

Appalachian Community Capital Corporation

Report on Financial Statements

For the years ended December 31, 2019 and 2018

elliott davis

Appalachian Community Capital Corporation

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Independent Auditor's Report

To the Board of Directors
Appalachian Community Capital Corporation
Christiansburg, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Appalachian Community Capital Corporation (the "Company"), which comprise the consolidated statements of financial position as of December 31, 2019 and 2018, and the related consolidated statements of activities and cash flows for the years then ended and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Appalachian Community Capital Corporation as of December 31, 2019 and 2018, and the results of its activities and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Elliott Davis, PLLC". The signature is written in a cursive, flowing style.

Raleigh, North Carolina
April 30, 2020

Appalachian Community Capital Corporation

Consolidated Statements of Financial Position

As of December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Assets		
Cash and cash equivalents	\$ 1,656,965	\$ 2,465,160
Cash funded loan loss reserves	150,000	150,000
Loans receivable, net of allowance for loan losses of \$200,829 and \$186,050 at December 31, 2019 and 2018, respectively	18,052,021	15,682,122
Grants receivable	1,635,189	831,613
Accrued interest receivable	44,715	31,061
Property and equipment, net	1,547	1,126
Prepaid expenses and other assets	34,712	36,293
Total assets	<u>\$ 21,575,149</u>	<u>\$ 19,197,375</u>
Liabilities and Net Assets		
Notes payable	\$ 16,000,000	\$ 14,835,000
Accrued interest payable	8,991	44,520
Accounts payable	8,500	9,050
Deferred revenue	1,676,442	637,769
Accrued expenses and other liabilities	25,989	32,080
Total liabilities	<u>17,719,922</u>	<u>15,558,419</u>
Net assets - without donor restrictions	868,227	651,956
Net assets - with donor restrictions	2,987,000	2,987,000
Total net assets	<u>3,855,227</u>	<u>3,638,956</u>
Total liabilities and net assets	<u>\$ 21,575,149</u>	<u>\$ 19,197,375</u>

See Notes to Consolidated Financial Statements

Appalachian Community Capital Corporation

Consolidated Statements of Activities

For the year ended December 31, 2019

	Without Donor Restrictions	With Donor Restrictions	Total
Support and revenue			
Grant income	\$ 552,327	\$ -	\$ 552,327
Interest income - loans	633,029	-	633,029
Interest income - certificates of deposits	10,242	-	10,242
Other operating income	490	-	490
Total support and revenue	<u>1,196,088</u>	<u>-</u>	<u>1,196,088</u>
Expenses			
Program Services			
Interest expense	478,475	-	478,475
Provision for loan losses	14,779	-	14,779
Salaries and employee benefits	149,549	-	149,549
Data processing	38,675	-	38,675
Office and administrative	633	-	633
Professional fees	146,831	-	146,831
Travel expense	7,904	-	7,904
Dues and subscriptions	24,438	-	24,438
Board of Directors' expense	5,851	-	5,851
Other expense	39,698	-	39,698
Total program services expenses	<u>906,833</u>	<u>-</u>	<u>906,833</u>
Management and General			
Salaries and employee benefits	26,391	-	26,391
Data processing	6,825	-	6,825
Office and administrative	112	-	112
Professional fees	25,911	-	25,911
Travel expense	1,395	-	1,395
Dues and subscriptions	4,313	-	4,313
Board of Directors' expense	1,033	-	1,033
Other expense	7,005	-	7,005
Total management and general expenses	<u>72,985</u>	<u>-</u>	<u>72,985</u>
Total expenses	<u>979,818</u>	<u>-</u>	<u>979,818</u>
Change in net assets	216,271	-	216,271
Net assets - beginning of year	651,956	2,987,000	3,638,956
Net assets - end of year	<u>\$ 868,227</u>	<u>\$ 2,987,000</u>	<u>\$ 3,855,227</u>

