (5,258)</u>	<u>\$ 91,022</u>	<u>\$ -</u>	<u>\$ 7,075,503</u>

	Year Ended December 31, 2018				Ending Balance
	Beginning Balance	Charge-Offs	Recoveries	Provision	
Allowance for loan losses:					
Commercial and industrial	\$ 1,355,943	\$ -	\$ 157,870	\$ 24,976	\$ 1,538,789
Consumer	11,898	-	-	7,754	19,652
Construction and land development	130,135	-	-	(66,364)	63,771
Commercial real estate	3,540,241	-	775,432	(285,199)	4,030,474
1-4 family residential	999,318	-	-	(159,068)	840,250
Multi-family residential	336,386	-	-	13,377	349,763
Vacant land and farm land	35,235	-	-	(935)	34,300
Unallocated	47,281	-	-	65,459	112,740
Total	<u>\$ 6,456,437</u>	<u>\$ -</u>	<u>\$ 933,302</u>	<u>\$ (400,000)</u>	<u>\$ 6,989,739</u>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

The allowance for loan losses and loan balances as of December 31, 2019 and 2018 are as follows:

	Year Ended December 31, 2019		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Ending Balance
Ending allowance attributable to loans:			
Commercial and industrial	\$ -	\$ 1,312,581	\$ 1,312,581
Consumer	-	61,132	61,132
Construction and land development	-	60,745	60,745
Commerical real estate	-	4,128,776	4,128,776
1-4 family residential	-	841,712	841,712
Multi-family residential	-	417,415	417,415
Vacant land and farm land	-	24,924	24,924
Unallocated	-	228,218	228,218
<b>Total</b>	<b>\$ -</b>	<b>\$ 7,075,503</b>	<b>\$ 7,075,503</b>
Ending loans:			
Commercial and industrial	\$ 1,061,588	\$ 126,988,372	\$ 128,049,960
Consumer	-	2,126,874	2,126,874
Construction and land development	210,056	3,499,692	3,709,748
Commerical real estate	9,153,387	226,615,820	235,769,207
1-4 family residential	762,719	62,721,010	63,483,729
Multi-family residential	-	34,214,380	34,214,380
Vacant land and farm land	937,662	1,233,853	2,171,515
Cash secured	-	1,881,773	1,881,773
<b>Total</b>	<b>\$ 12,125,412</b>	<b>\$ 459,281,774</b>	<b>\$ 471,407,186</b>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

	Year Ended December 31, 2018		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Ending Balance
Ending allowance attributable to loans:			
Commercial and industrial	\$ -	\$ 1,538,789	\$ 1,538,789
Consumer	-	19,652	19,652
Construction and land development	-	63,771	63,771
Commerical real estate	-	4,030,474	4,030,474
1-4 family residential	-	840,250	840,250
Multi-family residential	-	349,763	349,763
Vacant land and farm land	-	34,300	34,300
Unallocated	-	112,740	112,740
<b>Total</b>	<b>\$ -</b>	<b>\$ 6,989,739</b>	<b>\$ 6,989,739</b>
Ending loans:			
Commercial and industrial	\$ 1,011,751	\$ 114,651,031	\$ 115,662,782
Consumer	-	1,433,453	1,433,453
Construction and land development	273,448	3,686,194	3,959,642
Commerical real estate	3,770,792	208,654,462	212,425,254
1-4 family residential	575,244	57,271,383	57,846,627
Multi-family residential	-	26,297,944	26,297,944
Vacant land and farm land	-	2,104,314	2,104,314
Cash secured	-	1,606,912	1,606,912
<b>Total</b>	<b>\$ 5,631,235</b>	<b>\$ 415,705,693</b>	<b>\$ 421,336,928</b>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

#### Credit Risk Rating

The following is a summary of the loan portfolio by loan risk grades at December 31, 2019 and 2018:

