# Northumberland Bancorp

## Consolidated Financial Statements

December 31, 2022 and 2021

# Northumberland Bancorp

## Contents

# Northumberland Bancorp

245 Front Street • P.O. Box 271 • Northumberland, PA 17857
(570) 473-3531 Fax (570) 473-9697

April 14, 2023

Dear Shareholder:

Greetings, I am pleased to provide this report and commentary on our journey through the turbulent economic year of 2022. To characterize 2022, we faced the highest inflation in many decades, witnessed one of the most volatile stock markets combined with one of the worse periods for bond values as the Federal Reserve quickly raised interest rates over a very short period. The quickly rising short term interest rates are proving to have a negative impact on interest rate margins for community banks as we are expected to pay more for deposits in the short term while loan yields rise at a much slower pace. The higher interest rate environment continues to cause historic lows for mortgage application activity nationwide which greatly impacted our non-interest income generated by “Gain on Sale” mortgages compared to previous time periods. To illustrate, your company had Gain on Sale of mortgages for 2022 reported at a historic low of $255,539 compared to $1.3 million in 2021 and $2.0 million in 2020.

As we continue the work to convert our core software, you will see that Net Income for 2022 was greatly impacted by over $600,000 of “one time” de-conversion expenses captured within non-interest expense. These are fees and costs that the current core and current managed IT provider require to assist in transferring data and handling tasks required for a successful conversion. These fees must be “expensed” when paid and cannot be amortized. The year 2022 is also the first year reporting a full year of expense for the sub debt interest. We are now mitigating that expense by investing the unutilized portion in higher yielding investments currently available.

Our 2022 financial results are summarized as follows:

- Net Income for 2022 was $3.05 million, or $2.38 per share. This was a 26.8% decrease compared to 2021 and mainly attributed to the aforementioned items.

- Net Loans grew to $418.05 million in 2022 compared to $376.8 million in 2021, an increase of over 11%.

- Total Deposits ended 2022 at $622.2 million as compared to $628.9 million in 2021 a slight decrease. I will note that current deposits exhibit strong overall growth when compared to $545.1 million at 2020-year end.

- Total Assets stood at $691.7 million for year end 2022 compared to $703.3 million at year end 2021. More details as follows.

Reviewing the results above, even though loans grew significantly, and deposits remained relatively stable, reported total assets exhibited a decrease. This is mainly attributed to the effect that the higher short term interest rate environment has on certain fixed rate investments of the company (various bonds) and are then stated at lower market values while being held on the asset side of the balance sheet. These lower values must be reported as "unrealized losses" even though the asset was not sold for a loss and the intention is to hold it to maturity. These lower valuations continue through the balance sheet to Stockholder Equity causing a reported "unrealized" decline from $61.4 million for this period in 2021 to $44.9 million at December 31, 2022. When the unrealized losses are excluded, book value at December 31, 2022 increases to $49.34, versus $47.10 as of December 31, 2021, or a 4.75% increase.

The preceding is another common theme to be seen on the balance sheet of most all banks with certain fixed rate investments. The media has recently been featuring these unrealized losses as a major point of concern. Using a single metric like unrealized losses does not accurately capture the health of our bank or any bank unless it were their only source of liquidity in the event of large deposit losses. Although management has made a decision from time to time to sell an investment at a loss, it is usually only done so when the payback period to recover the loss makes sense against other sources of liquidity. Your bank continues to enjoy other sources of liquidity as needed such as Federal Home Loan Bank advances.

General loan quality remains strong. Classified assets remain low, at 4.62% of Tier One Risk-Based Capital. 2022 ended with an overall delinquency ratio of 1.20%

The Bank continues to be well-capitalized based on regulatory capital standards, with a Tier One Leverage capital ratio of 9.61% at December 31, 2022. The Bank's Risk-Based capital ratios also remain strong and well in excess of regulatory requirements. Tier One capital to risk-weighted assets was 15.52% and Total Risk-Based capital to risk-weighted assets was 16.39%. When calculating these capital ratios, the unrealized loss impact on reported equity capital is not considered.

We continue to be excited about the conversion of our core software including a new mobile and internet banking platform with expanded features and capabilities. All teams are working diligently through trainings and data testing and all is reported to be on schedule and going well. Our staff members report they like what they see and are very excited for the experience that they and our customers will enjoy as we continue into the future. We are scheduled to be converted during July 2023.

I will close by basically reiterating an earlier message from the September 2022 letter - The Capital position we have and the foundation we have built in our 120-year history, provide an ideal situation to meet the cyclical economic challenges ahead. While we may not be able to expect tremendous growth in the short term, we are definitely in a place where we are confident in long-term sustainability to the next growth cycle with various sources of liquidity in place. For banking in general, these head winds will most likely persist through much of 2023 and quite possibly into 2024 as the Federal Reserve will most likely continue their current course in an effort to beat down inflation.

We thank you, our shareholders, for your continued investment and support.

Very truly yours,

J. Todd Troxell
President and CEO

# INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
Northumberland Bancorp
Northumberland, Pennsylvania

***Opinion***

We have audited the consolidated financial statements of Northumberland Bancorp, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of income (loss), comprehensive income (loss), stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Northumberland Bancorp as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Northumberland Bancorp and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Northumberland Bancorp's ability to continue as a going concern for one year from the date the consolidated financial statements are available to be issued.

***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Northumberland Bancorp's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Northumberland Bancorp's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

***Other Information***

Management is responsible for the other information included in the annual report. The other information comprises the information included in the annual report but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Crowe LLP

Crowe LLP

Washington, D.C.
April 20, 2023

# Northumberland Bancorp

## Consolidated Balance Sheets

(amounts in thousands except share and per share data)

| *December 31,* | | **2022** | | 2021 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and due from banks | $ | **12,444** | $ | 13,690 |
| Interest-bearing deposits in other banks | | **4,965** | | 21,925 |
| Total cash and cash equivalents | | **17,409** | | 35,615 |
| Investment securities available-for-sale | | **216,008** | | 255,442 |
| Investment securities held-to-maturity (fair value 2022 - $1,918, 2021 - $780) | | **2,038** | | 779 |
| Equity securities | | **207** | | 216 |
| Total investment securities | | **218,253** | | 256,437 |
| Restricted stock, at cost | | **2,799** | | 2,450 |
| Loans held for sale | | **350** | | 2,979 |
| Loans | | **421,693** | | 380,273 |
| Less allowance for loan losses | | **3,641** | | 3,481 |
| Net loans | | **418,052** | | 376,792 |
| Premises and equipment | | **8,745** | | 9,058 |
| Bank-owned life insurance | | **14,755** | | 14,423 |
| Accrued interest and other assets | | **11,308** | | 5,574 |
| **Total Assets** | $ | **691,671** | $ | 703,328 |
| **Liabilities and Stockholders' Equity** | | | | |
| **Liabilities** | | | | |
| Deposits: | | | | |
| Noninterest-bearing demand | $ | **150,583** | $ | 152,391 |
| Interest-bearing demand | | **236,350** | | 250,635 |
| Savings | | **112,591** | | 116,525 |
| Time deposits | | **122,701** | | 109,375 |
| Total deposits | | **622,225** | | 628,926 |
| Borrowings | | **13,000** | | 1,000 |
| Subordinated Debt, less unamortized issuance costs | | **9,830** | | 9,810 |
| Accrued interest and other liabilities | | **1,716** | | 2,226 |
| **Total Liabilities** | | **646,771** | | 641,962 |
| **Stockholders' Equity** | | | | |
| Common stock, par value $0.10; 5,000,000 shares authorized, 1,502,500 shares issued and 1,282,054 shares outstanding in 2022 and 1,309,822 shares outstanding in 2021 | | **150** | | 150 |
| Capital surplus | | **3,832** | | 3,832 |
| Retained earnings | | **62,875** | | 61,025 |
| Unearned ESOP shares | | **(837)** | | (548) |
| Accumulated other comprehensive income (loss) | | **(18,355)** | | (328) |
| Treasury stock, at cost (190,642 shares in 2022 and 190,642 in 2021) | | **(2,765)** | | (2,765) |
| Total Northumberland Bancorp stockholders' equity | | **44,900** | | 61,366 |
| **Total Stockholders' Equity** | | **44,900** | | 61,366 |
| **Total Liabilities and Stockholders' Equity** | $ | **691,671** | $ | 703,328 |

