

DIMECO, INC.
HONESDALE, PENNSYLVANIA

AUDIT REPORT
DECEMBER 31, 2023

DIMECO, INC.
AUDITED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2023

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INDEPENDENT AUDITOR’S REPORT

Board of Directors and Shareholders
Dimeco, Inc.
Honesdale, Pennsylvania

Opinion

We have audited the accompanying consolidated financial statements of Dimeco, Inc. and its subsidiary (the “Company”), which comprise the consolidated balance sheets as of December 31, 2023 and 2022; the related consolidated statements of income, comprehensive income (loss), changes in stockholders’ equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements (collectively, the financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2023 and 2022, 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 the Company 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.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company changed its method of accounting for credit losses effective January 1, 2023, due to the adoption of Accounting Standards Codification (ASC) Topic 326, *Financial Instruments – Credit Losses*. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 financial statements that are free from material misstatement, whether due to fraud or error.

PITTSBURGH, PA
2009 Mackenzie Way • Suite 340
Cranberry Township, PA 16066
(724) 934-0344

PHILADELPHIA, PA
2100 Renaissance Blvd. • Suite 110
King of Prussia, PA 19406
(610) 278-9800

WHEELING, WV
980 National Road
Wheeling, WV 26003
(304) 233-5030

STEUBENVILLE, OH
511 N. Fourth Street
Steubenville, OH 43952
(304) 233-5030

S.R. Snodgrass, P.C. d/b/a S.R. Snodgrass, A.C. in West Virginia



Responsibilities of Management for the Financial Statements (Continued)

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 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 the Company'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 financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company'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 Included in Annual Report

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.



Other Information Included in Annual Report (Continued)

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 whether 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.

B. R. Brockhaus, P.C.

Cranberry Township, Pennsylvania
March 14, 2024

CONSOLIDATED BALANCE SHEET

(in thousands, except shares and per share data)	December 31,	
	2023	2022
Assets		
Cash and due from banks	\$ 8,047	\$ 6,262
Interest-bearing deposits in other banks	661	1,735
Total cash and cash equivalents	8,708	7,997
Investment securities available for sale	197,086	218,768
Equity securities	52	55
Loans, net of unearned income	722,446	679,072
Less allowance for credit losses	10,807	10,588
Net loans	711,639	668,484
Premises and equipment	20,154	20,558
Accrued interest receivable	3,788	3,308
Bank-owned life insurance	27,345	26,732
Other real estate owned	224	224
Other assets	20,965	23,441
TOTAL ASSETS	\$ 989,961	\$ 969,567
Liabilities		
Deposits:		
Noninterest-bearing	\$ 178,553	\$ 193,322
Interest-bearing	647,987	594,252
Total deposits	826,540	787,574
Short-term borrowings	15,677	65,164
Other borrowed funds	34,466	14,890
Accrued interest payable	759	214
Other liabilities	13,941	13,712
TOTAL LIABILITIES	891,383	881,554
Stockholders' Equity		
Common stock, \$.50 par value; 7,500,000 shares authorized; 2,647,587 and 2,643,220 shares issued in 2023 and 2022; 2,534,119 and 2,554,752 shares outstanding in 2023 and 2022, respectively	1,324	1,322
Capital surplus	11,002	10,631
Retained earnings	105,761	98,799
Accumulated other comprehensive loss	(15,977)	(20,030)
Treasury stock, at cost (113,468 and 88,468 shares, in 2023 and 2022, respectively)	(3,532)	(2,709)
TOTAL STOCKHOLDERS' EQUITY	98,578	88,013
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 989,961	\$ 969,567

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

(in thousands, except per share data)	Year Ended December 31,		
	2023	2022	2021
Interest Income			
Interest and fees on loans	\$ 40,268	\$ 32,616	\$ 31,182
Investment securities:			
Taxable	5,753	3,869	2,367
Exempt from federal income tax	1,810	1,796	1,603
Other	436	297	258
Total interest income	48,267	38,578	35,410
Interest Expense			
Deposits	10,705	2,892	1,833
Short-term borrowings	2,779	424	41
Other borrowed funds	808	453	1,594
Total interest expense	14,292	3,769	3,468
Net Interest Income	33,975	34,809	31,942
Provision (credit) for credit losses	833	(825)	1,200
Net Interest Income After Provision (Credit) for Credit Losses	33,142	35,634	30,742
Noninterest Income			
Service charges on deposit accounts	1,227	1,077	968
Mortgage loans held for sale gains, net	175	184	587
Investment securities (losses) gains, net	(40)	(860)	225
Equity security (losses) gains, net	(3)	3	5
Brokerage commissions	2,138	2,171	1,993
Earnings on bank-owned life insurance	613	584	522
Debit card interchange fees	1,901	1,721	1,666
Other income	673	76	179
Total noninterest income	6,684	4,956	6,145
Noninterest Expense			
Salaries and employee benefits	15,850	14,861	13,269
Occupancy expense, net	2,433	2,925	1,896
Professional fees	1,061	1,378	1,599
Data processing expense	1,761	1,604	1,372
Communication expense	303	469	455
ATM expense	780	648	546
PA shares tax	350	339	512
Other expense	4,261	3,538	3,130
Total noninterest expense	26,799	25,762	22,779
Income before income taxes	13,027	14,828	14,108
Income taxes	2,199	2,487	2,156
NET INCOME	\$ 10,828	\$ 12,341	\$ 11,952
Earnings Per Share:			
Basic	\$ 4.27	\$ 4.86	\$ 4.73
Diluted	\$ 4.27	\$ 4.85	\$ 4.72

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(in thousands)	Year Ended December 31,		
	2023	2022	2021
Net income	\$ 10,828	\$ 12,341	\$ 11,952
Other comprehensive income (loss) :			
Unrealized gain (loss) on available for sale securities	5,118	(28,422)	(2,967)
Tax effect	(1,075)	5,969	623
	4,043	(22,453)	(2,344)
Investment securities losses (gains), net	40	860	(225)
Tax effect	(8)	(181)	47
	32	679	(178)
Unrealized gain on derivative	-	54	20
Tax effect	-	(11)	(4)
	-	43	16
Reclassification adjustment for (gains) losses on derivatives included in net income	(28)	(32)	8
Tax effect	6	7	(2)
	(22)	(25)	6
Other comprehensive income (loss)	4,053	(21,756)	(2,500)
Comprehensive income (loss)	\$ 14,881	\$ (9,415)	\$ 9,452

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands, except shares and per share data)	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2020	\$ 1,293	\$ 9,158	\$ 82,999	\$ 4,226	\$ (2,061)	\$ 95,615
Net income			11,952			11,952
Other comprehensive loss				(2,500)		(2,500)
Stock compensation expense		135				135
Purchase of treasury stock (18,000 shares)					(648)	(648)
Exercise of stock options (39,794 shares)	20	915				935
Employee stock purchase plan (2,584 shares)	1	89				90
Employee stock bonus plan (120 shares)		4				4
Issuance of 5,600 shares for restricted stock plan	3	(3)				-
Cash dividends (\$1.88 per share)			(4,772)			(4,772)
Balance, December 31, 2021	\$ 1,317	\$ 10,298	\$ 90,179	\$ 1,726	\$ (2,709)	\$ 100,811
Net income			12,341			12,341
Other comprehensive loss				(21,756)		(21,756)
Stock compensation expense		166				166
Exercise of stock options (1,690 shares)	1	61				62
Employee stock purchase plan (2,582 shares)	1	109				110
Issuance of 5,300 shares for restricted stock plan	3	(3)				-
Cash dividends (\$1.46 per share)			(3,721)			(3,721)
Balance, December 31, 2022	\$ 1,322	\$ 10,631	\$ 98,799	\$ (20,030)	\$ (2,709)	\$ 88,013
Net income			10,828			10,828
Adjustment for CECL adoption			50			50
Other comprehensive income				4,053		4,053
Stock compensation expense		225				225
Exercise of stock options (730 shares)		26				26
Employee stock purchase plan (3,637 shares)	2	120				122
Purchase of treasury stock (25,000 shares)					(823)	(823)
Cash dividends (\$1.54 per share)			(3,916)			(3,916)
Balance, December 31, 2023	<u>\$ 1,324</u>	<u>\$ 11,002</u>	<u>\$ 105,761</u>	<u>\$ (15,977)</u>	<u>\$ (3,532)</u>	<u>\$ 98,578</u>