See Notes to Consolidated Financial Statements

Appalachian Community Capital Corporation

Consolidated Statements of Activities

For the year ended December 31, 2018

	Without Donor Restrictions	With Donor Restrictions	Total
Support and revenue			
Grant income	\$ 612,806	\$ -	\$ 612,806
Interest income - loans	463,436	-	463,436
Interest income - certificates of deposits	8,971	-	8,971
Other operating income	23,123	-	23,123
Total support and revenue	<u>1,108,336</u>	<u>-</u>	<u>1,108,336</u>
Expenses			
Program Services			
Interest expense	386,200	-	386,200
Provision for loan losses	11,210	-	11,210
Salaries and employee benefits	145,926	-	145,926
Data processing	38,709	-	38,709
Office and administrative	499	-	499
Professional fees	136,619	-	136,619
Travel expense	13,138	-	13,138
Dues and subscriptions	21,944	-	21,944
Board of Directors' expense	5,636	-	5,636
Other expense	35,847	-	35,847
Total program services expenses	<u>795,728</u>	<u>-</u>	<u>795,728</u>
Management and General			
Salaries and employee benefits	25,752	-	25,752
Data processing	6,831	-	6,831
Office and administrative	87	-	87
Professional fees	24,109	-	24,109
Travel expense	2,319	-	2,319
Dues and subscriptions	3,872	-	3,872
Board of Directors' expense	995	-	995
Other expense	6,326	-	6,326
Total management and general expenses	<u>70,291</u>	<u>-</u>	<u>70,291</u>
Total expenses	<u>866,019</u>	<u>-</u>	<u>866,019</u>
Change in net assets	242,317	-	242,317
Net assets - beginning of year	409,639	2,987,000	3,396,639
Net assets - end of year	<u>\$ 651,956</u>	<u>\$ 2,987,000</u>	<u>\$ 3,638,956</u>

See Notes to Consolidated Financial Statements

Appalachian Community Capital Corporation

Consolidated Statements of Cash Flows

For the years ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities		
Change in net assets	\$ 216,271	\$ 242,317
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	670	66
Provision for loan losses	14,779	11,210
Change in assets and liabilities:		
Grants receivable	(803,576)	(344,114)
Prepaid expenses and other assets	1,581	3,491
Accounts payable	(550)	9,050
Accrued expenses and other liabilities	(6,091)	16,761
Deferred revenue	1,038,673	149,270
Accrued interest payable	(35,529)	16,413
Accrued interest receivable	(13,654)	(4,902)
Net cash provided by operating activities	<u>412,574</u>	<u>99,562</u>
Cash flows from investing activities		
Net increase in loans	(2,384,678)	(2,667,941)
Purchase of property, plant, and equipment	(1,091)	(1,192)
Net cash used in investing activities	<u>(2,385,769)</u>	<u>(2,669,133)</u>
Cash flows from financing activities		
Increase in notes payable	1,165,000	2,835,000
Net cash provided by financing activities	<u>1,165,000</u>	<u>2,835,000</u>
Change in cash and cash equivalents	(808,195)	265,429
Cash and cash equivalents - beginning of year	<u>2,465,160</u>	<u>2,199,731</u>
Cash and cash equivalents - end of year	<u>\$ 1,656,965</u>	<u>\$ 2,465,160</u>
Supplemental disclosure of cash flow information		
Interest paid	\$ 514,004	\$ 369,787

See Notes to Consolidated Financial Statements

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 1. Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

Appalachian Community Capital Corporation ("ACC" or the "Company") is a non-profit, wholesale capital intermediary created to increase business lending in Appalachia by providing community loan funds with a new source of capital. Formed in 2013, ACC's mission is to increase business lending by providing member institutions, which serve underserved people and communities, with new sources of capital. The Company provides financing, as well as educational programs and technical assistance to its members and to small businesses throughout the thirteen-state Appalachian Region. ACC's work enables reliable and sufficient capital for all of its members, leading to a growing economy, increased entrepreneurship, higher quality jobs, and increased local wealth in the Appalachian region. Appalachian Community Capital Development Foundation is a non-profit organization that is under common control by ACC and is therefore consolidated for financial reporting purposes. The consolidation of this organization does not have a material impact on the financial statements of ACC.

The accounting and reporting policies of the Company follow generally accepted accounting principles and general practices within the non-profit and financial services industry. The following is a summary of the more significant policies:

Critical Accounting Policies

Management believes the policies with respect to the methodology for the determination of the allowance for loan losses and asset impairment judgments involve a high degree of complexity. Management must make difficult and subjective judgments which require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Board of Directors.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

The determination of whether or not grant conditions have been met has a significant impact on revenue and is, in some cases, an estimate.