	December 31, 2019				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 126,988,372	\$ 1,017,401	\$ 44,187	\$ -	\$ 128,049,960
Consumer	2,126,874	-	-	-	2,126,874
Construction and land development	3,499,692	-	210,056	-	3,709,748
Commercial real estate	226,615,820	6,696,900	2,456,487	-	235,769,207
1-4 family residential	62,721,010	219,934	542,785	-	63,483,729
Multi-family residential	34,214,380	-	-	-	34,214,380
Vacant land and farm land	1,233,853	-	937,662	-	2,171,515
Cash secured	1,881,773	-	-	-	1,881,773
<b>Total</b>	<b>\$ 459,281,774</b>	<b>\$ 7,934,235</b>	<b>\$ 4,191,177</b>	<b>\$ -</b>	<b>\$ 471,407,186</b>

	December 31, 2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	\$ 114,651,031	\$ 351,624	\$ 660,127	\$ -	\$ 115,662,782
Consumer	1,433,453	-	-	-	1,433,453
Construction and land development	3,686,194	-	273,448	-	3,959,642
Commercial real estate	208,654,462	1,431,617	2,339,175	-	212,425,254
1-4 family residential	57,271,383	-	575,244	-	57,846,627
Multi-family residential	26,297,944	-	-	-	26,297,944
Vacant land and farm land	2,104,314	-	-	-	2,104,314
Cash secured	1,606,912	-	-	-	1,606,912
<b>Total</b>	<b>\$ 415,705,693</b>	<b>\$ 1,783,241</b>	<b>\$ 3,847,994</b>	<b>\$ -</b>	<b>\$ 421,336,928</b>

The Corporation categorized each loan into credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, collateral coverage, historical payment experience, and current economic trends. The Corporation uses the following definitions for credit risk ratings:

**Pass** - Credits not covered by the definitions presented below are pass credits, which are not considered to be adversely rated.

**Special Mention** - Loans classified as special mention, or watch credits, have a potential weakness or weaknesses that deserves management's close attention. 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.

**Substandard** - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution may sustain some loss if the deficiencies are not corrected.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

**Doubtful** - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

#### Age Analysis of Past Due and Nonaccrual Loans

The following tables detail the age analysis of past due and nonaccrual loans at December 31, 2019 and 2018:

	Year Ended December 31, 2019						
	Loans on Accrual Status			Nonaccrual Loans	Total Past Due and Nonaccrual	Current	Total Loans Receivable
	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days				
Commercial and industrial	\$ -	\$ -	\$ -	\$ 44,187	\$ 44,187	\$ 128,005,773	\$ 128,049,960
Consumer	-	-	-	-	-	2,126,874	2,126,874
Construction and land development	-	-	-	210,056	210,056	3,499,692	3,709,748
Commercial real estate	-	222,197	-	2,177,641	2,399,838	233,369,369	235,769,207
1-4 family residential	263,886	-	-	542,785	806,671	62,677,058	63,483,729
Multi-family residential	-	-	-	-	-	34,214,380	34,214,380
Vacant land and farm land	-	-	-	937,662	937,662	1,233,853	2,171,515
Cash secured	-	-	-	-	-	1,881,773	1,881,773
<b>Total</b>	<b>\$ 263,886</b>	<b>\$ 222,197</b>	<b>\$ -</b>	<b>\$ 3,912,331</b>	<b>\$ 4,398,414</b>	<b>\$ 467,008,772</b>	<b>\$ 471,407,186</b>