*See accompanying notes to consolidated financial statements.*

# Northumberland Bancorp

## Consolidated Statements of Income[A1][A2]

(amounts in thousands except share and per share data)

| Years Ended December 31, | 2022 | 2021 |
|---|---|---|
| **Interest and Dividend Income** | | |
| Interest and fees on loans: | | |
| Taxable | $ **16,674** | $ 14,932 |
| Tax-exempt | **401** | 268 |
| Interest on interest-bearing deposits in other banks | **151** | 31 |
| Interest and dividends on investment securities: | | |
| Taxable | **2,921** | 1,988 |
| Tax-exempt | **797** | 797 |
| Dividends | **212** | 163 |
| **Total Interest and Dividend Income** | **21,156** | 18,179 |
| **Interest Expense** | | |
| Deposits | **3,277** | 2,295 |
| Borrowings | **214** | 16 |
| Subordinated Debt, less unamortized issuance costs | **450** | 256 |
| **Total Interest Expense** | **3,941** | 2,567 |
| Net interest income | **17,215** | 15,612 |
| **Provision (Credit) for Loan Losses** | **158** | (194) |
| **Net Interest Income After Provision for Loan Losses** | **17,057** | 15,806 |
| Noninterest Income | | |
| Service charges on deposit accounts | **1,522** | 1,481 |
| Trust services income | **1,011** | 971 |
| Investment securities gains (loss), net | **(35)** | 207 |
| Gains on sales of loans | **226** | 1,363 |
| Earnings on bank-owned life insurance | **332** | 340 |
| Change in fair value of equity securities | **(8)** | 11 |
| Other income | **970** | 1,261 |
| **Total Noninterest Income** | **4,018** | 5,634 |
| **Noninterest Expense** | | |
| Salaries and employee benefits | **9,750** | 9,419 |
| Occupancy expense, net | **840** | 843 |
| Equipment expense | **1,686** | 1,113 |
| Professional fees | **873** | 526 |
| Data processing | **867** | 883 |
| Shares tax | **529** | 477 |
| Federal deposit insurance expense | **205** | 174 |
| Other expense | **2,838** | 2,975 |
| **Total Noninterest Expense** | **17,588** | 16,410 |
| Income before income taxes | **3,487** | 5,030 |
| **Income Taxes** | **434** | 772 |
| **Net Income** | **3,053** | 4,258 |
| Net income attributable to non-controlling interest | **0** | 6 |
| **Net Income Attributable to Northumberland Bancorp** | $ **3,053** | $ 4,252 |
| **Earnings Per Share** | $ **2.38** | $ 3.25 |
| **Weighted-Average Shares Outstanding** | **1,282,054** | 1,309,826 |

*See accompanying notes to consolidated financial statements.*

# Northumberland Bancorp

## Consolidated Statements of Comprehensive Income[A3][A4]

(amounts in thousands)

| *Years Ended December 31,* | | **2022** | | 2021 |
|---|---|---|---|---|
| **Net Income** | $ | **3,053** | $ | 4,258 |
| **Other Comprehensive Income / (Loss)** | | | | |
| Change in unrealized holding gains/(losses) on investment securities available-for-sale | | **(22,853)** | | (3,193) |
| Tax effect | | **4,798** | | 671 |
| Reclassification adjustment for investment securities (gains) / losses recognized in net income | | **35** | | (207) |
| Tax effect | | **(7)** | | 43 |
| **Other Comprehensive Income (Loss), Net of Tax** | | **(18,027)** | | (2,686) |
| Comprehensive income before non-controlling interest | | **(14,974)** | | 1,572 |
| Less: net income attributable to non-controlling interest | | **0** | | 6 |
| **Comprehensive Income (Loss)** | $ | **(14,974)** | $ | 1,566 |

*See accompanying notes to consolidated financial statements.*

# Northumberland Bancorp

## Consolidated Statements of Stockholders' Equity

(amounts in thousands excepts share and per share data)

| | Common Stock | Capital Surplus | Retained Earnings | Accum Comp Inc | Treasury Stock | Non-Controlling Interest | Unearned ESOP Shares | **Total** |
|---|---|---|---|---|---|---|---|---|
| **Balance December 31, 2020** | 150 | 3,832 | 57,961 | 2,358 | (2,265) | 6 | | **62,042** |
| Net Income | | | 4,252 | | | 6 | | **4,258** |
| Dissolution of Non-contolling interest | | | | | | (12) | | **(12)** |
| Other Comprehensive Income (Loss) | | | | (2,686) | | | | **(2,686)**[A5][A6] |
| Treasury Stock Purchase (16,000 shares) | | | | | (500) | | | **(500)** |
| Shares purchased for ESOP (24,307 shares) | | | | | | | (923) | **(923)** |
| ESOP shared committed to be released (8,942 shares) | | | (10) | | | | 375 | **365** |
| Dividends declared ($0.90 per share) | | | (1,178) | | | | | **(1,178)** |
| **Balance December 31, 2021** | 150 | 3,832 | 61,025 | (328) | (2,765) | 0 | (548) | **61,366** |
| Net Income | | | 3,053 | | | 0 | | **3,053** |
| Other Comprehensive Income (Loss) | | | | (18,027) | | | | **(18,027)**[A7][A8] |
| Shares purchased for ESOP (24,307 shares) | | | | | | | (899) | **(899)** |
| ESOP shared committed to be released (15,696 shares) | | | (6) | | | | 610 | **604** |
| Dividends declared ($0.92 per share) | | | (1,197) | | | | | **(1,197)** |
| **Balance December 31, 2022** | **150** | **3,832** | **62,875** | **(18,355)** | **(2,765)** | **0** | **(837)** | **44,900** |

*See accompanying notes to consolidated financial statements.*

# Northumberland Bancorp

## Consolidated Statements of Cash Flows
(amounts in thousands)

| *Years Ended December 31,* | **2022** | 2021 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Net income | $ **3,053** | $ 4,258 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Change in fair value of Equity Securities | **(8)** | 11 |
| Provision (credit) for loan losses | **158** | (194) |
| Share based compensation expense | **604** | 365 |
| Depreciation, amortization, and accretion, net | **3,379** | 3,092 |
| Proceeds from sales of loans held for sale | **14,065** | 38,578 |
| Gains on sales of loans | **(226)** | (1,363) |
| Originations of residential loans held for sale | **(11,210)** | (37,573) |
| Gain on sale of other real estate owned | **0** | (33) |
| Investment securities (losses) gains, net | **(35)** | 207 |
| Deferred income tax benefit | **0** | (187) |
| Earnings on bank-owned life insurance | **(332)** | (340) |
| Increase in accrued interest receivable | **(283)** | (195) |
| Decrease in accrued interest payable | **148** | (37) |
| Other, net | **(1,318)** | (1,770) |
| **Net Cash Provided by Operating Activities** | **7,996** | 4,819 |
| **Cash Flows from Investing Activities** | | |
| Investment securities available-for-sale: | | |
| Proceeds from sales | **8,752** | 24,913 |
| Proceeds from maturities or redemptions | **31,218** | 38,188 |
| Purchases | **(25,941)** | (134,447) |
| **Investment securities held-to-maturity:** | | |
| Proceeds from maturities or redemptions | **0** | 230 |
| Purchases | **(1,257)** | 0 |
| ~~(~~Increase~~) decrease~~ in loans, net | **(41,486)** | (15,954) |
| Purchases of premises and equipment, net | **(355)** | (312) |
| Purchases of restricted stock | **(1,548)** | (173) |
| Redemptions of restricted stock | **1,200** | 725 |
| Proceeds from sale of other real estate owned | **0** | 307 |
| **Net Cash Used in Investing Activities** | **(29,417)** | (86,523) |
| **Cash Flows from Financing Activities** | | |
| Net Increase (Decrease) in deposits | **(6,701)** | 83,746 |
| Net Increase (Decrease) in borrowings | **12,020** | (1,000) |
| Issuance of subordinated debt, net of issuance costs | **0** | 9,810 |
| Purchase of common stock - ESOP | **(899)** | (923) |
| Purchase of treasury stock | **0** | (500) |
| Cash dividends paid | **(1,205)** | (1,179) |
| **Net Cash Provided by Financing Activities** | **3,215** | 89,954 |
| Increase in cash and cash equivalents | **(18,206)** | 8,250 |
| **Cash and Cash Equivalents, Beginning Of Year** | **35,615** | 27,365 |
| **Cash and Cash Equivalents, End Of Year** | $ **17,409** | $ 35,615 |

*See accompanying notes to consolidated financial statements.*

## *Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

## 1. Summary of Significant Accounting Policies

A summary of significant accounting and reporting policies applied in the presentation of the accompanying consolidated financial statements follows:

### *Nature of Operations and Basis of Presentation*

Northumberland Bancorp (the "Company") is a Pennsylvania corporation and is registered under the Bank Holding Company Act. The Company was organized as the holding company of its wholly owned subsidiary, The Northumberland National Bank (the "Bank"). The Bank is a nationally chartered commercial bank located in Northumberland, Pennsylvania. The Bank's service area includes portions of Northumberland, Snyder, and Union counties in Pennsylvania. The Company and the Bank derive substantially all of their income from banking and bank-related services, which include interest earnings on commercial, commercial mortgage, residential real estate, and consumer loan financing as well as interest earnings on investment securities and deposit and trust services to their customers. The Company is supervised by the Federal Reserve Board, while the Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. Intercompany activity has been eliminated in consolidation.