Basis of Accounting

The financial statements are prepared on the accrual basis of accounting. Under this basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 1. Nature of Activities and Summary of Significant Accounting Policies, continued

Financial Statement Presentation

Net assets, revenues and expenses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Company and changes therein are classified and reported as follows:

- Without Donor Restrictions – All resources over which the governing board has discretionary control. The Board of Directors of the Company may elect to designate such resources for specific purposes. This designation may be removed at the Board of Directors' discretion.
- With Donor Restrictions – Resources accumulated through donations or grants for specific operating or capital purposes. Such resources will be without restrictions when the requirements of the donor or grantee have been satisfied through expenditures for the specified purpose or program or through the passage of time. Also includes resources accumulated through donations or grants subject to donor-imposed stipulations that are to be maintained permanently by the Company. Generally, the donors of these assets permit the Company to use all or part of the income earned on related investments for general or specific purposes.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents are considered to include those amounts included in "cash and cash equivalents" on the statement of financial position. Cash and cash equivalents are considered to be highly liquid investments with maturities of 90 days or less.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future, until maturity or pay-off are reported at their outstanding principal amount adjusted for any charge-offs. Loan origination fees, net of certain direct origination costs, are deferred and recognized, as an adjustment of the related loan yield using the effective interest method.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest for the current year is reversed and any subsequent payments received are applied only to the loan's outstanding principal balance. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

Allowance for Loan Losses

The allowance for loan losses 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 uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 1. Nature of Activities and Summary of Significant Accounting Policies, continued

Allowance for Loan Losses, continued

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 and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows, collateral's net realizable value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and includes both a quantitative and qualitative component. The quantitative component is based on historical loss experience, while the qualitative component is based on specific internal and external factors that may have a negative impact on the performance of the loan portfolio.

In 2017, the Company had allocated \$150,000 of a grant funding received from the Community Development Financial Institutions ("CDFI") Fund to create a cash funded loan loss reserve in order to offset losses in the Small/Emerging CDFI loan portfolio. The portion of the allowance for loan losses attributable to the Small/Emerging CDFI's will be a reduction against the overall allowance of loan losses as the funds can be used to offset small business loan losses and provisions per the grant document.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and other circumstances impacting 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 the 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. Impairment is measured on a loan-by-loan basis for 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 net realizable value of the collateral if the loan is collateral dependent.

Grants Receivable, Revenue Recognition, and Deferred Revenue

Grants receivable and related deferred revenue are recorded at the time of award from a grantor. Grants are classified in one of two categories, with donor restrictions and without donor restrictions. Classification is determined based on the designation by the grantor for the use of funds. Grant revenue is recognized when earned by the Company through performance as specified in each grant award.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 1. Nature of Activities and Summary of Significant Accounting Policies, continued

Property and Equipment

Property and equipment consists of computer equipment and is carried at cost, less accumulated depreciation computed by the straight-line method over three years. When items of property and equipment are sold or retired, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is included in income. Maintenance and repairs are charged to expenses as incurred; major renewals and betterments are capitalized.

Functional Allocation of Expenses

The consolidated financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include salaries and employee benefits, the data processing, office and administrative, professional fees, travel, dues and subscriptions, Board of Directors', and other expenses. These costs are allocated either based on the actual nature of the expense or estimates of time and effort.

Income Taxes

The Company is a not-for-profit organization that is exempt from income taxes under Section 501(c)(4) of the Internal Revenue Code. Management is not aware of any uncertain tax positions and has not accrued any expense for the effect of an uncertain tax position as of December 31, 2019 and 2018. Tax years beginning in 2016 are open to examination by taxing authorities.

Recently Adopted Accounting Standards

The following accounting standards were adopted during the year by Appalachian Community Capital Corporation:

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance was adopted effective January 1, 2019, using the modified retrospective method. These amendments did not have a material impact on the Company's financial statements.