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	Year Ended December 31,		
	2023	2022	2021
Operating Activities			
Net income	\$ 10,828	\$ 12,341	\$ 11,952
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision (credit) for credit losses	833	(825)	1,200
Depreciation and amortization	1,070	902	758
Amortization of premium and discount on investment securities, net	872	1,247	1,081
Accretion of net deferred loan origination fees	(414)	(1,485)	(2,855)
Investment securities losses (gains), net	40	860	(225)
Equity securities losses (gains), net	3	(3)	(5)
Origination of loans held for sale	(5,784)	(8,138)	(17,512)
Proceeds from sale of loans	5,959	8,322	18,099
Mortgage loans held for sale gains, net	(175)	(184)	(587)
Gain on the sale of other real estate owned	-	-	(18)
(Increase) decrease in accrued interest receivable	(480)	(480)	59
Increase (decrease) in accrued interest payable	545	92	(71)
Deferred federal income taxes	(111)	389	(334)
Earnings on bank-owned life insurance	(613)	(584)	(522)
Stock compensation expense	225	166	135
Increase (decrease) in prepaid federal income taxes	81	(161)	23
Other, net	157	1,617	1,561
Net cash provided by operating activities	13,036	14,076	12,739
Investing Activities			
Investment securities available for sale:			
Proceeds from sales or calls	10,361	8,228	10,639
Proceeds from maturities or paydown	20,802	22,487	22,665
Purchases	(5,235)	(58,313)	(88,953)
Redemption of Federal Home Loan Bank stock	8,829	3,696	1,742
Purchase of Federal Home Loan Bank stock	(8,039)	(5,179)	(367)
Net increase in loans	(43,005)	(20,440)	(9,984)
Purchase of fixed annuity	-	-	(3,000)
Redemption of fixed annuity	-	2,185	-
Purchase of bank-owned life insurance	-	-	(4,288)
Purchase of premises and equipment	(542)	(6,361)	(2,860)
Net cash used for investing activities	(16,829)	(53,697)	(74,406)
Financing Activities			
Net increase (decrease) in deposits	38,966	(9,342)	110,501
(Decrease) increase in short-term borrowings	(49,487)	62,664	(20,700)
Proceeds from other borrowed funds	26,902	-	-
Repayment of other borrowed funds	(7,326)	(29,439)	(21,655)
Purchase of treasury stock	(823)	-	(648)
Proceeds from exercise of stock options	26	62	935
Proceeds from employee stock purchase and stock bonus plan	122	110	94
Cash dividends paid	(3,876)	(4,937)	(3,438)
Net cash provided by financing activities	4,504	19,118	65,089
Increase (decrease) in cash and cash equivalents	711	(20,503)	3,422
Cash and cash equivalents at beginning of year	7,997	28,500	25,078
Cash and cash equivalents at end of year	\$ 8,708	\$ 7,997	\$ 28,500

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Nature of Operations and Basis of Presentation

Dimeco, Inc. (the “Company”) is a Pennsylvania company organized as the holding company of The Dime Bank (the “Bank”). The Bank is a state-chartered bank and operates from seven locations in northeastern Pennsylvania. The Company and its subsidiary derive substantially all of their income from banking and bank-related services that include interest earnings on residential real estate, commercial mortgage, commercial and consumer financing as well as interest earnings on investment securities. The Company, through its subsidiary, provides deposit services including checking, savings and certificate of deposit accounts and investment services. The Company is supervised by the Federal Reserve Board, while the Bank is subject to regulation and supervision by the Federal Deposit Insurance Corporation (“FDIC”) and the Pennsylvania Department of Banking.

The consolidated financial statements of the Company include its wholly owned subsidiary, the Bank. All inter-company items have been eliminated in preparing the consolidated financial statements. The investment in subsidiary on the parent company financial statements is carried at the parent company’s equity in the underlying net assets of the Bank. Wealth management assets held by the Bank in fiduciary or agency capacities for its customers are not included in the accompanying Consolidated Balance Sheet, since such items are not assets of the Bank or the Company. In accordance with industry practice, wealth management fees are recorded on a cash basis and approximate the fees that would have been recognized on the accrual basis.

The consolidated financial statements have been prepared in conformity with U.S. GAAP. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the consolidated balance sheet date and revenues and expenses for the period. 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 available for sale. Debt securities have been classified as available for sale to serve principally as a source of liquidity. 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 and included in noninterest income. Amortization of premium and discounts for U.S. government agencies, obligations of states and political subdivisions and corporate securities use the constant yield method. Amortization of premium and discounts for collateralized mortgage obligations is a two-step proration method. This method uses a proration component and the calculated final amortization/accretion date. Mortgage-backed securities and Small Business Administration (“SBA”) securities also use a two-step proration method that has a proration component and a three-month historical constant pre-payment rate (“CPR”) and periodic discounted cash flow yield. The SBA securities are included in the U.S. government agency category. Interest and dividends on investment securities are recognized as income when earned.

Allowance for Credit Losses – Available for Sale Securities

The Company measures available-for-sale debt securities in an unrealized loss position, on at least a quarterly basis, for impairment. An investment security is deemed impaired if the fair value of the investment is less than its amortized cost. We consider both our intent to sell and the likelihood that we will not have to sell the investment securities before recovery of their amortized cost basis during our evaluation. If we intend to sell the investment security or if it is more likely than not that we will be required to sell the investment security, the entire impairment is recorded in earnings. For available-for-sale debt securities that do not meet these criteria, we evaluate whether the decline in fair value has resulted from credit losses or other factors. In making this assessment we consider the issuer of the securities and their creditworthiness, any changes to the rating of the security and any adverse conditions specifically related to the security, among other factors. Also, we may evaluate the business and financial outlook of the issuer, as well as broader economic performance indicators.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for Credit Losses – Available for Sale Securities (continued)

If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security is compared to the amortized cost basis. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, equal to the amount that the fair value is less than amortized cost. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as provision for (or reversal of) credit loss expense in the Consolidated Statement of Income. Losses are charged against the allowance when we believe the uncollectibility of an available-for-sale security is confirmed or when there is an intent or requirement to sell the security.

Accrued interest receivable on available-for-sale debt securities totaled \$1.2 million at December 31, 2023, and is included within accrued interest receivable on the consolidated balance sheet. This amount is excluded from the estimate of credit losses. Available-for-sale securities are typically as nonaccrual when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about the further collectability of principal or interest. The receivable for interest income that is accrued but not collected is reversed against interest income when the debt security is placed on nonaccrual status. No debt securities were on nonaccrual status as of December 31, 2023.

Credit Losses on Investment Securities – Prior to adopting ASU 2016-13

The Company adopted ASU 2016-13 effective January 1, 2023. Financial statement amounts related to Investment Securities recorded as of December 31, 2022, are presented in accordance with accounting policies described as follows. Securities are periodically reviewed for other than temporary impairment based upon a number of factors. Those factors include, but are not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security's ability to recover any decline in its fair value and whether management intends to sell and their belief that they will not be required to sell these securities before recovery of their cost basis, which may be at maturity. A decline in value that is considered to be other than temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income. Any remaining difference between fair value and amortized cost is recognized in other comprehensive income, net of applicable taxes.

Equity Securities

Equity securities are held at fair value. Holding gains and losses are recorded in non-interest income. Dividends on equity securities are recognized as income when earned.

Restricted Stock

Common stock of the Federal Home Loan Bank of Pittsburgh ("FHLB") and the Atlantic Community Bankers Bank ("ACBB") represents ownership in institutions that are wholly owned by other financial institutions. These securities are accounted for at cost and are classified with other assets.

The Bank is a member of FHLB and as such, is required to maintain a minimum investment in stock of FHLB that varies with the level of advances outstanding with FHLB. The stock is bought from and sold to FHLB based upon its \$100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost, and evaluated for impairment by management. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of FHLB as compared to the capital stock amount and the length of time this situation has persisted; (b) commitments by FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance; (c) the impact of legislative and regulatory changes on the customer base of FHLB and; (d) the liquidity position of FHLB.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Restricted Stock (continued)

Management evaluated the stock of both ACBB and FHLB and concluded that the stock was not impaired for the periods presented herein. This evaluation took into consideration regulatory capital ratios and liquidity. In addition, new shares of ACBB and FHLB stock continue to exchange hands at the \$250 and \$100 par value, respectively.