### *Use of Estimates*

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") and with general practice within the banking industry. In preparing the financial statements, management makes estimates and assumptions based upon available information. These estimates and assumptions affect the amounts reported in financial statements and the disclosures provided. Actual results could differ significantly from those estimates.

### *Investment Securities*

Investment securities are classified at the time of purchase, based on management's intention and ability, as securities held-to-maturity or securities available-for-sale. Debt securities acquired with the intent and ability to hold to maturity are stated at cost adjusted for amortization of premium and accretion of discount that are computed using the level yield method and recognized as adjustments of interest income. Certain other debt securities have been classified as available-for- sale to serve principally as a source of liquidity. Equity securities are measured at fair value with changes in fair value recognized in current period earnings. Unrealized holding gains and losses for available-for-sale securities are reported as a separate component of stockholders' equity, net of tax, until realized. Realized securities gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Debt securities are periodically reviewed for other-than-temporary impairment ("OTTI") based upon a number of factors including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, and the ability of the issuer to meet contractual obligations. Management also assesses whether it intends to sell, or is more likely than not that it will be required to sell, a debt security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: OTTI related to credit loss, which must be recognized in the income statement, and OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

### *Federal Home Loan Bank Stock*

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Pittsburgh and, as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB, as well as a minimum level of mortgages in the Mortgage Partnership Finance ("MPF") program. FHLB Stock is carried at cost, classified as restricted securities, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

### *Loans Held for Sale and Loans Serviced*

Loans held for sale are carried at the lower of cost or fair value, as determined on an aggregate basis. Gains and losses on sales of mortgage loans are determined by the difference between the sale proceeds and the carrying value of the loans. All sales are made with limited recourse. [A9][A10]Loans held for sale were $350,000 and $2,979,000 at December 31, 2022 and 2021, respectively. At December 31, 2022 and 2021, the amounts of loans serviced by the Company for the benefit of others were $129,032,000 and $138,412,000, respectively. These loans are not included on the Company's consolidated balance sheet.

### *Mortgage Servicing Rights ("MSRs")*

The Company has agreements for the express purpose of selling loans in the secondary market. The Company maintains servicing rights for certain loans. Originated MSRs are recorded by allocating total costs incurred between the loan and servicing rights based on their relative fair values. MSRs are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio. Annually, the Company performs an impairment review of the MSRs and recognizes impairment through a valuation account. No impairment was recognized in 2022 or 2021. MSRs are a component of other assets on the consolidated balance sheets. The balance of loan servicing assets was $486,000 and $568,000 at December 31, 2022 and 2021, respectively.

### *Loans*

Loans originated with the intention to hold to maturity are reported at their principal amount, net of unearned income and the allowance for loan losses. Interest income on all loans is recognized on an accrual basis. Nonrefundable loan fees and certain direct costs are deferred and amortized over the life of the loans using the interest method. The amortization is reflected as an interest yield adjustment, and the deferred portion of the net fees and costs is reflected as part of the loan balance.

Accrual of interest is discontinued when, in the opinion of management, reasonable doubt exists as to the collectability of additional interest. Loans are returned to accrual status when past due interest is collected and the collection of principal is probable. Commercial and commercial real estate loans are considered for nonaccrual status when they are 90 days past due, unless the loan is well- secured and in the process of collection. Residential mortgages are considered for nonaccrual when they are 180 days past due, unless they are well secured and in the process of collection. Consumer loans continue to accrue interest until they are charged off after they have reached 120 days past due. Past due status is based upon the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days and still accruing may include smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

### *Allowance for Loan Losses*

The allowance for loan losses represents the amount that management estimates is adequate to provide for probable losses inherent in its loan portfolio. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based on management's periodic evaluation of individual loans, economic factors, past loan loss experience, changes in the composition and volume of the portfolio, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses are particularly susceptible to changes in the near term.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings ("TDRs") and classified as impaired.

Impaired loans are commercial and commercial real estate loans for which it is probable the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Company individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of impaired loans is determined as the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans, are collectively evaluated for impairment, and accordingly, they are not included in the separate identified impairment disclosures. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Loans whose terms are modified are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The general component convers loans that are collectively evaluated for impairment. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not included in the separately identified impairment disclosures. The general allowance component also includes loans that are not individually identified for impairment evaluation, such as commercial loans below the individual evaluation threshold, as well as those loans that are individually evaluated but are not considered impaired. The general component is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent 2 years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans (including TDRs); levels of and trend in charge-offs and recoveries; migration of loans to the classification of special mention, substandard, or doubtful; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentration.

### *Premises and Equipment*

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years for furniture, fixtures, and equipment and 15 to 50 years for buildings and building improvements. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions, improvements are capitalized.

### *Other Real Estate Owned ("OREO")*

Other real estate owned acquired in settlement of foreclosed loans is carried as a component of other assets at fair value minus estimated cost to sell. Prior to foreclosure, the estimated collectible value of the collateral is evaluated to determine whether a partial charge-off of the loan balance is necessary. After transfer to real estate owned, any subsequent write-downs are charged against other operating expenses. Direct costs incurred in the foreclosure process and subsequent holding costs incurred on such properties are recorded as expenses of current operations.

### *Bank Owned Life Insurance*

The Company invests in bank owned life insurance ("BOLI") as a source of funding for employee benefit expenses. BOLI involves purchasing life insurance on a select group of employees. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies or from death benefits realized is included in other income on the consolidated statements of income.

### *Loan Commitments and Related Financial Instruments*

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

### *Advertising Expenses*

Advertising expenses are expensed as costs are incurred. Advertising expenses were to $142,000 and $137,000 in 2022 and 2021, respectively.

### *Income Taxes*

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted marginal tax rates. Deferred income tax expenses or benefits are based on the changes in the deferred tax asset or liability from period to period.

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

### *Employee Benefit Plans – 401(k) and Employee Stock Ownership Plan*

401(k)
The Company has a defined contribution benefit plan in the form of a 401(k) plan, that covers all eligible employees. During 2019, the Company amended the 401(k) plan to include Roth elective deferral contributions by employees. The amendment also included employer Safe Harbor Matching Contributions by the Company for both traditional 401(k) employee contributions and Roth contributions. The Bank matches 100% of employee contributions up to 3%, and 50% of employee contributions that exceed 3% up to a maximum of 5%.

Employee Stock Ownership Plan ("ESOP")
The Company established an ESOP in 2021 to provide additional benefits to employees. The ESOP borrowed money from the Company to purchase shares, which are eligible to be allocated to employees. The Company makes discretionary contributions to the ESOP, as well as paying dividends

on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Dividends on allocated shares increase participant accounts. Participants receive their allocated shares at the end of employment. A participant may require stock received to be repurchased unless the stock is traded on an established market. See footnote 9 to the consolidated financial statements for additional information.

### *Trust Assets*

Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the accompanying consolidated financial statements, since such items are not assets of the Company. The fair value of trust assets under administration were $174,572,000 and $174,923,000 as of December 31, 2022 and 2021, respectively.

### *Comprehensive Income (Loss)*

The Company is required to present comprehensive income (loss) and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) is comprised of net unrealized holding gains or losses on its available-for-sale investment securities, net of tax.