	Year Ended December 31, 2018						
	Loans on Accrual Status			Nonaccrual Loans	Total Past Due and Nonaccrual	Current	Total Loans Receivable
	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days				
Commercial and industrial	\$ -	\$ -	\$ -	\$ 65,127	\$ 65,127	\$ 115,597,655	\$ 115,662,782
Consumer	-	-	-	-	-	1,433,453	1,433,453
Construction and land development	-	-	-	273,448	273,448	3,686,194	3,959,642
Commercial real estate	-	-	-	2,046,721	2,046,721	210,378,533	212,425,254
1-4 family residential	-	-	-	575,244	575,244	57,271,383	57,846,627
Multi-family residential	-	-	-	-	-	26,297,944	26,297,944
Vacant land and farm land	-	-	-	-	-	2,104,314	2,104,314
Cash secured	-	-	-	-	-	1,606,912	1,606,912
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,960,540</b>	<b>\$ 2,960,540</b>	<b>\$ 418,376,388</b>	<b>\$ 421,336,928</b>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

#### Impaired Loans

A loan is considered impaired when it is probable that not all principal and interest amounts will be collected according to the loan contract. Individual commercial loans are evaluated for impairment. Impaired loans are written down by the establishment of a specific allowance where necessary.

The Corporation had additional funds committed to be advanced in connection with impaired loans of \$872,000 and \$655,000 at December 31, 2019 and 2018, respectively.

Information regarding impaired loans is as follows as of and for the years ended December 31, 2019 and 2018:

	Year Ended December 31, 2019				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	\$ 805,893	\$ 817,909	\$ -	\$ 859,029	\$ 44,983
Construction and land development	210,056	802,993	-	242,265	-
Commercial real estate	3,414,321	3,788,531	-	3,514,488	75,110
Vacant land and farm land	937,662	937,662	-	963,517	38,683
1-4 family residential	762,719	852,975	-	915,803	18,446
<b>Total</b>	<b>\$ 6,130,651</b>	<b>\$ 7,200,070</b>	<b>\$ -</b>	<b>\$ 6,495,102</b>	<b>\$ 177,222</b>

  

	Year Ended December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	\$ 660,127	\$ 668,227	\$ -	\$ 813,136	\$ 27,511
Construction and land development	273,448	824,656	-	307,320	-
Commercial real estate	2,339,175	2,617,390	-	2,425,011	10,196
1-4 family residential	575,244	646,425	-	589,566	11,936
<b>Total</b>	<b>\$ 3,847,994</b>	<b>\$ 4,756,698</b>	<b>\$ -</b>	<b>\$ 4,135,033</b>	<b>\$ 49,643</b>

For purposes of the disclosure above, recorded investment represents the borrower's unpaid principal balance, less partial charge-offs to date.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 3 - Loans (Continued)

#### Troubled Debt Restructurings

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Corporation offers various types of concessions when modifying a loan; however, forgiveness of principal is rarely granted.

There were no loans modified in a TDR during the year ended December 31, 2019. The table below presents information related to loans modified in a TDR during the year ended December 31, 2018:

Type of Loan	Year Ended December 31, 2018		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial real estate	2	\$ 73,227	\$ 65,127

None of the troubled debt restructurings that were modified or renewed during 2019 or 2018 subsequently defaulted.

### Note 4 - Premises and Equipment

A summary of the cost and accumulated depreciation and amortization of premises and equipment at December 31 is as follows:

	2019	2018
Land	\$ 810,000	\$ 810,000
Buildings and building improvements	4,511,069	4,371,486
Furniture, fixtures, and equipment	2,329,172	2,299,204
Leasehold improvements	317,571	312,071
Construction in progress	24,487	-
Total premises and equipment	7,992,299	7,792,761
Accumulated depreciation	(4,678,309)	(4,582,539)
Net premises and equipment	\$ 3,313,990	\$ 3,210,222

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 4 – Premises and Equipment (Continued)

The Bank operates its Crystal Lake and Lake Zurich branch facilities, its Naperville business banking center, and a loan operations center subject to operating leases. The Bank also leases copiers in each facility that are also subject to operating leases. Future minimum rental commitments under these leases are as follows:

2020	\$	260,711
2021		172,268
2022		124,753
2023		68,515
Thereafter		<u>-</u>
Total undiscounted lease payments		626,247
Less imputed interest		<u>(48,049)</u>
Total lease liability	\$	<u>578,198</u>

The Crystal Lake lease expires in December 2020 and contains two one-year options to extend with an increase to the base rent of 2.5% per year.