In June 2018, the FASB updated the Not-for-Profit Entities Topic of the Accounting Standards Codification. The amendments clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. For contributions received, the amendments are effective for annual periods beginning January 1, 2019. For contributions made, the amendments are effective for annual periods beginning after January 1, 2020. Grants received by the Company are all considered to be contributions and therefore there is no material effect on the accounting for grant income. These amendments did not have a material effect on the financial statements.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 1. Nature of Activities and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements

The following accounting standards may affect the future financial reporting by Appalachian Community Capital Corporation:

In November 2019, the FASB issued guidance to defer the effective dates for private companies, not-for-profit organizations, and certain smaller reporting companies applying standards on current expected credit losses (CECL), and leases. The new effective dates will be CECL: fiscal years beginning after December 15, 2022 including interim periods within those fiscal years; Leases: fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

The Company will apply the amendments to the ASU related to CECL through a cumulative-effect adjustment to net assets as of the beginning of the year of adoption. The Company is evaluating the impact of the ASU on the financial statements. The Company has not formed an expectation of what, if any impact on the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Reclassifications

Certain items in the prior year have been reclassified to conform to current year presentation. These reclassifications had no impact on net assets, changes in net assets, or cash flows.

Note 2. Cash and Cash Equivalents

Cash and cash equivalents at December 31, 2019 and 2018 totaled \$1,656,965 and \$2,465,160, respectively. Of this balance, \$935,397 exceeded the federally insured limit as of December 31, 2019.

Note 3. Loans Receivable

The major components of loans receivable as of December 31, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Loans to CDFI's	\$ 17,295,675	\$ 14,598,154
Small business loans*	957,175	1,270,018
Allowance for loan losses	<u>(200,829)</u>	<u>(186,050)</u>
Total	<u>\$ 18,052,021</u>	<u>\$ 15,682,122</u>

*Small business loans represent small business participation loans purchased from member organizations

There were no loans pledged at December 31, 2019 or 2018.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 3. Loans Receivable, continued

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its members. This financial instrument includes commitments to extend credit. This instrument involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheets position. The contractual or notional amounts of this instrument reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual or notional amount of this instrument. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counter-party.

Note 4. Allowance for Loan Losses

The allocation of the allowance for loan losses by loan components at December 31, 2019 was as follows:

Allowance for loan losses:

	Loans to CDFI's	Small business loans	Total
December 31, 2018	\$ 186,050	\$ -	\$ 186,050
Provision for loan losses	14,779	-	14,779
December 31, 2019	<u>\$ 200,829</u>	<u>\$ -</u>	<u>\$ 200,829</u>
Ending Balance:			
Individually evaluated for impairment	\$ -	\$ -	\$ -
Collectively evaluated for impairment	<u>\$ 200,829</u>	<u>\$ -</u>	<u>\$ 200,829</u>

Loans Receivable

Ending Balance:			
Individually evaluated for impairment	\$ -	\$ -	\$ -
Collectively evaluated for impairment	<u>\$ 17,295,675</u>	<u>\$ 957,175</u>	<u>\$ 18,252,850</u>

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 4. Allowance for Loan Losses, continued

The allocation of the allowance for loan losses by loan components at December 31, 2018 was as follows:

Allowance for loan losses:	Loans to CDFI's	Small business loans	Total
December 31, 2017	\$ 174,840	\$ -	\$ 174,840
Provision for loan losses	11,210	-	11,210
December 31, 2018	\$ 186,050	\$ -	\$ 186,050
Ending Balance:			
Individually evaluated for impairment	\$ -	\$ -	\$ -
Collectively evaluated for impairment	\$ 186,050	\$ -	\$ 186,050
Loans Receivable			
Ending Balance:			
Individually evaluated for impairment	\$ -	\$ -	\$ -
Collectively evaluated for impairment	\$ 14,598,154	\$ 1,270,018	\$ 15,868,172

The Company utilizes a cash funded loan loss reserve in the amount of \$150,000 to offset reserves related to small business loans. This has resulted in a reserve balance of \$0 related to "Small business" loans as of December 31, 2019 and 2018.

There were no impaired loans as of December 31, 2019 and 2018. In addition, there were no loans identified as impaired during the years ended December 31, 2019 and 2018. As a result, there was no average recorded investment in impaired loans or interest income recognized on impaired loans for the years ended December 31, 2019 and 2018. In addition, there were no nonaccrual loans as of December 31, 2019 and 2018.

As of December 31, 2019 and 2018, there were no loans past due.

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.