### *Earnings Per Share*

The Company currently maintains a simple capital structure; therefore, there are no dilutive effects on earnings per share. As such, earnings per share are calculated using the weighted-average number of shares outstanding for the periods. Shares purchased by the ESOP are excluded from weighted-average shares, but shares allocated to participants in the ESOP are included in weighted-average shares. Treasury stock shares are excluded from weighted-average shares.

### *Loss contingencies*

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. No loss contingency liabilities have been recorded at December 31, 2022 or December 31, 2021.

### *Cash Flow Information*

The Company has defined cash and cash equivalents as those amounts included in the consolidated balance sheet captions "cash and due from banks," and "interest-bearing deposits in other banks," with original maturities of 90 days or less. The following are supplemental disclosures for the consolidated statements of cash flows (in thousands):

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Cash paid during the year for: | | |
| Interest | **$ 3,424** | $ 2,604 |
| Income Taxes | **580** | 1,030 |

## *Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

### *Reclassification of Comparative Amounts*

Certain comparative amounts for the prior year have been reclassified to conform to current-year classifications. Reclassifications had no effect on prior year stockholders' equity or net income.

### *Accounting Standards Update (ASU) – Current Expected Credit Losses*[A11][A12]

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be affected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. With certain exceptions, transition to the new requirements will be through a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. This Update is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. We expect to recognize a one-time cumulative-effect adjustment to the allowance for loan losses[A13][A14] when the new standard is adopted in the first quarter of 2023. This onetime adjustment will be to Retained Earnings. We have not yet finalized the overall impact of the one-time adjustment at adoption in the consolidated financial statements.

## 2. Investment Securities

The amortized cost and fair values of investment securities are as follows (in thousands):

| *December 31, 2022* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Approximate Fair Value |
|---|---|---|---|---|
| Available-for-sale: | | | | |
| Obligations of states and political subdivisions | **$ 83,877** | **1** | **(9,869)** | **74,009** |
| Mortgage-backed securities in government sponsored entities | **155,355** | **277** | **(13,633)** | **141,999** |
| **Total** | **$ 239,232** | **278** | **(23,502)** | **216,008** |
| December 31, 2021 | | | | |
| Available-for-sale: | | | | |
| Obligations of states and political subdivisions | $ 85,647 | $ 1,111 | $ (666) | $ 86,092 |
| Mortgage-backed securities in government sponsored entities | 170,210 | 587 | (1,447) | 169,350 |
| **Total** | $ 255,857 | $ 1,698 | $ (2,113) | $ 255,442 |

| *December 31, 2022* | Amortized Cost | Gross Unrecognized Gains | Gross Unrecognized Losses | Approximate Fair Value |
|---|---|---|---|---|
| Held-to-maturity: | | | | |
| Obligations of states and political subdivisions | **$ 2,038** | **0** | **(120)** | **1,918** |
| **Total** | **$ 2,038** | **0** | **(120)** | **1,918** |
| *December 31, 2021* | | | | |
| Held-to-maturity: | | | | |
| Obligations of states and political subdivisions | $ 779 | $ 3 | $ (2) | $ 780 |
| **Total** | $ 779 | $ 3 | $ (2) | $ 780 |

*Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2022 and 2021 (in thousands).

| | Less than 12 Months | | 12 months or Longer | | Total | |
|---|---|---|---|---|---|---|
| *December 31,2022* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Available-for-sale: | | | | | | |
| Obligations of state and political subdivisions | $ 28,013 | (1,652) | 44,347 | (8,217) | 72,360 | (9,869) |
| Mortgage-backed securities in government sponsored entities | 30,745 | (1,365) | 91,212 | (12,268) | 121,957 | (13,633) |
| **Total** | $ 58,758 | (3,017) | 135,559 | (20,485) | 194,317 | (23,502) |

| | Less than 12 Months | | 12 months or Longer | | Total | |
|---|---|---|---|---|---|---|
| *December 31,2022* | Fair Value | Unrecognized Losses | Fair Value | Unrecognized Losses | Fair Value | Unrecognized Losses |
| Held-to-maturity: | | | | | | |
| Obligations of state and political subdivisions | $ 1,416 | (100) | 493 | (20) | 1,909 | (120) |
| **Total** | $ 1,416 | (100) | 493 | (20) | 1,909 | (120) |

| | Less than 12 Months | | 12 months or Longer | | Total | |
|---|---|---|---|---|---|---|
| *December 31, 2021* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Available-for-sale: | | | | | | |
| Obligations of state and political subdivisions | $ 33,330 | $ (490) | $ 6,474 | $ (176) | $ 39,804 | $ (666) |
| Mortgage-backed securities in government sponsored entities | 105,625 | (1,201) | 18,435 | (246) | 124,060 | (1,447) |
| **Total** | $ 138,955 | $ (1,691) | $ 24,909 | $ (422) | $ 163,864 | $ (2,113) |
| Held-to-maturity: | | | | | | |
| Obligations of state and political subdivisions | $ 508 | $ (2) | $ - | $ - | $ 508 | $ (2) |
| **Total** | $ 508 | $ (2) | $ - | $ - | $ 508 | $ (2) |

The Company reviews its unrealized loss positions quarterly and has determined that at December 31, 2022 and 2021, the declines outlined in the above tables represent temporary declines and the Company does not intend to sell and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 382 and 234 positions that were temporarily impaired at December 31, 2022 and 2021, respectively. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, or issuer-specific ratings changes that are not expected to result in the non-collection of principal and interest during the period. In each case, the issuers continue to make timely principal and interest payments. Fair value is expected to recover as the security approaches maturity.

The amortized cost and fair value of debt securities at December 31, 2022, by contractual maturity, are shown below. Securities not due at a single maturity date are shown separately. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands).

| | Available-for-Sale | | Held-to-Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due in one year or less | $ 5,764 | $ 5,676 | $ - | $ - |
| Due after one year through five years | 35,933 | 33,202 | 2,021 | 1,902 |
| Due after five years through ten years | 44,162 | 37,094 | - | - |
| Due after ten years | - | - | 17 | 16 |
| Mortgage Backed Securities | 153,373 | 140,036 | - | - |
| **Total** | $ 239,232 | $ 216,008 | $ 2,038 | $ 1,918 |

Proceeds from the sales of available-for-sale securities during 2022 amounted to $8,752,000 resulting in gross gains and gross losses of $5,000 and $40,000, respectively. Proceeds from the sales of available-for-sale securities during 2021 amounted to $24,913,000 resulting in gross gains and gross losses of $241,000 and $34,000, respectively. Investment securities with fair values of $120,103,000 and $104,149,000 at December 31, 2022 and 2021, respectively, were pledged to secure public deposits and other purposes as required by law.

## 3. Loans

Major classifications of loans are summarized as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Commercial | $ 99,087 | $ 99,901 |
| Commercial real estate | 88,840 | 86,344 |
| Residential real estate | 226,996 | 188,704 |
| Consumer | 6,770 | 5,324 |
| | 421,693 | 380,273 |
| Less allowance for loan losses | 3,641 | 3,481 |
| **Net Loans** | $ 418,052 | $ 376,792 |

The Company grants residential, commercial, and consumer loans to customers throughout its trade area, which is concentrated in North Central Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2022 and 2021, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area. The bank also participated in the SBA Paycheck Protection Program Loan Program with 14 loans at $806,000 as of December 31, 2022 and 14 loans at $806,000 as of December 31, 2021, which are included in the commercial segment above.