The Lake Zurich lease expires in March 2020. Subsequent to December 31, 2019, the lease was extended to expire in March 2021 under the same terms as the existing lease.

The Naperville lease expires in June 2022 and contains two options to extend the term of the lease for five years at the conclusion of the initial lease term at a market rate of rent in effect at the commencement of each option period.

The loan operations center lease expires in October 2023 and contains two options to extend the term of the lease for five years at the conclusion of the initial lease term with an increase to the base rent of 2.0% per year.

The Corporation leases copiers in each of its locations under leases that expire between March 2021 and September 2023.

The Corporation has adopted Accounting Standards Update 2016-02 on January 1, 2019. As a result of adopting this standard, the Corporation recorded a lease obligation for the operating leases described above in the amount of \$578,198, with a corresponding right to use asset in the amount of \$560,013, in other liabilities and other assets, respectively, in the consolidated financial statements. These amounts were calculated using a discount rate of 4.00 percent. The Corporation's leases have a weighted average remaining term of 2.7 years.

Total rent expense approximated \$275,000 and \$242,000 for the years ended December 31, 2019 and 2018, respectively.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 5 - Deposits

The following is a summary of the distribution of deposits at December 31:

	<u>2019</u>	<u>2018</u>
Noninterest-bearing deposits	\$ 166,436,734	\$ 147,707,994
NOW accounts	56,930,070	56,188,245
Savings and money market accounts	267,447,537	245,607,735
Time:		
Under \$250,000	31,883,646	35,046,169
\$250,000 and over	<u>43,745,905</u>	<u>23,252,693</u>
Total	<u>\$ 566,443,892</u>	<u>\$ 507,802,836</u>

At December 31, 2019, the scheduled maturities of time deposits are as follows:

2020	\$ 59,244,014
2021	9,604,984
2022	4,343,891
2023	1,518,225
2024	<u>918,437</u>
Total	<u>\$ 75,629,551</u>

Deposits from related parties held by the Corporation totaled approximately \$23,975,000 and \$24,511,000 at December 31, 2019 and 2018, respectively.

### Note 6 - Junior Subordinated Debentures

The Corporation has established a Delaware statutory trust (the "Trust") for the sole purpose of issuing trust-preferred securities and related trust common securities. The proceeds from the issuance were used by the Trust to purchase junior subordinated debentures of the Corporation, which is the sole asset of the Trust. Concurrently with the issuance of the trust-preferred securities, the Corporation issued guarantees for the benefit of the holders of the trust-preferred securities. The trust-preferred securities are issues that qualify, and are treated by the Corporation, as Tier I regulatory capital. The Corporation wholly owns all of the common securities of the Trust. The trust-preferred securities issued by the Trust rank equally with the common securities in right of payment, except that if an event of default under the indenture governing the debentures has occurred and is continuing, the preferred securities will rank senior to the common securities in right of payment.

At December 31, 2019 and 2018, the outstanding balance of the junior subordinated debentures was \$10,310,000. The subordinated debentures have a stated maturity date of March 31, 2034 and a floating interest rate per annum reset quarterly equal to the three-month LIBOR plus 2.85% (4.95% at December 31, 2019 and 5.65% at December 31, 2018). Interest is payable quarterly and all payments have been paid as agreed.

In 2018, the Corporation entered into an interest rate swap contract with a notional value of \$5,000,000 to convert a portion of its junior subordinated debentures to a fixed rate of interest. The swap contract expires with the maturity of the underlying junior subordinated debentures and carries a fixed rate of 5.997%. The interest rate swap qualifies as a cash flow hedge and, as a result, the unrealized gain (loss) on the swap instrument is reflected in other comprehensive income (loss) until the swap is terminated or matures. An unrealized loss of \$503,951 and \$246,233 was recorded in other comprehensive income at December 31, 2019 and 2018, respectively.