Loans graded Good or Satisfactory are excluded from the scope of the annual review and considered "Pass Credits" until: (a) they become past due; (b) management becomes aware of a deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as Watch, Substandard, Doubtful or Loss. Loans are graded as loss are charged off. The Company uses the following definitions for risk ratings:

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 4. Allowance for Loan Losses, continued

Credit Quality Indicators, continued

Good - Loans in this category are of good quality. The borrower has a history of successful performance, but may be susceptible to economic changes. Asset quality and liquidity are considered good. Overall leverage is normal for the industry in which the borrower operates and is stable. Cash flow levels may fluctuate but are sufficient to meet obligations. Margins and ratios are generally in line with or exceed industry norms. Earnings may have been inconsistent in the past, but have now stabilized and are equivalent to or better than the industry average. Other sources of financing, particularly from a number of other financial institutions, should be obtainable.

Satisfactory - Loans in this category are of satisfactory quality and risk is well within the Company's range of acceptability. They may differ from loans rated "Good" because the borrower may be entering an expansion mode, acquiring another company, introducing new products or investing large amounts of capital in upgrading equipment or the facility. The borrower's business may be cyclical or its customer base may have concentrations. Asset quality is acceptable. Liquidity levels fluctuate and usage of short term credit may be needed on a regular basis to finance growth or fluctuations in revenues and current assets. Leverage may be slightly to moderately higher than the industry, but is stable. Cash flow may fluctuate, but is evident in sales and earnings. The long-term outlook should be favorable. Management and owners have unquestioned character, although depth of management may be an issue.

Watch - Loans in this grade are considered to have a higher than normal credit risk and servicing needs. Asset quality is marginally acceptable. Leverage may fluctuate and is above normal for the industry. Cash flow is marginally adequate, but is not clearly sufficient to ensure continued performance of contractual obligations without improving trends. A loss year or earnings decline may occur, but the borrower has sufficient strength and financial flexibility to offset these events. A reasonable expectation exists that operating performance will improve in the near future. Some management weaknesses may exist. These borrowers are currently performing as agreed, but may be adversely affected by deteriorating industry conditions, competition, operating deficiencies, pending litigation of a significant nature, or declining asset quality, and therefore should be monitored closely. Access to alternative financing sources may not be possible or limited to asset-based lenders and other institutions specializing in high risk financing. Management has determined these loans require enhanced monitoring.

Substandard - Substandard assets are inadequately protected by the net worth and paying capacity of the borrower or the collateral pledged. Sound worth and paying capacity of a guarantor should be considered only if judged to be strong and dependable. Customers in this category have well defined weaknesses and the possibility exists that the Company will sustain some loss if the deficiencies are not corrected. Characteristics of a substandard loan include one or more of the following characteristics: a significant deterioration in earnings, cash flow or balance sheet composition, a deficient equity position, insufficient cash flow to meet maturity obligations, recent evidence of slow payments, a lack of adequate collateral or a dependence on illiquid collateral for repayment.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 4. Allowance for Loan Losses, continued

Credit Quality Indicators, continued

Doubtful - Doubtful ratings are applied to loans that exhibit weaknesses that make collection or liquidation in full improbable. This rating is used when the expected loss cannot be calculated, but estimates indicate that the loss will be significant in relation to the outstanding loan balance. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as a loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss - This rating is applied when the borrower's outstanding debt is considered uncollectible or of such little value that continuance as a Company asset is not warranted. This rating does not suggest that there is absolutely no recovery or salvage value, but that it is not practical or desirable to defer charging off the loan.

Loans by Risk Rating as of December 31, 2019

	<u>Loans to CDFI's</u>	<u>Small business loans</u>	<u>Total</u>
Pass Credits	\$ 17,245,675	\$ 957,175	\$ 18,202,850
Watch	50,000	-	50,000
Total	<u>\$ 17,295,675</u>	<u>\$ 957,175</u>	<u>\$ 18,252,850</u>

Loans by Risk Rating as of December 31, 2018

	<u>Loans to CDFI's</u>	<u>Small business loans</u>	<u>Total</u>
Pass Credits	\$ 14,548,154	\$ 1,270,018	\$ 15,818,172
Watch	50,000	-	50,000
Total	<u>\$ 14,598,154</u>	<u>\$ 1,270,018</u>	<u>\$ 15,868,172</u>

Troubled Debt Restructurings

There were no loans modified in a troubled debt restructuring in 2019 or 2018.