## 4. Allowance for Loan Losses

Changes in the allowance for loan losses by portfolio segment are as follows (in thousands):

| *December 31, 2022* | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| **Beginning Balance** | **$ 845** | **690** | **1,343** | **60** | **543** | **3,481** |
| Charge-offs | **0** | **0** | **(1)** | **(11)** | **0** | **(12)** |
| Recoveries | **1** | **0** | **3** | **10** | **0** | **14** |
| Provision (credit) | **11** | **(61)** | **434** | **(29)** | **(197)** | **158** |
| **Ending Balance** | **$ 857** | **629** | **1,779** | **30** | **346** | **3,641** |

| *December 31, 2021* | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| **Beginning Balance** | $ 744 | $ 816 | $ 1,499 | $ 135 | $ 527 | $ 3,721 |
| Charge-offs | (50) | - | - | - | - | (50) |
| Recoveries | 4 | - | - | - | - | 4 |
| Provision | 147 | (126) | (156) | (75) | 16 | (194) |
| **Ending Balance** | $ 845 | $ 690 | $ 1,343 | $ 60 | $ 543 | $ 3,481 |

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, commercial real estate loans, residential real estate loans, and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a two-year period during 2022 and during 2021 for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to apply the adjusted factor to non-classified loans. The following qualitative factors are analyzed for each portfolio segment and are adjusted based upon relevant changes within the portfolio:

- Levels of and trends in delinquencies
- Trends in volume and terms
- Trends in credit quality ratings
- Changes in management and lending staff
- Economic trends
- Concentrations of credit

## *Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the consolidated balance sheet date. The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment evaluation method as of December 31, 2022 and 2021 (in thousands):

| *December 31, 2022* | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | |
| Individually evaluated for impairment | **$ 0** | **0** | **0** | **0** | **0** | **0** |
| Collectively evaluated for impairment | **857** | **629** | **1,779** | **31** | **345** | **3,641** |
| **Total** | **$ 857** | **629** | **1,779** | **31** | **345** | **3,641** |
| Loans: | | | | | | |
| Individually evaluated for impairment | **$ 0** | **0** | **0** | **0** | **0** | **0** |
| Collectively evaluated for impairment | **99,087** | **88,840** | **226,996** | **6,770** | **0** | **421,693** |
| **Total** | **$ 99,087** | **88,840** | **226,996** | **6,770** | **0** | **421,693** |

| *December 31, 2021* | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | |
| Individually evaluated for impairment | $ - | $ - | $ - | $ - | $ - | $ - |
| Collectively evaluated for impairment | 845 | 690 | 1,343 | 60 | 543 | 3,481 |
| **Total** | $ 845 | $ 690 | $ 1,343 | $ 60 | $ 543 | $ 3,481 |
| Loans: | | | | | | |
| Individually evaluated for impairment | $ 460 | $ - | $ - | $ - | $ - | $ 460 |
| Collectively evaluated for impairment | 99,441 | 86,344 | 188,704 | 5,324 | - | 379,813 |
| **Total** | $ 99,901 | $ 86,344 | $ 188,704 | $ 5,324 | $ - | $ 380,273 |

### *Credit Quality Information*

The Company's internally assigned loan grades are as follows:

Pass loans are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. There are five sub-grades within the pass category to further distinguish the loan.

Special Mention loans are loans for which a potential weakness or risk exists, which could cause a more serious problem if not corrected.

Substandard loans have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful loans have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

Loss loans are considered uncollectible, or of such value that continuance as an asset is not warranted.

The following tables represent credit exposures for commercial real estate and commercial loans by internally assigned grades for the years ended December 31, 2021 and 2020. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans (in thousands).

| *December 31, 2022* | Loans to States and Political Subdivisions | Other Commercial Loans | Loans for Investment Properties | Other Commercial Real Estate Loans | Total |
|---|---|---|---|---|---|
| Pass | **$ 22,881** | **72,357** | **26,432** | **61,500** | **183,170** |
| Special Mention | **0** | **4,280** | **0** | **908** | **4,756** |
| Substandard | **0** | **0** | **0** | **0** | **0** |
| Doubtful | **0** | **0** | **0** | **0** | **0** |
| Loss | **0** | **0** | **0** | **0** | **0** |
| **Total** | **$ 22,881** | **76,637** | **26,432** | **62,408** | **188,358** |

| *December 31, 2021* | Loans to States and Political Subdivisions | Other Commercial Loans | Loans for Investment Properties | Other Commercial Real Estate Loans | Total |
|---|---|---|---|---|---|
| Pass | $ 23,330 | $ 73,183 | $ 26,376 | $ 58,978 | $ 181,867 |
| Special Mention | - | 1,264 | - | 934 | 2,198 |
| Substandard | - | 2,124 | 56 | - | 2,180 |
| Doubtful | - | - | - | - | - |
| Loss | - | - | - | - | - |
| **Total** | $ 23,330 | $ 76,571 | $ 26,432 | $ 59,912 | $ 186,245 |

The Company evaluates credit quality for residential real estate and consumer loans based upon the aging status of the loan, which is presented below, and by payment activity. The following tables present performing and nonperforming residential real estate and consumer loans based on payment activity for the years ended December 31, 2022 and 2021 (in thousands):

| *December 31, 2022* | First Mortgages | Home Equity Loans | Consumer | Total |
|---|---|---|---|---|
| Performing | $ 196,955 | 29,154 | 6,770 | 232,879 |
| Nonperforming (Nonaccrual loans) | 838 | 49 | 0 | 887 |
| **Total** | $ 197,793 | 29,203 | 6,770 | 233,766 |

| *December 31, 2021* | First Mortgages | Home Equity Loans | Consumer | Total |
|---|---|---|---|---|
| Performing | $ 166,145 | $ 21,603 | $ 5,324 | $ 193,072 |
| Nonperforming (Nonaccrual loans) | 887 | 69 | - | 956 |
| **Total** | $ 167,032 | $ 21,672 | $ 5,324 | $ 194,028 |

Following are tables which include an aging analysis of the recorded investment of past-due loans as of December 31, 2022 and 2021 (in thousands):

| | Loans Past Due (Days) | | | | | |
|---|---|---|---|---|---|---|
| **2022** | **30-59** | **60-89** | **90+** | **Total** | **Current** | **Total Loans** |
| Commercial: | | | | | | |
| Obligations of states and political subdivisions | $ 90 | 0 | 0 | 90 | 22,791 | 22,881 |
| Other commercial loans | 26 | 0 | 0 | 26 | 76,180 | 76,206 |
| Commercial real estate: | | | | | | |
| Loans for investment property | 139 | 466 | 188 | 793 | 25,639 | 26,432 |
| Other commercial real estate loans | 0 | 0 | 0 | 0 | 62,408 | 62,408 |
| Residential mortgage loans: | | | | | | |
| First mortgages | 1,349 | 1,169 | 1,098 | 3,616 | 194,177 | 197,793 |
| Home equity loans | 89 | 229 | 58 | 376 | 28,827 | 29,203 |
| Consumer | 81 | 37 | 2 | 120 | 6,650 | 6,770 |
| **Total** | $ 1,774 | 1,901 | 1,346 | 5,021 | 416,672 | 421,693 |

| 2021 | Loans Past Due (Days) 30-59 | 60-89 | 90+ | Total | Current | Total Loans |
|---|---|---|---|---|---|---|
| Commercial: | | | | | | |
| Obligations of states and political subdivisions | $ 26 | $ - | $ - | $ 26 | $ 23,304 | $ 23,330 |
| Other commercial loans | 56 | - | - | 56 | 76,515 | 76,571 |
| Commercial real estate: | | | | | | |
| Loans for investment property | 147 | 194 | - | 341 | 26,091 | 26,432 |
| Other commercial real estate loans | - | - | - | - | 59,912 | 59,912 |
| Residential mortgage loans: | | | | | | |
| First mortgages | 2,303 | 40 | 93 | 2,436 | 164,596 | 167,032 |
| Home equity loans | 195 | 3 | 6 | 204 | 21,468 | 21,672 |
| Consumer | 20 | 4 | - | 24 | 5,300 | 5,324 |
| **Total** | $ 2,747 | $ 241 | $ 99 | $ 3,087 | $ 377,186 | $ 380,273 |

### *Impaired Loans*

Management evaluates commercial loans and commercial real estate loans which are 90 days or more past due and considers them to be impaired. Loans rated substandard or doubtful are also evaluated for impairment. These loans are analyzed to determine whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees, or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable, as of and for the years ending December 31 (in thousands):

| *December 31, 2022* | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial: | | | | | |
| Other commercial loans | $ **0** | **0** | **0** | **0** | **0** |
| Commercial real estate: | | | | | |
| Loans for investment properties | **0** | **0** | **0** | **0** | **0** |
| Residential real estate: | | | | | |
| First mortgages | **226** | **261** | **0** | **276** | **16** |
| With an allowance recorded: | | | | | |
| Commercial: | | | | | |
| Other commercial loans | **0** | **0** | **0** | **0** | **0** |
| Commercial real estate: | | | | | |
| Loans for investment properties | **0** | **0** | **0** | **0** | **0** |
| Residential mortgage loans: | | | | | |
| First mortgages | **0** | **0** | **0** | **0** | **0** |
| **Total** | $ **226** | **261** | **0** | **276** | **16** |

| *December 31, 2021* | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial: | | | | | |
| Other commercial loans | $ 460 | $ 994 | $ - | $ 559 | $ - |
| Commercial real estate: | | | | | |
| Loans for investment properties | - | - | - | - | - |
| Residential real estate: | | | | | |
| First mortgages | 310 | 347 | - | 315 | 18 |
| With an allowance recorded: | | | | | |
| Commercial: | | | | | |
| Other commercial loans | - | 0 | - | - | - |
| Commercial real estate: | | | | | |
| Loans for investment properties | - | 0 | - | - | - |
| Residential mortgage loans: | | | | | |
| First mortgages | - | 0 | - | - | - |
| **Total** | $ 770 | $ 1,341 | $ - | $ 874 | $ 18 |