Mortgage Loans Held for Sale

In general, fixed rate residential mortgage loans originated by the Bank that qualify for sale in the secondary market are held for sale and are carried at the aggregate lower of cost or fair value. Such loans sold are generally serviced by the Bank.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: 1) the assets have been isolated from the Company; 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and 3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Loans

Loans are stated at the principal amount outstanding, net of any unearned income, deferred loan fees and the allowance for credit losses. Interest on consumer loans is credited to operations over the term of each loan using a method which results in a level yield or the simple interest method. Interest income on mortgage loans is accrued on the amortized balance. Interest income on other loans is accrued on the principal amount outstanding. Loan fees which represent an adjustment to interest yield are deferred and amortized over the life of the loan. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is generally discontinued when it is determined that a reasonable doubt exists as to the collectability of additional interest. When a loan is placed on nonaccrual status, unpaid interest is charged against income. Payments received on nonaccrual loans are either applied to principal or reported as interest income according to management's judgment as to the collectability of principal. Loans are returned to accrual status when past due principal and interest is collected and the collection of principal is probable.

Accrued interest receivable on loans totaled \$2.6 million at December 31, 2023, and is included within accrued interest receivable on the consolidated balance sheet and is excluded from the estimate of credit losses.

Allowance for Credit Losses

The ACL is a valuation reserve established and maintained by charges against operating income and is deducted from the amortized cost basis of loans to present the net amount expected to be collected on the loans. Loans, or portions thereof, are charged off against the ACL when they are deemed uncollectible. The ACL is an estimate of expected credit losses, measured over the contractual life of a loan, that considers our historical loss experience, current conditions and forecasts of future economic conditions. Determination of an appropriate ACL is inherently subjective and may have significant changes from period to period.

The methodology for determining the ACL has two main components: evaluation of expected credit losses for certain groups of homogeneous loans that share similar risk characteristics and evaluation of loans that do not share similar risk characteristics with other loans and are individually evaluated.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for Credit Losses (continued)

The ACL for homogeneous loans is calculated using a life-time loss rate methodology with both a quantitative and a qualitative analysis that is applied on a quarterly basis. The ACL model is comprised of 5 distinct portfolio segments: 1) Commercial and Industrial, or C&I, 2) Commercial Real Estate, or CRE, 3) Construction and Development, 4) Residential Real Estate and 5) Consumer. Each segment has a distinct set of risk characteristics monitored by management. Our quantitative model uses historic data back to the second quarter of 2009. We apply historical loss rates to pools of loans with similar risk characteristics. After consideration of the historic loss calculation, management applies qualitative adjustments to reflect the current conditions and reasonable and supportable forecasts not already reflected in the historical loss information at the balance sheet date. Our reasonable and supportable forecast is for a period of two years and is based on the unemployment forecast and management judgment. For periods beyond our two-year reasonable and supportable forecast, we revert to historical loss rates utilizing a straight-line method over a one-year reversion period.

The qualitative adjustments for current conditions are based upon the following factors:

- Changes in lending policies and procedures,
- Changes in national, regional, and local economic and business conditions,
- Changes in nature and volume of the portfolio and in terms of loans,
- Changes in the experience, ability, and depth of lending management and other relevant staff,
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans,
- Changes in the quality of the institution's loan review system,
- Changes in the value of underlying collateral for collateral-dependent loans,
- Changes in any concentration of credit, and
- Other external factors such as competition and legal and regulatory requirements.

These modified historical loss rates are multiplied by the outstanding principal balance of each loan to calculate a required reserve.

The ACL for individual loans begins with the use of normal credit review procedures to identify whether a loan no longer shares similar risk characteristics with other pooled loans and therefore, should be individually assessed. We evaluate our entire loan portfolio that meet the following criteria: 1) when nonaccrual loans are greater than \$250,000, 2) Restructured residential mortgages greater than \$100,000, 3) Loans over 90 days past due greater than \$100,000 and still accruing interest, 4) Loans modifications to borrowers experiencing financial difficulty that are accruing interest or are on nonaccrual.

Specific reserves are established based on the following three acceptable methods for measuring the ACL: 1) the present value of expected future cash flows discounted at the loan's original effective interest rate; 2) the loan's observable market price; or 3) the fair value of the collateral when the loan is collateral dependent. Our individual loan evaluations consist primarily of the fair value of collateral method because most of our loans are collateral dependent. Collateral values are discounted to consider disposition costs, selling costs, transfer tax and standard legal fees. A specific reserve is established or a charge-off is taken if the fair value of the loan is less than the loan balance.

For off-balance-sheet credit exposures, we estimate expected credit losses over the contractual period in which we are exposed to credit risk via a contractual obligation to extend credit, unless that obligation is unconditionally cancellable. The liability for credit losses on off-balance-sheet credit exposures is adjusted through a provision for credit loss on the Consolidated Statements of Income.

We estimate the liability balance using relevant available information, from internal and external sources, relating to past events, current conditions and reasonable and supportable forecasts. The estimate includes a consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. Off-balance-sheet exposures that are not unconditionally cancellable have been identified for the mortgage, home equity, commercial real estate, and commercial loan portfolios.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for Loan Losses- Prior to adopting ASU 2016-13

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date. 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, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to changes in the near term.

Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to non-classified loans. The following qualitative factors are analyzed:

- Levels of and trends in delinquencies
- Trends in volume and terms
- Changes in lending policies and procedures
- Changes in collateral value
- Changes in adverse classification levels
- Quality of the loan review function
- Economic trends
- Concentrations of credit
- Experience, depth, and ability of management
- Other factors affecting the collectability of the loans

The Bank analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan losses.

In situations where, for economic or legal reasons related to a borrower's financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a troubled debt restructuring ("TDR"). Management strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring and charges down the principal balance as determined in the analysis. This process is completed for all types of loans. It is then further analyzed to determine if the loan should be classified as impaired.

Impaired loans are primarily commercial and commercial real estate loan relationships for which it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Management considers loans which are 90 days or more past due and accruing or any loans classified as modification for borrowers experiencing financial difficulty with a balance of \$100,000 or greater as impaired, and if warranted, includes the entire customer relationship in that status. Non-accruing loans greater than \$250,000 are considered impaired. The Bank individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. The definition of "impaired loans" is not the same as the definition of "nonaccrual loans," although the two categories overlap. The Bank may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. 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 by 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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for Loan Losses- Prior to adopting ASU 2016-13 (continued)

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively unless included in an impaired loan relationship. 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 the 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. Residential mortgages and consumer loans are generally evaluated to determine a fair value of the collateral when 90 days past due and then are fully or partially charged down to reflect that fair value unless the loan is well secured and in the process of collection.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is principally computed on the straight-line method over the estimated useful lives of the related assets, which range from 3 to 20 years for furniture and equipment and 5 to 31 years for office buildings and improvements. Leasehold improvements are amortized over the shorter of their estimated useful lives or their respective lease terms, which range from 5 to 20 years. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance ("BOLI")

The Bank owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet, and any increases in cash surrender value are recorded as noninterest income on the Consolidated Statement of Income. In the event of the death of an insured individual under these policies, the Bank would receive a death benefit which would be recorded as noninterest income.

Other Real Estate Owned

Real estate acquired by foreclosure is classified on the Consolidated Balance Sheet at its fair value minus estimated costs of sale. Prior to foreclosure, the value of the underlying collateral is written down by a charge to the allowance for credit losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income and losses on their disposition, are included as other real estate owned expense.

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 the 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.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share are calculated utilizing net income as reported as the numerator and average shares outstanding as the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any options and non-vested restricted stock grants are adjusted for in the denominator.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock Based Compensation

The Company accounts for stock-based compensation issued to employees, and where appropriate non-employees, at fair value. Under fair value provisions, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the appropriate vesting period using the straight-line method. The amount of stock-based compensation recognized at any date must at least equal the portion of the grant date fair value of the award that is vested at that date and as a result it may be necessary to recognize the expense using a ratable method. Determining the fair value of stock-based awards at the date of grant requires judgment, including estimating the expected term of the stock options and the expected volatility of the Company's stock. In addition, judgment is required in estimating the amount of stock-based awards that are expected to be forfeited.

Mortgage Servicing Rights ("MSRs")

The Bank has agreements for the express purpose of selling loans in the secondary market. The Bank maintains servicing rights for most of these loans. MSRs are carried at the lower of cost or fair value. 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. MSRs are a component of other assets on the Consolidated Balance Sheet.