Note 5. Grants Receivable

ACC was due to receive grant awards from outside funding agencies as of December 31, 2019 as follows:

<u>Funding Agency</u>	<u>Amount Awarded</u>	<u>Amount Received</u>	<u>Amount Receivable</u>
Appalachian Regional Commission – 2017 Operating Grant	\$ 250,000	\$ 239,965	\$ 10,035
Appalachian Regional Commission – 2018 Operating Grant	175,000	13,346	161,654
Opportunity Appalachia Grant – 2019	1,039,500	-	1,039,500
CDFI – 2019 Financial Assistance Award	424,000	-	424,000
Total	<u>\$ 1,888,500</u>	<u>\$ 253,311</u>	<u>\$ 1,635,189</u>

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 5. Grants Receivable, continued

ACC was due to receive grant awards from outside funding agencies as of December 31, 2018 as follows:

<u>Funding Agency</u>	<u>Amount Awarded</u>	<u>Amount Received</u>	<u>Amount Receivable</u>
Appalachian Regional Commission – 2017 Operating Grant	250,000	143,387	106,613
Appalachian Regional Commission – 2018 Operating Grant	175,000	-	175,000
CDFI – 2018 Financial Assistance Award	<u>550,000</u>	<u>-</u>	<u>550,000</u>
Total	<u>\$ 975,000</u>	<u>\$ 143,387</u>	<u>\$ 831,613</u>

As of December 31, 2019 and 2018 the receivable has not been discounted due to its short term status.

Note 6. Property and Equipment

Details related to property and equipment as of December 31, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Computer equipment	\$ 4,101	\$ 3,009
Less, accumulated depreciation	<u>(2,554)</u>	<u>(1,883)</u>
Total	<u>\$ 1,547</u>	<u>\$ 1,126</u>

Depreciation for the years ended December 31, 2019 and 2018 was \$670 and \$66, respectively.

Note 7. Concentration Risks

ACC has a potential risk associated with the concentration of support received from governmental agencies. Any change in future funding could have an adverse impact on ACC. The Company also has little diversification in its loan portfolio with the significant portion of loans outstanding to CDFIs as discussed in Note 3.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 8. Borrowings

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

Description	Rate	Maturity	2019	2018
Bank of America*	LIBOR+2.00%	05/01/2023	\$ 3,000,000	\$ 3,000,000
Calvert Foundation*	4.50%	05/06/2023	3,000,000	3,000,000
Deutsche Bank*	LIBOR+0.50%	05/06/2023	3,000,000	3,000,000
Ford Foundation*	1.00%	05/06/2023	3,000,000	3,000,000
Regions Bank**	LIBOR+2.50%	10/16/2020	-	735,000
Opportunity Finance Network**	3.00%	05/01/2023	400,000	400,000
BBVA Compass Bank**	2.50%	08/07/2025	400,000	200,000
PNC Bank**	1.00%	06/30/2024	500,000	500,000
Northern Trust***	2.00%	11/26/2023	2,000,000	1,000,000
RCIF**	2.00%	3/15/2024	200,000	-
Amalgamated Bank****	4.25%	9/27/2021	500,000	-
M&T Bank*****	4.50%	9/01/2022	-	-
			<u>\$ 16,000,000</u>	<u>\$ 14,835,000</u>

*Disbursements on each loan are not to exceed \$3 million. Each loan is unsecured with interest payments due on a quarterly basis. Each loan requires principal payments of \$1 million due in May 2021 and May 2022, the sixth and seventh anniversary of the loan closing date, with the remaining principal due at maturity.

** Each loan is unsecured with interest payments due on a quarterly basis, with the remaining principal due at maturity.

***The loan is unsecured with interest payments due on a semi-annual basis, with the remaining principal due at maturity.

****The loan is unsecured with interest payable monthly in arrears, with the remaining principal due at maturity.

*****The loan is unsecured with interest payable quarterly in arrears, with the remaining principal due at maturity.

Performance against debt covenants is measured on a quarterly basis. As of December 31, 2019, ACC was in compliance with all covenants.

As of December 31, 2019, the Company had unused lines of credit of \$1,500,000 related to Regions Bank and Amalgamated Bank. The Company also has a term loan with M&T Bank in the amount of \$500,000 that was not yet funded as of December 31, 2019.

Note 9. Fair Value of Financial Instruments

Fair Value Hierarchy

There are three levels of inputs in the fair value hierarchy that may be used to measure fair value. Financial instruments are considered *Level 1* when valuation can be based on quoted prices in active markets for identical assets or liabilities. *Level 2* financial instruments are valued using quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or models using inputs that are observable or can be corroborated by observable market data of substantially the full term of the assets or liabilities. Financial instruments are considered *Level 3* when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable and when determination of the fair value requires significant management judgment or estimation.