### *Nonaccrual Loans*

Loans are considered for nonaccrual status when they are 90 days past due. When a loan is placed on nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

The following tables present loans that are on nonaccrual status and that are 90 days past due and still accruing interest by portfolio segment as of December 31 (in thousands):

| *December 31, 2022* | **Nonaccrual** | **Past Due 90 Days or More and Still Accruing** |
|---|---|---|
| Commercial: | $ | |
| Obligations of states and political subdivisions | **0** | **0** |
| Other commercial loans | **0** | **0** |
| Commercial real estate: | | |
| Loans for investment properties | **0** | **0** |
| Other commercial real estate loans | **0** | **0** |
| Residential mortgage loans: | | |
| First mortgages | **838** | **748** |
| Home equity loans | **49** | **58** |
| Consumer loans | **0** | **2** |
| | **$ 887** | **808** |

| *December 31, 2021* | Nonaccrual | Past Due 90 Days or More and Still Accruing |
|---|---|---|
| Commercial: | | $ |
| Obligations of states and political subdivisions | $ - | - |
| Other commercial loans | 460 | - |
| Commercial real estate: | | |
| Loans for investment properties | - | - |
| Other commercial real estate loans | - | - |
| Residential mortgage loans: | | |
| First mortgages | 887 | - |
| Home equity loans | 69 | - |
| Consumer loans | - | - |
| | $ 1,416 | $ - |

Interest income on nonaccrual loans not recognized during 2022 and 2021 was $69,000 and $67,000, respectively.

The Bank identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

TDRs may be designated as performing or non-performing. A TDR may be designated as performing if the loan has demonstrated sustained performance under the modified terms. The period of sustained performance may include the periods prior to modification if prior performance met or exceeded the modified terms. For non-performing restructured loans, the loan will remain on non-accrual status until the borrower demonstrates a sustained period of performance, generally six consecutive months of payments. The Bank had $226,000 and $310,000 in total performing restructured loans as of December 31, 2022 and 2021, respectively. During the year ended December 31, 2022 and 2021, the Bank did not have any loans classified as troubled debt restructurings that subsequently defaulted.

There was no troubled debt restructuring activity for the Bank during 2022 and 2021 periods, respectively.

*Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

## 5. Premises and Equipment

Major classifications of premises and equipment are summarized as follows (in thousands):

| *December 31,* | 2022 | 2021 |
|---|---|---|
| Land and improvements | $ **1,969** | $ 1,969 |
| Buildings and improvements | **10,267** | 10,338 |
| Furniture, fixtures and equipment | **5,295** | 4,976 |
| | **17,531** | 17,283 |
| Less accumulated depreciation | **8,786** | 8,225 |
| **Total** | $ **8,745** | $ 9,058 |

Depreciation expense for the years ended December 31, 2022 and 2021 was $609,000 and $634,000, respectively.

## 6. Leases

In the normal course of business, the Company leases a property for one of its branch locations. This lease has a remaining term of eight years with no renewal options remaining. This lease was classified as an operating lease as of the commencement date. Lease expense for operating leases is recognized on a straight line basis over the lease term. Right-of-use assets represent our right to use an underlying asset for the lease term, and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors. The incremental borrowing rate used at lease commencement was 3.00%.

Right-of-use assets and lease liabilities by lease type and associated balance sheet captions are as follows (in thousands):

| | Balance Sheet Classification | December 31, 2022 | 2021 |
|---|---|---|---|
| Right-of-use asset: | | | |
| Operating Lease | Buildings and Improvements | **309** | $368 |
| Lease liability: | | | |
| Operating Lease | Other Liabilities | **309** | $368 |

*Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

Future undiscounted lease payments as of December 31, 2022 are as follows (in thousands):

| *Year Ending December 31,* | |
|---|---|
| 2023 | $ 70 |
| 2024 | 70 |
| 2025 | 70 |
| 2026 | 70 |
| 2027 | 70 |
| Thereafter | 290 |
| Total undiscounted lease payments | 640 |
| Less: imputed interest | (331) |
| Net lease Liability | $ 309 |

## 7. Deposits

The components of deposits at December 31, 2022 and 2021 are as follows (in thousands):

| *December 31,* | 2022 | 2021 |
|---|---|---|
| Demand, noninterest-bearing | $ **150,583** | $ 152,391 |
| Demand, interest-bearing | **108,924** | 98,905 |
| Savings | **112,591** | 116,525 |
| Money Market Accounts | **127,426** | 151,730 |
| Time, $250 and over | **24,166** | 19,681 |
| Time, other | **98,535** | 89,694 |
| **Total** | $ **622,225** | $ 628,926 |

Time deposits and their remaining maturities at December 31, 2022 are as follows (in thousands):

| *Year Ending December 31,* | |
|---|---|
| 2023 | $ 59,504 |
| 2024 | 25,037 |
| 2025 | 29,341 |
| 2026 | 5,770 |
| 2027 | 2,801 |
| Thereafter | 248 |
| | $ 122,701 |

## 8. Borrowings and Subordinated Debt

*Borrowings*

Borrowings at December 31, 2022 and 2021 consisted of the following advances from the Federal Home Loan Bank (dollars in thousands):

| Maturity Date | Interest Rate | December 31, 2022 | December 31, 2021 |
|---|---|---|---|
| March 7, 2022 | **0.909%** | | 1,000 |
| January 17, 2023 | **4.506%** | **4,000** | |
| January 25, 2023 | **4.474%** | **2,500** | |
| February 27, 2023 | **4.655%** | **2,500** | |
| March 27, 2023 | **4.776%** | **2,000** | |
| December 8, 2023 | **2.936%** | **2,000** | |
| **Total** | | **$ 13,000** | $ 1,000 |

Each advance is payable at its maturity date, with a prepayment penalty for fixed rate advances. The advances were collateralized by $315,507,000 and $318,218,000 of mortgage and non-mortgage loans under a blanket lien arrangement at December 31, 2022 and December 31, 2021, respectively. Based on this collateral, and the Company's holding of FHLB stock, the Company is eligible to borrow up to $247,288,000 at December 31, 2022. Additionally, the Company had unused unsecured lines of credit with correspondent banks which provided another $11,000,000 of available credit at December 31, 2022.

*Subordinated Debt*

In June 2021, the Company issued $10 million of subordinated debt. The subordinated debt has a term of 10 years, maturing in June 2031, and a contractual fixed interest rate of 4.50% through June 30, 2026. The effective rate is 4.70%, which includes the amortization of issuance costs. Subsequent to June 30, 2026, the interest rate will be floating, based on the 90-day average Secured Overnight Financing Rate ("SOFR") plus 382 basis points. Interest is paid semi-annually in June and December. The Company may redeem or prepay any or all of the subordinated debt, in whole or in part, without premium or penalty, at any time on or after June 30, 2026, and prior to the maturity date at a price of 100% of the principal amount, plus interest accrued and unpaid to the date of redemption or prepayment.

## 9. Employee Stock Ownership Plan

The Company established an Employee Stock Ownership Plan in 2021 to provide additional benefits to employees. In 2021 the ESOP borrowed money from the Company to purchase 24,307 shares of stock at $38.00 per share. In 2022 the ESOP borrowed money from the Company to purchase 24,307 shares of stock at $37.00 per share. The Company makes discretionary contributions to the ESOP, as well as paying dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. In 2022, the total expense was 10% of qualifying compensation, or approximately $604,000. Dividends on allocated shares increase participant accounts.