The trust-preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the junior subordinated debentures at the stated maturity date or upon redemption. The debentures are callable by the Corporation with 90 days' notice to the holders. The Trust's ability to pay amounts due on the trust-preferred securities is solely dependent upon the Corporation making payment on the related junior subordinated debentures. The Corporation has the right to defer payment of interest on the debentures.

The Corporation's obligation under the junior subordinated debentures and other relevant trust agreements, in aggregate, constitutes a full and unconditional guarantee by the Corporation of the Trust's obligations under the trust-preferred securities issued by the Trust.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 7 - Income Taxes

The components of the net deferred tax asset, included in other assets at December 31, are as follows:

	2019	2018
Deferred tax assets:		
Allowance for loan losses	\$ 2,016,872	\$ 1,723,728
Deferred compensation	232,221	192,090
Nonaccrual loan interest	186,825	139,934
Net unrealized loss on securities available for sale and interest rate swap - net	-	220,609
Total deferred tax assets	<u>2,435,918</u>	<u>2,276,361</u>
Deferred tax liabilities:		
Unearned stock awards	420,572	-
Accretion on securities available for sale	136,282	111,696
Depreciation and amortization	94,841	90,233
Prepaid expenses	29,365	27,129
Net unrealized gain on securities available for sale and interest rate swap - net	38,572	-
Total deferred tax liabilities	<u>719,632</u>	<u>229,058</u>
Net deferred tax asset	<u>\$ 1,716,286</u>	<u>\$ 2,047,303</u>

The allocation of income taxes between current and deferred portions at December 31 is as follows:

	2019	2018
Current expense	\$ 1,825,199	\$ 2,867,528
Deferred expense (benefit)	<u>71,836</u>	<u>(433,838)</u>
Total	<u>\$ 1,897,035</u>	<u>\$ 2,433,690</u>

The reason for the differences between income tax expense at the federal statutory income tax rate and the recorded income tax expense at December 31 are summarized as follows:

	2019	2018
Income tax calculated at statutory rate (21%)	\$ 1,469,419	\$ 1,884,503
Add (subtract) tax effect of:		
State income tax - net of federal tax benefit	509,074	811,204
Tax-exempt securities	(178,566)	(196,386)
Meals, entertainment and related expenses	50,337	59,478
Other items - net	46,771	(125,109)
Provision for income taxes	<u>\$ 1,897,035</u>	<u>\$ 2,433,690</u>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 8 – Profit Sharing Plan

The Corporation sponsors a 401(k) profit-sharing plan for substantially all employees. The plan provides for the Corporation to make a required matching contribution up to 25% of employee contributions up to 8% of their salary. The Corporation may also make additional profit-sharing contributions at the discretion of the board of directors. Contributions to the plan totaled \$922,000 and \$833,000 for the years ended December 31, 2019 and 2018, respectively.

### Note 9 - Equity Compensation Plans

The Corporation's equity compensation plans consist of a stock incentive plan, restricted stock awards, and stock appreciation rights.

The stock incentive plan permits the grant of both incentive stock options and nonqualified stock options to its directors, officers, and employees for up to 107,470 shares of common stock. Option awards are granted with an exercise price equal to the market price of the entity's stock at the date of grant; those option awards generally vest based on five years of continuous service and must be exercised within 10 years of the grant date. There are no options outstanding and 8,326 shares available for grant at December 31, 2019 and 2018. There were no options granted during 2019 or 2018. There were 2,000 shares exercised during 2018 at \$35.00 per share. There was no compensation cost charged against income for the stock incentive plan in 2019 and 2018.