Derivative Instruments and Hedging Activities

The Bank records all derivatives on the Consolidated balance sheet at fair value. The accounting for changes in fair value of derivatives depends on the intended use of the derivative, whether the Bank elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability of expected future cash flows are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes of the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Bank may enter into derivative contracts that are intended to economically hedge certain of its risk, even though the hedge accounting does not apply, or the Bank elects not to apply hedge accounting. Changes in the fair value of derivatives designated as fair value hedges are recorded in earnings. Changes in the fair value of derivatives designated as cash flow hedges are recorded in accumulated other comprehensive income (loss) and are reclassified into the income statement when the hedge item affects earnings. Hedge ineffectiveness and gains on losses on the excluded component of a derivative in assessing hedge effectiveness are recorded in earnings. The interest rate swap with the swap counterparty and the hedging agreement is a derivative contract. As the interest rate swap and the customer hedging agreement are structured to offset each other, changes to the underlying market values of these instruments do not result in an impact to earnings; however, there may be fair value adjustments related to credit quality variations between counterparties, which may impact earnings as required by FASB ASC 820.

Revenue Recognition

The primary sources of the revenue the Company recognizes emanates from interest and dividend income on loans and securities along with noninterest revenue resulting from investment security gains, loan servicing, gains on the sale of loans, commitment fees, fees from financial guarantees, certain credit card fees and income on bank owned life insurance which are not in the scope of Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers. Services within the scope of ASC 606 include income from fiduciary activities, brokerage fees, service charges on deposits accounts, other service income, ATM fees, interchange fees and gain on sale of other real estate owned, net. For these accounts, fees are related to specific customer transactions that are attributable to specific performance obligations of the Bank where revenue is recognized at a defined point in time, completion of the requested service/transaction.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash Flows

The Company has defined cash and cash equivalents as cash and due from banks and interest-bearing deposits in other banks that have original maturities of 90 days or less.

Amounts paid for interest and income taxes and noncash activities are as follows (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Cash paid during the year for:			
Interest	\$ 13,748	\$ 3,677	\$ 3,539
Income taxes	\$ 1,978	\$ 2,268	\$ 2,627
Noncash investing activities:			
Transfer of loans to other real estate owned	\$ -	\$ -	\$ 109
Loans to facilitate the sale of other real estate owned	\$ -	\$ -	\$ 101
Dividends payable	\$ 1,013	\$ 971	\$ 2,189
Changes in unrealized holding gains and (losses) on available for sale securities	\$ 5,158	\$ (27,562)	\$ (3,192)
Investment purchase not settled	\$ -	\$ 970	\$ -

Accounting Pronouncements Adopted in 2023

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" and subsequent related updates. This ASU replaces the incurred loss methodology for recognizing credit losses and requires businesses and other organizations to measure the current expected credit losses (CECL) on financial assets measured at amortized cost, including loans and held-to-maturity securities, net investments in leases, off-balance sheet credit exposures such as unfunded commitments, and other financial instruments. In addition, ASC 326 requires credit losses on available-for-sale debt securities to be presented as an allowance rather than as a write-down when management does not intend to sell or believes that it is not more likely than not they will be required to sell. This guidance became effective on January 1, 2023, for the Bank. The results reported for periods beginning after January 1, 2023, are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable accounting standards.

The Bank adopted this guidance, and subsequent related updates, using the modified retrospective approach for all financial assets measured at amortized cost, including loans, available-for-sale debt securities and unfunded commitments. On January 1, 2023, the Bank recorded a cumulative effect increase to retained earnings of \$50 thousand, net of tax, of which a decrease of \$420 thousand is related to loans, an increase of \$370 related to unfunded commitments, and no allowance for available-for-sale securities.

The Bank adopted the provisions of ASC 326 related to presenting other-than-temporary impairment on available-for-sale debt securities prior to January 1, 2023, using the prospective transition approach, though no such charges had been recorded on the securities held by the Bank as of the date of adoption.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements

In March 2023, the FASB issued ASU 2023-02, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*. ASU 2023-02 permits reporting entities to elect to account for their tax equity investments, regardless of the tax credit program from which the income tax credits are received, using the proportional amortization method if certain conditions are met. ASU 2023-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2023. This update is not expected to have a significant impact on the Company's financial statements.

Reclassification of Comparative Amounts

Certain comparative amounts for prior years have been reclassified to conform to current year presentations. The reclassified amounts did not affect net income or stockholders' equity.

NOTE 2 - EARNINGS PER SHARE

There are no convertible securities that would affect the numerator in calculating basic and diluted earnings per share; therefore, net income as presented on the Consolidated Statement of Income will be used as the numerator. The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation for the years ended December 31:

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Weighted-average common shares issued	2,644,986	2,635,734	2,607,475
Average treasury stock shares	(99,561)	(88,468)	(76,202)
Average unearned nonvested shares	<u>(7,704)</u>	<u>(5,888)</u>	<u>(4,848)</u>
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	2,537,721	2,541,378	2,526,425
Additional common stock equivalents (nonvested stock) used to calculate diluted earnings per share	-	131	50
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	<u>142</u>	<u>4,456</u>	<u>64</u>
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	<u><u>2,537,863</u></u>	<u><u>2,545,965</u></u>	<u><u>2,526,539</u></u>

For the years ended December 31, 2023, 2022, and 2021, the Company excluded from the computation of diluted weighted average shares the impact of 57,730, 15,150, and 47,150 options to purchase shares of the Company's common stock as the effect would have been anti-dilutive.

NOTE 3 - INVESTMENT AND EQUITY SECURITIES

The amortized costs and fair value of investment securities at December 31 are summarized as follows (in thousands):

	2023			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AVAILABLE FOR SALE				
U.S. government agencies	\$ 4,651	\$ 1	\$ (227)	\$ 4,425
Mortgage-backed securities				
of government-sponsored entities	22,608	1	(3,263)	19,346
Collateralized mortgage obligations				
of government-sponsored entities	79,507	68	(6,492)	73,083
Obligations of states and				
political subdivisions:				
Taxable	15,301	-	(2,919)	12,382
Tax-exempt	68,404	134	(5,812)	62,726
Asset backed securities	9,998	8	(83)	9,923
Corporate securities	16,841	-	(1,640)	15,201
Total	<u>\$ 217,310</u>	<u>\$ 212</u>	<u>\$ (20,436)</u>	<u>\$ 197,086</u>
	2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AVAILABLE FOR SALE				
U.S. government agencies	\$ 5,663	\$ 3	\$ (284)	5,382
Mortgage-backed securities				
of government-sponsored entities	24,962	-	(3,759)	21,203
Collateralized mortgage obligations				
of government-sponsored entities	92,020	34	(7,177)	84,877
Obligations of states and				
political subdivisions:				
Taxable	15,333	-	(3,545)	11,788
Tax-exempt	78,510	46	(9,055)	69,501
Asset backed securities	9,303	-	(200)	9,103
Corporate securities	18,359	5	(1,450)	16,914
Total	<u>\$ 244,150</u>	<u>\$ 88</u>	<u>\$ (25,470)</u>	<u>\$ 218,768</u>

Securities with unrealized losses are evaluated quarterly to determine if the decline in fair value has resulted from credit losses or other factors. Management does not believe that any individual unrealized losses as of December 31, 2023, are indicative of a credit loss and no allowance for credit loss has been established.

NOTE 3 - INVESTMENT AND EQUITY SECURITIES (continued)

The following table summarizes debt securities available for sale in an unrealized loss position for which an allowance for credit losses has not been recorded at December 31, 2023, aggregated by security type and length of time in a continuous loss position (in thousands):

	2023					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agencies	\$ -	\$ -	\$ 4,263	\$ (227)	\$ 4,263	\$ (227)
Mortgage-backed securities of government-sponsored entities	-	-	19,058	(3,263)	19,058	(3,263)
Collateralized mortgage obligations of government-sponsored entities	1,870	(11)	62,380	(6,481)	64,250	(6,492)
Obligations of states and political subdivisions:						
Taxable	-	-	12,382	(2,919)	12,382	(2,919)
Tax-exempt	1,096	(7)	51,725	(5,805)	52,821	(5,812)
Asset backed securities	3,481	(18)	4,461	(65)	7,942	(83)
Corporate securities	2,387	(94)	11,114	(1,546)	13,501	(1,640)
Total	\$ 8,834	\$ (130)	\$ 165,383	\$ (20,306)	\$ 174,217	\$ (20,436)

At December 31, 2023, the Company had 3 government sponsored mortgage backed or collateralized mortgage obligation securities, 3 obligations of state and political subdivisions securities, 3 asset backed securities and 4 corporate securities that have been in a gross unrealized loss position for less than 12 months with depreciation of 1.4 percent from the Company's amortized cost basis.

At December 31, 2023, the Company had 15 U.S. government agency securities, 123 government sponsored mortgage backed or collateralized mortgage obligation securities, 126 obligations of state and political subdivisions securities, 6 asset backed securities and 27 corporate securities that have been in a gross unrealized loss position for greater than 12 months with depreciation of 11 percent from the Company's amortized cost basis.