Participants receive their allocated shares at the end of employment. A participant may require stock received to be repurchased unless the stock is traded on an established market.

| Shares held by the ESOP were as follows: | 2022 | 2021 |
|---|---|---|
| Allocated to participants | 24,639 | 8,942 |
| Unallocated | 23,975 | 15,365 |
| Total ESOP shares | 48,614 | 24,307 |

| | |
|---|---|
| Fair value of unearned shares at December 31, 2022 | $794,771 |

## 10. Revenue Recognition

All the revenue from contracts with customers, within the scope of ASC 606 is recognized in Non Interest Income. The following table presents the Company's sources of Non-Interest Income for the years ended December 31, 2022 and 2021, respectively. Items outside the scope of ASC 606 are noted as such.

| *December 31,* | **2022** | 2021 |
|---|---|---|
| Non-Interest Income | | |
| Service Charges on Deposit Accounts | $ **401** | $ 341 |
| Trust Services - Asset Management | **1,011** | 947 |
| Trust Services - Estate Settlement | **5** | 24 |
| Debit Card Income | **1,036** | 1,058 |
| Insurance and Investment Management Fees | **250** | 179 |
| ATM Service Charge Income | **66** | 61 |
| Loan Servicing income | **400** | 417 |
| Gains on Sale of Loans* | **226** | 1,363 |
| Earnings on Bank-Owned Life Insurance* | **332** | 340 |
| Investment Security Gains (Losses)* | **(35)** | 207 |
| Other | **326** | 697 |
| **Total** | $ **4,018** | $ 5,634 |

"*" Not within the scope of ASC 606

Sources of revenue for the Company which fall within the scope of ASC 606 are described as follows:

- Service Charges on Deposit Accounts – The Bank earns fees from its deposit customers for various services, including transaction-based services and periodic account maintenance. Transaction based services include, but are not limited to stop payment fees, overdraft fees, check cashing fees, wire transfer fees, and early withdrawal penalties. Maintenance fees include account maintenance fees, minimum balance fees, and monthly service charge. Transaction based fees are only recognized when the transaction is complete, and maintenance fees are recognized when the period of the obligation is complete.

- Trust Services
    - Asset Management - The Trust department receives fees for providing trust related services including Investment Management, Security Custody, and Other Trust Services. These fees are based upon the value of assets under management and are assessed using a tiered rate schedule. Fees are recognized on a monthly basis when the service obligation is complete. These fees are recognized in trust services income on the Consolidated Statement of Income.

    - Estate Settlement – The trust department provides estate settlement services. These fees are based on the estimated fair value of the estate according to a tiered rate schedule. Each estate is unique in the nature, size, and complexity, and may include many tasks or milestones to complete. Fees are recognized in proportion to the number of milestones completed which is a judgement made by the trust management team. These fees are included in trust services income on the Consolidated Statements of Income.

- Debit Card Income – The Bank provides electronic funds transfer processing services for the debit cards it offers to its customers. The Bank earns interchange fees from each cardholder transaction conducted through various networks. The fees are transaction based and are earned when the transaction is complete. These fees are recognized in other income on the Consolidated Statements of Income.

- Insurance and Investment Service Fees – The Company sells investments and insurance through its Trust and Wealth Management division. Commissions from the sale of these products are recognized upon the completion of the transaction. These fees are recognized in other income on the Consolidated Statements of Income.

- ATM Service Charges – ATM service charges are earned when non customers use Bank ATMs. These fees are recognized when the transaction is complete. These fees are recognized in other income on The Consolidated Statements of Income.

- Gains/ Losses on the Sale of Other Real Estate – these assets are de-recognized when control of the property transfers to the buyer. These gains/losses are included in other income on the Consolidated Statements of Income.

*Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

## 11. Income Taxes

The provision for Federal income taxes consists of (in thousands):

| *December 31,* | 2022 | 2021 |
|---|---|---|
| Current expense | $ **434** | $ 959 |
| Deferred (benefit) | **0** | (187) |
| **Total** | $ **434** | $ 772 |

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities, respectively, at December 31 are as follows (in thousands):

| *December 31,* | 2022 | 2021 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for loan losses | $ **765** | $ 731 |
| Nonaccrual loan interest | **147** | 133 |
| Lease liability | **65** | 77 |
| Unrealized loss on investment securities | **4,873** | 87 |
| Other | **145** | 157 |
| Total gross deferred tax assets | **5,995** | 1,185 |
| Deferred tax liabilities: | | |
| Premises and equipment | **172** | 152 |
| Investment accretion | **18** | 6 |
| Loan origination fees and costs | **113** | 88 |
| Mortgage servicing rights | **102** | 119 |
| Right of use asset | **65** | 77 |
| Other | **8** | 12 |
| Total gross deferred tax liabilities | **478** | 454 |
| **Net Deferred Tax Asset/(Liability)** | $ **5,517** | $ 731 |

No valuation allowance was established at December 31, 2022 and 2021, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential. Net deferred tax assets are included in Accrued Interest and Other Assets on the consolidated balance sheets.

*Notes to Consolidated Financial Statements for December 31, 2022 and 2021*

The following is a reconciliation of the federal statutory rate and the Company's effective income tax rate for the years ended December 31 (dollars in thousands):

| | 2022 | | 2021 | |
|---|---|---|---|---|
| | Amount | Percent of Pretax Income | Amount | Percent of Pretax Income |
| Provision at statutory rate | **$ 732** | **21.0 %** | $ 1,055 | 21.0 % |
| Effect of tax-exempt income | **(246)** | **(7.1)** | (222) | (4.4) |
| Nondeductible interest expense | **14** | **0.4** | 8 | 0.2 |
| Bank Owned Life Insurance | **(70)** | **(2.0)** | (71) | (1.4) |
| Other | **4** | **0.1** | 2 | 0.0 |
| **Actual Tax Expense and Effective Rate** | **$ 434** | **12.4 %** | $ 772 | 15.4 % |

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated statements of income. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2019.

## 12. Commitments and Contingencies

In the normal course of business, the Company makes various commitments that are not reflected in the accompanying consolidated financial statements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments is represented by the contractual amounts as disclosed. Losses, if any, are charged to the allowance for loan losses. The Company minimizes its exposure to credit loss under these commitments by subjecting them to credit approval, review procedures, and collateral requirements as deemed necessary.

The off-balance sheet commitments consisted of the following (in thousands):

| *December 31,* | 2022 | 2021 |
|---|---|---|
| Commitments to extend credit | **$ 117,222** | $ 105,768 |
| Standby letters of credit | **4,934** | 4,695 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. These commitments are composed primarily of available commercial lines of credit and mortgage loan commitments. The Company uses the same credit policies in making loan commitments and conditional obligations as it does for on-balance sheet instruments. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary, is based upon management's credit evaluation in compliance with the Company's lending policy guidelines. Customers use credit commitments to ensure funds will be available for working capital purposes, for capital expenditures, and to ensure access to funds at specified terms and conditions.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Performance letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid or performance-related contracts. The coverage period for these instruments is typically a one-year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically company deposit instruments or customer business assets.

## 13. Accumulated Other Comprehensive Loss

The following tables present the changes in accumulated other comprehensive loss by component net of tax for the years ended December 31, 2022 and 2021 (in thousands):

| | Unrealized Gains (Losses) on Available-for-Sale Securities |
|---|---|
| **Balance as of December 31, 2020** | $ 2,358 |
| Other comprehensive income before reclassification | (2,522) |
| Amount reclassified from accumulated other comprehensive loss | (164) |
| Total other comprehensive income | (2,686) |
| **Balance as of December 31, 2021** | (328) |
| Other comprehensive income before reclassification | **(18,055)** |
| Amount reclassified from accumulated other comprehensive loss | **28** |
| Total other comprehensive income | **(18,027)** |
| **Balance as of December 31, 2022** | **$ (18,355)** |

The following table presents significant amounts reclassified out of accumulated other comprehensive loss for the years ended December 31, 2022 and 2021 (in thousands):

| | Amount Reclassified from Accumulated Other Comprehensive Loss | | Affected Line Item in the Consolidated Statements of Income |
|---|---|---|---|
| | **2022** | **2021** | |
| Unrealized gains on available-for-sale securities: | | | |
| | **$ 35** | $ (207) | Investment securities gains, net |
| | **(7)** | 43 | Income taxes |
| | **$ 28** | $ (164) | Net of tax |

## 14. Regulatory Matters

### *Cash and Due from Banks*

The Bank is required to maintain average cash reserve balances in vault cash or with the Federal Reserve Bank. There are no required reserves at December 31, 2022 or December 31, 2021.