Restricted stock awards entitle holders to voting and dividend rights upon grant. The awards vest to the awardee over a three-year period from the date of grant and are subject to forfeiture until they vest. The awards become immediately vested in the event of a change in control of the Corporation or the death or disability of the awardee. There were 35,259 restricted awards issued during the year ending December 31, 2019 with a grant date fair value of \$53.00 per share. Compensation expense is recognized over the vesting period of the restricted award based on the market value of the award on the issue date. Compensation expense of \$207,600 was charged against income in 2019. Total unrecognized compensation cost of the restricted awards was \$1,661,000 as of December 31, 2019 which will be recognized over the next 2.7 years.

Under the stock appreciation rights plan, senior management and key officers are granted share unit awards, the value of which is calculated using the intrinsic value method and is equal to the incremental increase in the net book value, as defined, per share of the common stock of the Bank between the date of award and the date of full vesting. The share unit awards vest over a four-year period from the date of the grant. Share units totaling 1,010 and 1,024 were awarded for the years ended December 31, 2019 and 2018, respectively. Plan liabilities of approximately \$815,000 and \$674,000, consisting of share units of 4,361 and 4,053, were recorded at December 31, 2019 and 2018, respectively. Share units matured totaled approximately \$248,000 and \$242,000 during 2019 and 2018, respectively. The Corporation incurred plan expenses of \$383,000 and \$311,000 during the years ended December 31, 2019 and 2018, respectively.

### Note 10 - Off-Balance-Sheet Activities and Borrowings

**Credit-Related Financial Instruments** - The Corporation is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 10 - Off Balance-Sheet Activities and Borrowings (Continued)

At December 31, 2019 and 2018, the following financial instruments, whose contract amounts represent credit risk, were outstanding:

	Contract Amount	
	2019	2018
Unfunded commitments under lines of credit	\$ 178,114,129	\$ 155,749,668
Commercial and standby letters of credit	6,102,086	2,387,797
Commitments to originate mortgage loans subject to interest rate lock contracts	8,805,070	1,789,150

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

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

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

**Collateral Requirements** – To reduce credit risk related to the use of credit-related financial instruments, the Corporation might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Corporation's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, equipment, and real estate.

If the counterparty does not have the right and ability to redeem the collateral or the Corporation is permitted to sell or repledge the collateral on short notice, the Corporation records the collateral in its consolidated balance sheet at fair value with a corresponding obligation to return it.

**Repurchase Agreements** – Securities sold under agreements to repurchase totaled approximately \$6,173,000 and \$4,417,000 at December 31, 2019 and 2018, respectively. At December 31, 2019, all of these financings had overnight maturities and were secured by approximately \$8,418,000 of agency and mortgage backed securities which were owned and under the control of the Corporation. Risk could arise when the collateral pledged for the repurchase agreement declines in fair value. The Corporation minimizes the risk by monitoring the value of the collateral pledged. At the point in time where the collateral has declined in fair value, the Corporation is required to provide additional collateral based on the value of the underlying securities.

**Legal Contingencies** – Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Corporation's consolidated financial statements.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 10 - Off Balance-Sheet Activities and Borrowings (Continued)

**Restrictions on Cash and Cash Equivalents** – The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2019 and 2018, the restricted reserve balance amounted to \$2,931,000 and \$2,822,000, respectively. The Corporation was also required to post cash collateral to the counterparty of its interest rate swap. This restricted cash totaled \$960,000 at December 31, 2019.

**Other Contingencies** – The Corporation sells mortgage loans on a nonrecourse basis. In connection with the Corporation's loan sales, the Corporation makes representations and warranties customary in the industry relating to, among other things, compliance with laws, regulations, and program standards and accuracy of information. If there is a breach of the representations and warranties by the Corporation, typically the Corporation corrects these flaws. If the flaws cannot be corrected, the Corporation may be required to repurchase these loans. As of December 31, 2019 and 2018, the Corporation recorded a liability of \$50,000 for these potential contingencies.