Recurring Fair Value

The Company had no financial assets recorded at fair value on a recurring basis as of December 31, 2019 or 2018.

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 9. Fair Value of Financial Instruments, continued

Non-Recurring Fair Value

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: Impairment of a loan is based on a loan's observable market price, the fair value of the collateral of a collateral-dependent loan or the discounted cash flow method. Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. The value of business equipment is based upon an outside appraisal, if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports. The Company had no impaired loans as of December 31, 2019 or 2018.

Note 10. Significant Contracts

During 2014, the Company entered into an agreement with another CDFI, Virginia Community Capital ("VCC"), to provide accounting and data processing services, including loan servicing. Under the terms of the contract, ACC paid an initial set-up fee and a monthly fee of \$4,292, as well as additional fees for out of scope services as needed. ACC paid \$45,500 and \$45,540 under this agreement during the years ended December 31, 2019 and 2018, respectively. VCC is a member organization of ACC and a member of VCC's management team serves on the Board of Directors of the Company.

Note 11. Related Parties

The Company currently has twenty-three loans outstanding that have been made to CDFI's, each of which is a member organization of ACC. Each of these CDFI's have a member of management who also serves on the Board of Directors of the Company. Each of these loans are on substantially the same terms as those prevailing for comparable transactions with persons not related to the Company and do not involve more than normal risk of collection or present other unfavorable terms.

Note 12. Net Assets with Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes or periods.

Subject to expenditure for specified purpose:	<u>2019</u>	<u>2018</u>
Community development lending	\$ 2,987,000	\$ 2,987,000
Total net assets with donor restrictions	<u>\$ 2,987,000</u>	<u>\$ 2,987,000</u>

Appalachian Community Capital Corporation

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

Note 13. Liquidity and Availability of Financial Assets

The Company's financial assets available within one year of the balance sheet date for general expenditure are as follows:

	2019
Cash and due from banks	\$ 1,656,965
Loans and interest receivable, current portion	3,580,892
Grants receivable	<u>1,635,189</u>
Financial assets available within one year	<u>\$ 6,873,046</u>

As part of ACC's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations become due. ACC invests excess cash in short-term investments, including money market accounts, and has the ability to redeem certain investments as necessary to meet its obligations.

Note 14. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

The 2019 novel coronavirus ("COVID-19") has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. These events may adversely affect business and consumer confidence, generally, and the Company and its customers, and their respective suppliers, vendors and processors may be adversely affected. Following the COVID-19 outbreak in December 2019 and January 2020, market interest rates have declined significantly, with the 10-year Treasury bond falling below 1.00 percent on March 3, 2020 for the first time. On March 3, 2020, the Federal Open Market Committee (FOMC) reduced the target federal funds rate by 50 basis points to 1.00 percent to 1.25 percent. Subsequently on March 16, 2020, the FOMC further reduced the target federal funds rate by an additional 100 basis points to 0.00 percent to 0.25 percent. These reductions in interest rates and other effects of the COVID-19 outbreak may adversely affect the Company's financial condition and results of operations.

The Company evaluated subsequent events through the date its financial statements were issued, and no other subsequent events were noted through April 30, 2020.

MEMBERS OF APPALACHIAN COMMUNITY CAPITAL INCLUDE:

Access to Capital for Entrepreneurs (Georgia)

Alternatives Federal Credit Union (New York)

Appalachian Development Corporation (South Carolina)

Appalachian Growth Capital (Ohio)

Carolina Small Business Development Fund (North Carolina)

CommunityWorks (South Carolina)

Finance Fund Capital Corporation (Ohio)

Kentucky Highlands Investment Corporation (Kentucky)

LiftFund (Alabama)

Mountain Association for Community Economic Development (Kentucky)

Mountain BizWorks (North Carolina)

Natural Capital Investment Fund (West Virginia)

Pathway Lending (Tennessee)

People, Inc. (Virginia)

Piedmont Business Capital (North Carolina)

Sabre Financial (Alabama)

Southeast Kentucky Economic Development Corporation (Kentucky)

Three Rivers Planning & Development District (Mississippi)

Virginia Community Capital (Virginia)

Woodlands Community Lenders (West Virginia)