Unrealized losses have not been recognized into income because the issuer(s) bonds are of high credit quality (S&P rating of BBB- or higher and/or Moody's Baa3 or higher), management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The issuer(s) continues to make timely principal and interest payments on the bonds. The fair value is expected to recover as the bonds approach maturity.

Most of the unrealized losses are related to the Company's collateral mortgage obligations, mortgage-backed securities and obligations of state and political subdivisions. The decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The issuer(s) continues to make timely principal and interest payments on the bonds. The Company evaluates if a credit loss exists by monitoring to ensure it has adequate credit support and the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2023.

NOTE 3 - INVESTMENT AND EQUITY SECURITIES (continued)

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

	2022					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agencies	\$ 1,300	\$ (48)	\$ 3,847	\$ (236)	\$ 5,147	\$ (284)
Mortgage-backed securities of government-sponsored entities	5,061	(487)	16,142	(3,272)	21,203	(3,759)
Collateralized mortgage obligations of government-sponsored entities	44,959	(2,398)	32,342	(4,779)	77,301	(7,177)
Obligations of states and political subdivisions:						
Taxable	2,615	(444)	9,173	(3,101)	11,788	(3,545)
Tax-exempt	46,987	(4,694)	19,158	(4,361)	66,145	(9,055)
Asset backed securities	4,269	(55)	3,644	(145)	7,913	(200)
Corporate securities	7,357	(403)	6,130	(1,047)	13,487	(1,450)
Total debt securities	<u>\$ 112,548</u>	<u>\$ (8,529)</u>	<u>\$ 90,436</u>	<u>\$ (16,941)</u>	<u>\$ 202,984</u>	<u>\$ (25,470)</u>

The Company reviews its position quarterly and has asserted that at December 31, 2022, the declines outlined in the previous table represent temporary declines and the Company does not intend to sell and does not believe they will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 342 positions that were temporarily impaired at December 31, 2022. The Company has concluded that the unrealized losses disclosed above are not other than temporary, but are the result of interest rate changes, sector credit ratings changes or company-specific ratings changes that are not expected to result in the non-collection of principal and interest.

The amortized cost and fair values of debt securities at December 31, 2023, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities 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):

	Amortized Cost	Fair Value
Due in one year or less	\$ 19,457	\$ 18,449
Due after one year through five years	44,662	41,249
Due after five years through ten years	55,777	50,571
Due after ten years	97,414	86,817
Total debt securities	<u>\$ 217,310</u>	<u>\$ 197,086</u>

NOTE 3 – INVESTMENT AND EQUITY SECURITIES (continued)

The following table is a summary of proceeds received, gross gains, and gross losses realized on the sale, call, and merger of investment securities for the years ended December 31 (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Proceeds	\$ 10,361	\$ 8,228	\$ 10,639
Gross gains	\$ 20	\$ -	\$ 225
Gross losses	\$ (60)	\$ 860	\$ -

Investment securities that were pledged to secure deposits, short-term borrowings and for other purposes as required by law as of December 31 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Amortized cost	\$ 112,551	\$ 133,894
Fair value	\$ 102,747	\$ 120,723

Equity Securities

The following summary of unrealized and realized gains and losses recognized in net income on equity securities for the years ended December 31 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Net realized gains	\$ -	\$ -	\$ -
Net unrealized (losses) gains	(3)	3	5
Net (losses) gains	<u>\$ (3)</u>	<u>\$ 3</u>	<u>\$ 5</u>

There were no sales of equity securities in 2023, 2022 and 2021.

NOTE 4 - LOANS

Major classifications of loans at December 31 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Commercial	\$ 97,232	\$ 96,456
Construction and development	53,993	47,861
Commercial real estate	405,087	390,201
Consumer	23,214	14,065
Residential real estate	142,920	130,489
Total	<u>\$ 722,446</u>	<u>\$ 679,072</u>

Total loans were net of unearned income of \$2.3 million and \$2.2 million at December 31, 2023, and 2022, respectively.

Real estate loans serviced for others which are not included in the Consolidated Balance Sheet totaled \$92 million and \$94.6 million, respectively at December 31, 2023, and 2022. Commercial loans serviced for others which are not included in the Consolidated Balance Sheet totaled \$49.5 million and \$30.4 million at December 31, 2023, and 2022, respectively.

NOTE 4 – LOANS (continued)

In the normal course of business, loans are extended to officers and directors, their families, and corporations in which they are beneficially interested as stockholders, officers, or directors. A summary of loan activity for those officers and directors with aggregate loan balances in excess of \$60,000 for the year ended December 31, 2023, and 2022, is as follows (in thousands):

<u>December 31,</u> <u>2022</u>	<u>Additions</u>	<u>Amounts</u> <u>Collected</u>	<u>December 31,</u> <u>2023</u>
\$ 17,936	\$ 1,563	\$ 1,845	\$ 17,654

<u>December 31,</u> <u>2021</u>	<u>Additions</u>	<u>Amounts</u> <u>Collected</u>	<u>December 31,</u> <u>2022</u>
\$ 19,024	\$ 2,590	\$ 3,678	\$ 17,936

The Bank's primary business activity is with customers located within its local trade area. Generally, the Bank grants commercial, residential and consumer loans. The Bank also selectively funds and purchases commercial and residential loans outside of its local trade area provided such loans meet the Bank's credit policy guidelines. At December 31, 2023, and 2022, the Bank had approximately \$162 million and \$182 million, respectively, of outstanding loans to summer camps and recreational facilities in the northeastern United States. Although the Bank has a diversified loan portfolio at December 31, 2023, and 2022, loans outstanding to individuals and businesses are dependent upon the local economic conditions in its immediate trade area.

During 2021 and 2020, the Bank participated in the Paycheck Protection Program ("PPP"), administered directly by the U.S. SBA. The PPP provides loans to small businesses who were affected by economic conditions as a result of COVID-19 to provide cash-flow assistance to employers who maintain their payroll (including healthcare and certain related expenses), mortgage interest, rent, leases, utilities, and interest on existing debt during the COVID-19 emergency. During 2021 and 2020, the Bank funded \$65.1 million and \$69.8 million in PPP loan, respectively. As of December 31, 2023, the Bank had no loans outstanding and as of 2022, outstanding principal balances were \$4.4 million. The PPP loans are fully guaranteed by the SBA and may be eligible for forgiveness by the SBA to the extent that the proceeds are used to cover eligible payroll costs, interest costs, rent, and utility costs over a period of up to 24 weeks after the loan is made as long as certain conditions are met regarding employee retention and compensation levels. PPP loans deemed eligible for forgiveness by the SBA will be repaid by the SBA to the Bank. PPP loans are included in the commercial loan category.

In accordance with the SBA terms and conditions on these PPP loans, the Bank received approximately \$2.7 million in 2021 and \$2.5 million in 2020 in fees associated with the processing of these loans. \$77 thousand in fees was recognized in income in 2023, \$1.1 million in 2022 and \$2.8 million in fees in 2021. No fees were deferred as of December 31, 2023, and \$77 thousand was deferred in 2022. Upon funding of the loan, these fees were deferred and will be amortized over the life of the loan as an adjustment to yield in accordance with FASB ASC 310-20-25-2.

NOTE 5—ALLOWANCE FOR CREDIT LOSSES as per ASU 326

The total allowance reflects management's estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Bank considers the allowance for credit losses adequate to cover credit losses inherent in the loan portfolio. The following tables present by portfolio segment, the allowance for credit losses for the year ended December 31 (in thousands):

	2023						
	Commercial	Construction & Development	Commercial Real Estate	Consumer	Residential Real Estate	Unallocated	Total
Allowance for credit losses:							
Beginning balance	\$ 1,898	\$ 566	\$ 6,154	\$ 186	\$ 1,623	\$ 161	\$ 10,588
Impact of CECL adoption	45	682	23	2	(655)	(161)	(64)
Charge-offs	(82)	-	(160)	(116)	-	-	(358)
Recoveries	88	-	190	32	3	-	313
Provision *	(270)	151	176	230	41	-	328
Ending balance	<u>\$ 1,679</u>	<u>\$ 1,399</u>	<u>\$ 6,383</u>	<u>\$ 334</u>	<u>\$ 1,012</u>	<u>\$ -</u>	<u>\$ 10,807</u>

* Excludes provision for credit losses for unfunded commitments.