**Borrowing Facilities** – The Corporation is a member of the Federal Home Loan Bank of Chicago (FHLBC). Through the membership, the Corporation maintains a collateral pledge agreement covering secured advances whereby the Corporation has agreed to keep on hand, free of all other pledges, liens, and encumbrances, specifically identified whole first mortgages on improved residential property not more than 90-days delinquent to secure advances from the FHLBC. All of the Bank's FHLBC common stock is also pledged as additional collateral for any outstanding advances. There were no advances outstanding at both December 31, 2019 and 2018. At December 31, 2019, the Corporation had the ability to borrow approximately \$65,075,000 under its credit facilities with the FHLBC.

The Corporation has a line of credit with another financial institution. The details of the line of credit are shown in the table below:

	2019	2018
Total commitment	\$ 8,500,000	\$ 3,750,000
Outstanding at December 31	\$ 8,500,000	\$ 2,500,000
Maturity Date	June 30, 2020	June 30, 2020
Interest rate structure	One-Month LIBOR + 2.25%	One-Month LIBOR + 2.25%
Interest rate at December 31	3.95%	4.60%
Required payments	Interest - Quarterly	Interest - Quarterly
Collateral	100% of the voting stock of the Bank	Unsecured

During 2019, the Corporation also entered into a term note with the same financial institution. The total principal of the term note was \$14,500,000 with a variable interest rate structure of one-month LIBOR plus 2.25 percent. The term note and related interest was paid in full at December 31, 2019.

### Note 11 - Restrictions on Dividends

Banking regulations place certain restrictions on dividends paid by the Bank to the Corporation. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank. In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. At December 31, 2019, and as a result of recent dividend payments, the Bank is not allowed to pay dividends to the Corporation without prior regulatory approval.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 12 - Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, common and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2019 and 2018, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2019, the most recent notification from the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, common equity Tier 1 risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios as of December 31, 2019 and 2018 are presented in the table. This table does not include the 2.5 percent capital conservation buffer requirement. A Bank with a capital conservation buffer greater than 2.5 percent of risk-weighted assets would not be restricted by payout limitations. However, if the 2.5 percent threshold is not met, the Bank would be subject to increased limitations on capital distributions and discretionary bonus payments to executive officers as the capital conservation buffer approaches zero.

(Dollar Amounts In Thousands)	Actual		Minimum for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2019</b>						
Total capital to risk-weighted assets	\$ 62,132	11.2%	\$ 44,409	8.0%	\$ 55,498	10.0%
Tier I capital to risk-weighted assets	\$ 55,193	9.9%	\$ 33,299	6.0%	\$ 44,398	8.0%
Common equity tier I capital to risk-weighted assets	\$ 55,193	9.9%	\$ 24,974	4.5%	\$ 36,074	6.5%
Tier I capital to average assets	\$ 55,193	8.5%	\$ 26,033	4.0%	\$ 32,541	5.0%
<b>As of December 31, 2018</b>						
Total capital to risk-weighted assets	\$ 60,598	12.1%	\$ 40,006	8.0%	\$ 49,934	10.0%
Tier I capital to risk-weighted assets	\$ 54,348	10.9%	\$ 29,960	6.0%	\$ 39,947	8.0%
Common equity tier I capital to risk-weighted assets	\$ 54,348	10.9%	\$ 22,470	4.5%	\$ 32,457	6.5%
Tier I capital to average assets	\$ 54,348	9.6%	\$ 22,714	4.0%	\$ 28,392	5.0%

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 13 - Fair Value of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties other than in a forced liquidation. Fair value is best determined based upon quoted market prices. In many instances, however, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The standard excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The estimated fair values and related carrying or notional amounts of the Corporation's financial instruments at December 31 are as follows (in thousands):