### *Loans*

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific collateral. Further, such secured loans are limited in amount to 10 percent of the Bank's common stock and capital surplus.

### *Dividends*

The Company is subject to a dividend restriction that generally limits the amount of dividends that can be paid by a national bank. Prior approval of the Office of the Comptroller of the Currency ("OCC") is required if the total of all dividends declared by a national bank in any calendar year exceeds net profits, as defined for the year, combined with its retained net profits for the two preceding calendar years less any required transfers to surplus. Using this formula, the amount available for payment of dividends by the Bank in 2022, without approval of the OCC, is approximately $5,438,000 plus 2022 net profits retained up to the date of the dividend declaration.

### *Capital Requirements*

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the 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 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 the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Information presented for December 31, 2022 and 2021, reflects the Basel III capital requirements. Under these capital requirements and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk-weightings and other factors.

The risk-based capital rules adopted effective January 1, 2015 require that banks and holding companies maintain a "capital conservation buffer" of 250 basis points in excess of the "minimum capital ratio." The minimum capital ratio is equal to the prompt corrective action adequately capitalized threshold ratio. The capital conservation buffer is 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

Effective January 1, 2022, the capital levels required for the Bank to avoid these limitations were as follows:

- Common Equity Tier 1 capital ratio of 7.00%
- Tier 1 risk based capital ratio of 8.50%
- Total risk based capital ratio of 10.50%

As of December 31, 2022, the Bank had a conservation buffer greater than 2.5%.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2022 and 2021, the OCC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be classified as a well-capitalized financial institution, Common equity Tier 1, Total risk-based, Tier I risk-based, and Tier I leverage capital ratios must be at least 6.5 percent, 10.0 percent, 8.0 percent, and 5.0 percent, respectively.

The following table presents the Bank's Capital Ratios as of the dates indicated (dollars in thousands).

| | Actual | | To be Adequately Capitalized under Prompt Corrective Action Provisions | | To be Well Capitalized under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| **2022** | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| Common equity Tier 1 (total risk-weighted assets) | **$ 65,411** | **15.52%** | **≥18,965** | **≥4.5%** | **≥27,393** | **≥6.5%** |
| Total capital (to risk-weighted assets) | **69,052** | **16.39%** | **≥33,715** | **≥8.0%** | **≥42,143** | **≥10.0%** |
| Tier I capital (to risk-weighted assets) | **65,411** | **15.52%** | **≥25,286** | **≥6.0%** | **≥33,715** | **≥8.0%** |
| Tier I capital (to average assets) | **65,411** | **8.39%** | **≥27,218** | **≥4.0%** | **≥34,023** | **≥5.0%** |
| **2021** | | | | | | |
| Common equity Tier 1 (total risk-weighted assets) | $ 62,596 | 16.34% | $ ≥17,241 | ≥4.5% | $ ≥24,904 | ≥6.5% |
| Total capital (to risk-weighted assets) | 66,077 | 17.25% | ≥30,651 | ≥8.0% | ≥38,314 | ≥10.0% |
| Tier I capital (to risk-weighted assets) | 62,596 | 16.34% | ≥22,988 | ≥6.0% | ≥30,651 | ≥8.0% |
| Tier I capital (to average assets) | 62,596 | 9.12% | ≥27,449 | ≥4.0% | ≥34,312 | ≥5.0% |

## 15. Fair Value Measurements

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

> ***Level 1:*** Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
>
> ***Level 2***: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
>
> ***Level 3***: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

The following tables present the assets measured on a recurring basis on the consolidated balance sheets at their fair value as of December 31, 2022 and 2021, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands).

| *December 31, 2022* | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets measured on a recurring basis: | | | | |
| Investment securities available-for-sale: | | | | |
| Obligations of states and political subdivisions | $ - | $ 74,009 | $ - | $ 74,009 |
| Mortgage-backed securities in government-sponsored entities | - | 141,999 | - | 141,999 |
| Equity securities in financial institutions | 207 | - | - | 207 |
| **Total** | $ 207 | $ 216,008 | $ - | $ 216,215 |

| | | | | |
|---|---|---|---|---|
| Assets measured on a recurring basis: | | | | |
| Investment securities available-for-sale: | | | | |
| Obligations of states and political subdivisions | $ - | $ 86,092 | $ - | $ 86,092 |
| Mortgage-backed securities in government-sponsored entities | - | 169,350 | - | 169,350 |
| Equity securities in financial institutions | 216 | - | - | 216 |
| **Total** | $ 216 | $ 255,442 | $ - | $ 255,658 |

## 16. Fair Value of Financial Instruments

The fair values at December 31 of the Company's financial instruments are as follows (in thousands):

| *December 31, 2022* | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|
| **Financial Assets:** | | | | | |
| Cash and cash equivalents | $ **17,409** | **17,409** | **17,409** | | |
| Investment securities: | | | | | |
| Available-for-sale | **2**[A15][A16]**1 6,008** | **216,008** | | **216,008** | |
| Held-to-maturity | **2,**[A17][A18] **038** | **2,021** | | **2,021** | |
| Equity securities | **207** | **207** | **207** | | |
| Loans held for sale | **350** | **350** | **350** | | |
| Net loans | [A19][A20]**42 1,693** | **396,991** | | | **396,991** |
| Restricted stock | **2,799** | **N/A** | **N/A** | **N/A** | |
| Mortgage servicing rights | **486** | **1,336** | | **1,336** | |
| Accrued interest receivable | **2,107** | **2,107** | | **2,107** | |
| **Financial Liabilities:** | | | | | |
| Deposits | **622,225** | **561,498** | | **561,498** | |
| Borrowings | **13,000** | **13,000** | | **13,000** | |
| Accrued interest payable | **151** | **151** | | **151** | |

| *December 31, 2021* | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|
| **Financial Assets:** | | | | | |
| Cash and cash equivalents | $ 35,615 | $ 35,615 | $ 35,615 | $ - | $ - |
| Investment securities: | | | | | |
| Available-for-sale | 255,442 | 255,442 | - | 255,442 | - |
| Held-to-maturity | 779 | 780 | - | 780 | - |
| Equity securities | 216 | 216 | 216 | - | - |
| Loans held for sale | 2,979 | 2,979 | 2,979 | - | - |
| Net loans | 376,792 | 400,982 | - | - | 400,982 |
| Restricted stock | 2,450 | N/A | N/A | N/A | N/A |
| Mortgage servicing rights | 568 | 1,002 | - | 1,002 | - |
| Accrued interest receivable | 1,824 | 1,824 | - | 1,824 | - |
| **Financial Liabilities:** | | | | | |
| Deposits | 628,926 | 629,766 | - | 629,766 | - |
| Borrowings | 1,000 | 1,000 | - | 1,000 | - |
| Accrued interest payable | 74 | 74 | - | 74 | - |

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract that creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas. As many of these assumptions result from judgments made by management based upon estimates that are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

In accordance with Accounting Standards Update (ASU) 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*, the Company has considered the exit price notion when measuring the fair value of financial instruments.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

***Investment Securities***

The fair market value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair values for certain corporate bonds were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

***Mortgage Servicing Rights***

The fair value for mortgage servicing rights is estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon rates generally charged for such loans with similar characteristics.

***Commitments to Extend Credit and Commercial Letters of Credit***

These financial instruments are generally not subject to sale, and estimated fair values are not readily available.

The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 11.

## 17. Related Party Transactions

Certain officers, directors and other related parties have loans and conduct other transactions with the Company. Deposits of related parties totaled $4,889,000 and $4,259,000 at December 31, 2022 and 2021, respectively. The aggregate dollar amount of loans to related parties, along with an analysis of the activity for December 31, 2022 and 2021 are as follows (in thousands):

| *December 31,* | **2022** | 2021 |
|---|---|---|
| Balance, beginning | **$ 14,230** | $ 15,999 |
| Additions | **485** | 109 |
| Repayments | **(1,233)** | (1,547) |
| Effect of changes in composition of related parties | **0** | (331) |
| Balance, ending | **$ 13,482** | $ 14,230 |

## 18. Subsequent Events

Management has reviewed events occurring through April 20, 2023, the date the financial statements were available to be issued for items that should potentially be recognized or disclosed in these consolidated financial statements.