In 2023, due to the CECL adoption, all qualitative factor reserves were reallocated across all loan categories. Additionally, the use of peer historical loss data was implemented in 2023 as a more conservative approach to calculate our ACL.

NOTE 5—ALLOWANCE FOR LOAN LOSSES as per ASU 310

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Bank considers the allowance for loan losses adequate to cover loan losses inherent in the loan portfolio. The following tables present by portfolio segment, the allowance for loan losses for the year ended December 31 (in thousands):

	2022						
	Commercial	Construction & Development	Commercial Real Estate	Consumer	Residential Real Estate	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 2,090	\$ 431	\$ 6,804	\$ 141	\$ 1,531	\$ 535	\$ 11,532
Charge-offs	(218)	-	(160)	(87)	(16)	-	(481)
Recoveries	189	-	121	44	8	-	362
Provision	(163)	135	(611)	88	100	(374)	(825)
Ending balance	<u>\$ 1,898</u>	<u>\$ 566</u>	<u>\$ 6,154</u>	<u>\$ 186</u>	<u>\$ 1,623</u>	<u>\$ 161</u>	<u>\$ 10,588</u>
Ending allowance balance:							
Loans individually evaluated for impairment	\$ 89	\$ -	\$ 88	\$ -	\$ -	\$ -	\$ 177
Loans collectively evaluated for impairment	<u>1,809</u>	<u>566</u>	<u>6,066</u>	<u>186</u>	<u>1,623</u>	<u>161</u>	<u>10,411</u>
Total	<u>\$ 1,898</u>	<u>\$ 566</u>	<u>\$ 6,154</u>	<u>\$ 186</u>	<u>\$ 1,623</u>	<u>\$ 161</u>	<u>\$ 10,588</u>
Ending loan balance:							
Loans individually evaluated for impairment	\$ 652	\$ -	\$ 2,626	\$ -	\$ 813	\$ -	\$ 4,091
Loans collectively evaluated for impairment	<u>95,804</u>	<u>47,861</u>	<u>387,575</u>	<u>14,065</u>	<u>129,676</u>	<u>-</u>	<u>674,981</u>
Total	<u>\$ 96,456</u>	<u>\$ 47,861</u>	<u>\$ 390,201</u>	<u>\$ 14,065</u>	<u>\$ 130,489</u>	<u>\$ -</u>	<u>\$ 679,072</u>

In 2022, the overall allowance for loan losses decreased due to a reduction in the specific reserve for one loan relationship and a decrease in classified loans even though our loan portfolio increased by \$22 million.

NOTE 5 –ALLOWANCE FOR LOAN LOSSES as per ASU 310 (continued)

	2021						
	Commercial	Construction & Development	Commercial Real Estate	Consumer	Residential Real Estate	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 2,845	\$ 358	\$ 4,966	\$ 155	\$ 1,440	\$ 890	\$ 10,654
Charge-offs	(342)	-	(13)	(119)	(120)	-	(594)
Recoveries	48	-	170	40	14	-	272
Provision	(461)	73	1,681	65	197	(355)	1,200
Ending balance	<u>\$ 2,090</u>	<u>\$ 431</u>	<u>\$ 6,804</u>	<u>\$ 141</u>	<u>\$ 1,531</u>	<u>\$ 535</u>	<u>\$ 11,532</u>
Ending allowance balance:							
Loans individually evaluated for impairment	\$ 238	\$ -	\$ 1,400	\$ -	\$ 52	\$ -	\$ 1,690
Loans collectively evaluated for impairment	<u>1,852</u>	<u>431</u>	<u>5,404</u>	<u>141</u>	<u>1,479</u>	<u>535</u>	<u>9,842</u>
Total	<u>\$ 2,090</u>	<u>\$ 431</u>	<u>\$ 6,804</u>	<u>\$ 141</u>	<u>\$ 1,531</u>	<u>\$ 535</u>	<u>\$ 11,532</u>
Ending loan balance:							
Loans individually evaluated for impairment	\$ 929	\$ -	\$ 11,023	\$ -	\$ 747	\$ -	\$ 12,699
Loans collectively evaluated for impairment	<u>134,363</u>	<u>35,421</u>	<u>349,190</u>	<u>10,267</u>	<u>115,327</u>	<u>-</u>	<u>644,568</u>
Total	<u>\$ 135,292</u>	<u>\$ 35,421</u>	<u>\$ 360,213</u>	<u>\$ 10,267</u>	<u>\$ 116,074</u>	<u>\$ -</u>	<u>\$ 657,267</u>

In 2021, the allowance for loan losses on individually analyzed commercial real estate loans increased as overall balances on impaired loans of this type decreased. This increase was due to the changes in the collateral value supporting loans in the commercial real estate category.

NOTE 5 –ALLOWANCE FOR CREDIT LOSSES as per ASU 326

Credit Quality Information

The following table represent credit exposures by assigned grades for the years ended December 31, 2023 and 2022. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Bank's internal credit risk grading system is based on experiences with similarly graded loans.

The Bank's internally assigned grades are as follows:

Pass – loans which are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.

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

Substandard – loans that 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 classified as doubtful 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 classified as a loss are considered uncollectable, or of such value that continuance as an asset is not warranted.

Loans are graded by either independent loan review or internal review. Internally reviewed loans were assigned a risk weighting by the loan officer and approved by the loan committee but have not undergone a formal loan review by an independent party. These loans are typically smaller dollar balances that have not experienced delinquency issues. Balances are net of unearned income and include overdrafts, loan settlement and loan unposted, as of December 31 (in thousands):

NOTE 5 –ALLOWANCE FOR CREDIT LOSSES as per ASU 326 (continued)

Credit Quality Information (continued)

	Term Loans Amortized by Origination Year						Revolving Lines*	Revolving Lines Converted to Term Loans*	Total
	2023	2022	2021	2020	2019	Prior			
Commercial:									
Risk Rating									
Pass	\$ 16,134	\$ 11,248	\$ 9,168	\$ 7,897	\$ 12,092	\$ 16,247	\$ 12,940	\$ 5,970	\$ 91,696
Special Mention	1,230	632	291	172	580	-	226	462	3,593
Substandard	17	(31)	542	10	(5)	1,395	-	15	1,943
Total commercial	<u>\$ 17,381</u>	<u>\$ 11,849</u>	<u>\$ 10,001</u>	<u>\$ 8,079</u>	<u>\$ 12,667</u>	<u>\$ 17,642</u>	<u>\$ 13,166</u>	<u>\$ 6,447</u>	<u>\$ 97,232</u>
Commercial:									
Current period gross writeoffs	\$ (14)	\$ (59)	\$ -	\$ (8)	\$ (1)	\$ -	\$ -	\$ -	\$ (82)
Construction and development:									
Risk Rating									
Pass	\$ 423	\$ 4,017	\$ 2,592	\$ 4,398	\$ 95	\$ 12,677	\$ 8,086	\$ 17,011	\$ 49,299
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	1,472	-	-	3,222	-	-	4,694
Total construction and development	<u>\$ 423</u>	<u>\$ 4,017</u>	<u>\$ 4,064</u>	<u>\$ 4,398</u>	<u>\$ 95</u>	<u>\$ 15,899</u>	<u>\$ 8,086</u>	<u>\$ 17,011</u>	<u>\$ 53,993</u>
Construction and development:									
Current period gross writeoffs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate:									
Risk Rating									
Pass	\$ 41,548	\$ 61,865	\$ 45,619	\$ 77,780	\$ 27,554	\$ 89,960	\$ 28,778	\$ 20,705	\$ 393,809
Special Mention	99	-	-	-	-	2,599	-	-	2,698
Substandard	-	-	-	1,017	6,556	1,007	-	-	8,580
Total commercial real estate	<u>\$ 41,647</u>	<u>\$ 61,865</u>	<u>\$ 45,619</u>	<u>\$ 78,797</u>	<u>\$ 34,110</u>	<u>\$ 93,566</u>	<u>\$ 28,778</u>	<u>\$ 20,705</u>	<u>\$ 405,087</u>
Commercial real estate:									
Current period gross writeoffs	\$ (60)	\$ (100)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (160)
Consumer:									
Risk Rating									
Pass	\$ 14,444	\$ 5,773	\$ 1,734	\$ 668	\$ 440	\$ 82	\$ 55	\$ -	\$ 23,196
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	-	7	6	1	4	-	-	-	18
Total consumer	<u>\$ 14,444</u>	<u>\$ 5,780</u>	<u>\$ 1,740</u>	<u>\$ 669</u>	<u>\$ 444</u>	<u>\$ 82</u>	<u>\$ 55</u>	<u>\$ -</u>	<u>\$ 23,214</u>
Consumer:									
Current period gross writeoffs	\$ (57)	\$ (18)	\$ (26)	\$ (3)	\$ (7)	\$ -	\$ (5)	\$ -	\$ (116)
Residential real estate:									
Risk Rating									
Pass	\$ 21,572	\$ 25,398	\$ 24,178	\$ 16,533	\$ 6,872	\$ 27,549	\$ 12,212	\$ 6,526	\$ 140,840
Special Mention	157	-	-	-	446	286	-	-	889
Substandard	-	-	-	-	-	1,191	-	-	1,191
Total residential real estate	<u>\$ 21,729</u>	<u>\$ 25,398</u>	<u>\$ 24,178</u>	<u>\$ 16,533</u>	<u>\$ 7,318</u>	<u>\$ 29,026</u>	<u>\$ 12,212</u>	<u>\$ 6,526</u>	<u>\$ 142,920</u>
Residential real estate:									
Current period gross writeoffs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total loans	<u>\$ 95,624</u>	<u>\$ 108,909</u>	<u>\$ 85,602</u>	<u>\$ 108,476</u>	<u>\$ 54,634</u>	<u>\$ 156,215</u>	<u>\$ 62,297</u>	<u>\$ 50,689</u>	<u>\$ 722,446</u>