	December 31, 2019		December 31, 2018	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 58,644	\$ 58,644	\$ 45,541	\$ 45,541
Investment securities - Available-for-sale	99,323	99,323	99,447	99,447
Other securities	1,122	1,122	1,148	1,148
Loans held for sale	2,104	2,131	1,006	1,025
Loans - Net	463,814	462,396	413,806	408,093
Accrued interest receivable	1,702	1,702	1,681	1,681
Financial liabilities:				
Deposits	\$ (566,444)	\$ (566,568)	\$ (507,803)	\$ (506,840)
Securities sold under agreements to repurchase	(6,173)	(6,166)	(4,417)	(4,408)
Junior subordinated debentures	(10,310)	(7,835)	(10,310)	(8,598)
Borrowings under line of credit	(8,500)	(8,500)	(2,500)	(2,500)
Accrued interest payable	(169)	(169)	(139)	(139)
Interest rate swap	(750)	(750)	(246)	(246)

### Note 14 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 14 - Fair Value Measurements (Continued)

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

Fair values of securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Fair values of interest rate swap contracts are based on amounts payable to or receivable from counterparties based on the contractual terms of the agreements.

The following tables present information about the Corporation's assets and liabilities measured at fair value on a recurring basis at December 31, 2019 and 2018 and the valuation techniques used by the Corporation to determine those fair values.

	December 31, 2019			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2019
<b>Assets</b>				
Investment securities:				
U.S. government agencies	\$ -	\$ 17,238,558	\$ -	\$ 17,238,558
Mortgage-backed securities and collateralized mortgage obligations	-	10,959,049	-	10,959,049
State and municipal securities	-	50,631,319	-	50,631,319
Corporate debt securities	-	19,483,052	-	19,483,052
Community reinvestment fund	1,011,009	-	-	1,011,009
Total investment securities	<u>\$ 1,011,009</u>	<u>\$ 98,311,978</u>	<u>\$ -</u>	<u>\$ 99,322,987</u>
<b>Liabilities</b>				
Interest rate swap	<u>\$ -</u>	<u>\$ 750,184</u>	<u>\$ -</u>	<u>\$ 750,184</u>

# Cornerstone Bancorp, Inc. and Subsidiary

## Notes to Consolidated Financial Statements December 31, 2019 and 2018

### Note 14 - Fair Value Measurements (Continued)

	December 31, 2018			Balance at December 31, 2018
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>				
Investment securities:				
U.S. government agencies	\$ -	\$ 22,047,917	\$ -	\$ 22,047,917
Mortgage-backed securities and collateralized mortgage obligations	-	2,394,993	-	2,394,993
State and municipal securities	-	61,032,212	-	61,032,212
Corporate debt securities	-	12,991,871	-	12,991,871
Community reinvestment fund	979,652	-	-	979,652
<b>Total investment securities</b>	<b>\$ 979,652</b>	<b>\$ 98,466,993</b>	<b>\$ -</b>	<b>\$ 99,446,645</b>
<b>Liabilities</b>				
Interest rate swap	\$ -	\$ 246,233	\$ -	\$ 246,233

The Corporation also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include other real estate owned and impaired loans. The Corporation has estimated the fair values of these assets based primarily on Level 3 inputs. Other real estate and impaired loans are generally valued using the fair value of collateral provided by third-party appraisals. These valuations include assumptions related to cash flow projections, discount rates, and recent comparable sales. The numerical range of unobservable inputs for these valuation assumptions is not meaningful.

The following tables present information about the Corporation's assets measured at fair value on a non-recurring basis at December 31, 2019 and 2018 and the valuation techniques used by the Corporation to determine those fair values.

	December 31, 2019			Balance at December 31, 2019
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Other real estate owned	\$ -	\$ -	\$ -	\$ -
Impaired loans	-	-	6,130,651	6,130,651

	December 31, 2018			Balance at December 31, 2018
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Other real estate owned	\$ -	\$ -	\$ 513,625	\$ 513,625
Impaired loans	-	-	3,847,994	3,847,994