*amortized cost basis

There were no loans in a doubtful or loss position for the years presented above.

NOTE 5 –ALLOWANCE FOR LOAN LOSSES as per ASU 310**Credit Quality Information**

	2022					
	Commercial	Construction & Development	Commercial Real Estate	Consumer	Residential Real Estate	Total
Pass	\$ 94,254	\$ 44,514	\$ 369,170	\$ 14,053	\$ 128,527	\$ 650,518
Special Mention	143	-	17,231	-	444	17,818
Substandard	2,059	3,347	3,800	12	1,518	10,736
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	<u>\$ 96,456</u>	<u>\$ 47,861</u>	<u>\$ 390,201</u>	<u>\$ 14,065</u>	<u>\$ 130,489</u>	<u>\$ 679,072</u>

NOTE 5- ALLOWANCE FOR CREDIT LOSSES as per ASU 326**Age Analysis of Past Due Loans by Class**

The following is a table which includes an aging analysis of the amortized cost of past due loans as of December 31 including loans which are in nonaccrual status (in thousands):

	2023						
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Loans	Amortized Cost > 90 Days and Accruing
Commercial	\$ 10	\$ 15	\$ 17	\$ 42	\$ 97,190	\$ 97,232	\$ -
Construction and development	-	-	1,472	1,472	52,521	53,993	-
Commercial real estate	778	97	319	1,194	403,893	405,087	-
Consumer	39	4	-	43	23,171	23,214	-
Residential real estate	385	435	8	828	142,092	142,920	-
Total	<u>\$ 1,212</u>	<u>\$ 551</u>	<u>\$ 1,816</u>	<u>\$ 3,579</u>	<u>\$ 718,867</u>	<u>\$ 722,446</u>	<u>\$ -</u>

NOTE 5 –ALLOWANCE FOR LOAN LOSSES as per ASU 310

Age Analysis of Past Due Loans by Class

	2022						Recorded Investment> 90 Days and Accruing
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Loans	
Commercial	\$ 27	\$ 38	\$ -	\$ 65	\$ 96,391	\$ 96,456	\$ -
Construction and development	100	-	-	100	47,761	47,861	-
Commercial real estate	650	-	1,851	2,501	387,700	390,201	-
Consumer	11	11	5	27	14,038	14,065	-
Residential real estate	308	47	332	687	129,802	130,489	-
Total	<u>\$ 1,096</u>	<u>\$ 96</u>	<u>\$ 2,188</u>	<u>\$ 3,380</u>	<u>\$ 675,692</u>	<u>\$ 679,072</u>	<u>\$ -</u>

NOTE 5- ALLOWANCE FOR CREDIT LOSSES as per ASU 326

Collateral Dependent Loans

The following table presents individually analyzed and collateral dependent loans by classes of loan type (in thousands):

	2023			
	Type of Collateral			
	Real Estate	Blanket Lien	Other	Total
Commercial	\$ 663	\$ 8	\$ -	\$ 671
Construction and development	1,472	-	-	1,472
Commercial real estate	5,157	-	-	5,157
Consumer	-	-	-	-
Residential real estate	597	-	-	597
Total	<u>\$ 7,889</u>	<u>\$ 8</u>	<u>\$ -</u>	<u>\$ 7,897</u>

NOTE 5- ALLOWANCE FOR LOAN LOSSES as per ASU 310

Impaired Loans

Management considers loans which are 90 days or more past due and accruing or any modification for borrowers experiencing financial difficulty with a balance of \$100,000 or greater as impaired, and if warranted, includes the entire customer relationship in that status. Non-accruing loans greater than \$250,000 are considered impaired. These loans are analyzed to determine if 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 amortized cost and unpaid principal balances for impaired loans with the associated allowance amount, if applicable, as of December 31 (in thousands):

	2022				
	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal Balance	Allowance	Recorded Investment	Income Recognized
With no related allowance recorded:					
Commercial	\$ 81	\$ 90	\$ -	\$ 187	\$ 3
Commercial real estate	2,312	3,828	-	5,717	419
Residential real estate	813	1,069	-	739	48
With an allowance recorded:					
Commercial	571	740	89	609	36
Commercial real estate	314	314	88	332	60
Residential real estate	-	-	-	120	-
Total	<u>\$ 4,091</u>	<u>\$ 6,041</u>	<u>\$ 177</u>	<u>\$ 7,704</u>	<u>\$ 566</u>
	2021				
	Recorded	Unpaid	Related	Average	Interest
	Investment	Principal Balance	Allowance	Recorded Investment	Income Recognized
With no related allowance recorded:					
Commercial	\$ 166	\$ 168	\$ -	\$ 284	\$ 5
Commercial real estate	9,111	10,750	-	13,995	842
Residential real estate	517	867	-	726	49
With an allowance recorded:					
Commercial	763	803	238	784	55
Commercial real estate	1,912	2,002	1,400	1,970	104
Residential real estate	230	230	52	233	9
Total	<u>\$ 12,699</u>	<u>\$ 14,820</u>	<u>\$ 1,690</u>	<u>\$ 17,992</u>	<u>\$ 1,064</u>

NOTE 5 –ALLOWANCE FOR CREDIT LOSSES as per ASU 326**Nonperforming Loans**

The following table presents the amortized cost basis of loans on nonaccrual status and loan past due over 90 days still accruing interest as of December 31, 2023 (in thousands):

	2023				
	Nonaccrual with no ACL	Nonaccrual with ACL	Total Nonaccrual	Loans > 90 days and Accruing	Total Nonperforming
Commercial	\$ 3	\$ 538	\$ 541	\$ -	\$ 541
Construction and development	1,472	-	1,472	-	1,472
Commercial real estate	4,658	825	5,483	-	5,483
Consumer	-	17	17	-	17
Residential real estate	283	517	800	-	800
Total	<u>\$ 6,416</u>	<u>\$ 1,897</u>	<u>\$ 8,313</u>	<u>\$ -</u>	<u>\$ 8,313</u>

In 2023, cash payments received and applied to interest on nonaccrual loans were \$1 million.

There are four nonperforming loans with foreclosure probable. The residential real estate is secured by a first lien on the mortgage. Two of the commercial real estate loans are secured by first lien on the mortgage while the other commercial real estate loan is secured by corporate guarantee and assignment of leases and rents.

NOTE 5 –ALLOWANCE FOR LOAN LOSSES as per ASU 310**Nonaccrual Loans**

The following are the loans, presented by class, on nonaccrual status as of December 31, 2022 (in thousands):

	2022
Commercial	\$ 660
Commercial real estate	2,785
Consumer	11
Residential real estate	1,114
Total	<u>\$ 4,570</u>

Residential real estate loans in process of foreclosure were \$261 for the year ended December 31, 2022.

NOTE 5 –ALLOWANCE FOR CREDIT LOSSES as per ASU 326

Modifications to Borrowers Experiencing Financial Difficulty

The following table shows the amortized cost at the end of the reporting period of the loans modified to borrowers experiencing financial difficulty (dollars in thousands):

	<u>Interest Rate Reduction</u>	
	<u>Amortized Cost</u>	<u>% of Total Class Financing Receivable</u>
Commercial real estate	\$ 137	0.02%
Total	<u>\$ 137</u>	

There are no commitments to the lend to the borrowers included in the table above.

The following table describes the financial effect of the modifications made to borrowers experiencing financial difficulty during the year ended December 31, 2023:

<u>Loan Type</u>	<u>Interest Rate Reduction</u>
Commercial real estate	Financial Effect Reduced weighted average contractual interest rate from 7.04% to 5.60%

The Bank closes monitors the performance of the loans that are modified to borrowers experiencing financial difficulty to understand the effectiveness of its modification’s efforts. The following table depicts the performance of loans that have been modified in the last 12 months (in thousands):

	<u>2023</u>				
	<u>Current</u>	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 Days or Greater Past Due</u>	<u>Total Past Due</u>
Commercial real estate	\$ 84	\$ 53	\$ -	\$ -	\$ 53
Total	<u>\$ 84</u>	<u>\$ 53</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 53</u>

Defaulted modifications to borrowers experiencing financial difficulty are defined as loans having a payment default of 90 days or more after the restructuring takes place that were modified within the last 12 months prior to defaulting.

The effect of the modifications made to borrowers experiencing financial difficulty is already included in the ACL because the measurement methodologies used to estimate the ACL. Therefore, a change to the ACL is generally not recorded upon modification. If principal forgiveness is provided, that portion of loan will be charged off, resulting in a reduction of the amortized cost basis and a corresponding adjustment to the ACL. An assessment of whether the borrower is experiencing financial difficulty is made on the date of modification.

NOTE 5 –ALLOWANCE FOR LOAN LOSSES as per ASU 310**Troubled Debt Restructuring**

Loan modifications that are considered trouble debt restructurings completed during the year are as follows (dollars in thousands):

	2022		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Commercial	1	\$ 120	\$ 43
Residential real estate	1	254	254
Total	<u>2</u>	<u>\$ 374</u>	<u>\$ 297</u>

In 2022, the Bank restructured two loans. No additional interest was recognized because all loans are on non-accrual.

When a loan is classified as a troubled debt restructuring, we evaluated it for impairment. Unsecured loans are evaluated based on the present value of expected cash flows discounted at the contractual interest rate of the original loan agreement. Secured loans are evaluated based on a discounted fair market value of the collateral minus the cost to sell. If the value of the modified loan is less than the recorded investment, impairment is recognized either through a charge off to the allowance for credit losses or a specific reserve. As of December 31, 2022, a charge off of \$77 thousand was required on a commercial loan trouble debt restructuring.

NOTE 6 - PREMISES AND EQUIPMENT

A summary by asset classification at December 31 is as follows (in thousands):

	2023	2022
Land	\$ 3,521	\$ 3,493
Premises and improvements	22,472	22,370
Furniture and equipment	4,785	5,585
Leasehold improvements	1,179	2,080
Total, at cost	<u>31,957</u>	<u>33,528</u>
Less accumulated depreciation	<u>11,803</u>	<u>12,970</u>
Net premises and equipment	<u>\$ 20,154</u>	<u>\$ 20,558</u>

Depreciation and amortization expense was \$945, \$723, and \$535 thousand, in 2023, 2022, and 2021, respectively.

NOTE 7 - DEPOSITS

Deposits at December 31 are summarized as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Demand - noninterest-bearing	\$ 178,553	\$ 193,322
Demand - interest-bearing	162,132	185,149
Money market	88,031	88,981
Savings	125,208	155,720
Time deposits of \$250,000 or more	80,567	63,547
Other time deposits	<u>192,049</u>	<u>100,855</u>
Total	<u>\$ 826,540</u>	<u>\$ 787,574</u>

Included in the deposit accounts are deposits of one customer relationship totaling \$31.9 million and \$41 million at December 31, 2023, and 2022, respectively. This customer is a public fund relationship, and all deposits have bonds pledged to cover any balances over FDIC insured limit.

The following table summarizes the maturity distribution of time deposits at December 31, 2023 (in thousands):

2024	\$ 260,456
2025	8,236
2026	1,395
2027	1,760
2028	<u>769</u>
Total	<u>\$ 272,616</u>

Brokered deposits totaled \$62.7 million and \$9.6 million for the years ended December 31, 2023, and 2022, respectively.

NOTE 8 - SHORT-TERM BORROWINGS

Short-term borrowings consist of borrowings from correspondent banks and securities sold under agreements to repurchase. Average amounts outstanding during the year represent daily average balances and average interest rates represent interest expense divided by the related average balance.

The outstanding balances and related information for short-term borrowings at December 31 are summarized as follows (in thousands):

	<u>2023</u>		<u>2022</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
Balance at year-end	\$ 15,677	5.68%	\$ 65,164	4.43%
Average balance outstanding during the year	\$ 51,773	5.37%	\$ 13,144	3.23%
Maximum amount outstanding at any month-end	\$ 78,490		\$ 65,164	

FHLB borrowings are subject to annual renewal, incur no service charges and are secured by a blanket security agreement on certain investment securities, qualifying loans, and the Bank's investment in FHLB stock. At December 31, 2023, the Bank's remaining borrowing capacity with FHLB was approximately \$330 million. The Bank has unsecured lines of credit with correspondent banks in the amount of \$22 million. In addition, the Bank has the ability to borrow overnight at the Federal Reserve Bank of Philadelphia ("Fed") discount window based on the level of collateral pledged. At December 31, 2023, the balance available was approximately \$25 million.

NOTE 9 - OTHER BORROWED FUNDS

Other borrowed funds consist of FHLB fixed rate advances at December 31 as follows (in thousands):

Description	Maturity Range		Weighted-Average Rate	Stated Interest Rate Range		2023	2022
	From	To		From	To		
Fixed rate	04/01/24	05/30/25	3.19%	.80%	4.79%	\$ 17,041	\$ 11,541
Fixed rate amortizing	12/31/25	11/01/28	4.50%	2.31%	5.26%	17,425	3,349
Total						<u>\$ 34,466</u>	<u>\$ 14,890</u>

The following table represents maturities/repayments and weighted average rates of the remaining FHLB advances (in thousands):

<u>Year Ending December 31,</u>	<u>Maturities/Repayments</u>	<u>Weighted-Average Rate</u>
2024	\$ 6,937	3.93%
2025	20,521	4.00%
2026	4,500	4.92%
2027	2,062	4.97%
2028	446	5.05%
Total	<u>\$ 34,466</u>	4.05%

NOTE 10- DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses interest rate swaps as part of its interest rate risk management strategy. In 2020, the Bank entered into an interest rate swap designated as a cash flow hedge that involved the payment of fixed amount in exchange for the receipt of a variable amount from a counterparty. As of December 31, 2022, the Bank had one cash flow hedge with a notional amount of \$2.5 million. For derivatives designed as cash flow hedges, the effective portion of changes in fair value of the derivative is initially reported in other comprehensive income (outside of earnings), net of tax, and subsequently reclassified to earnings when the hedged transaction affects earnings and the ineffective portion of changes in the fair value of the derivative is recognized directly into earnings. The Bank assesses the effectiveness of the relationship by comparing the changes in cash flows of the designated hedged transaction. The Bank did not recognize any hedge ineffectiveness in earnings during the period ended December 31, 2022. As of December 31, 2022, the Bank was not required to pledge any collateral for the cash flow hedge. The cash flow hedge ended April 2023.

In 2018, the Bank entered into an interest rate swap to hedge the interest rate risk related to a fixed rate commercial loan. Under the commercial loan agreement, the Bank entered into a variable rate loan agreement with a customer in addition to a hedging agreement, which serves to effectively convert the customer's variable rate into a fixed rate. The Bank then entered into a corresponding interest rate swap agreement with a swap counterparty in order to economically hedge its exposure to the customer hedging agreement. The interest rate swap with the swap counterparty and the hedging agreement with the customer are not designated as hedges under FASB ASC 815. The customer hedging agreement meets the definition of a derivative contract (ASC 815-10-83) that must be bifurcated (ASC 815-15-25-1) and accounted for as a standalone derivative. The market value of both the interest rate swap and the customer hedging agreement are carried on the balance sheet at their underlying market values.

Changes in the underlying market values of the interest rate swap and the customer hedging agreement are recorded in current earnings. There was no effect on earnings in any periods presented. At December 31, 2023, based upon the swap contract values, a U.S. Government-sponsored mortgage-backed security was pledged for collateral with the third-party financial institution with a fair value \$404 thousand.

NOTE 10- DERIVATIVE FINANCIAL INSTRUMENTS (continued)

As part of the LIBOR transition considerations, the Bank recognizes that new LIBOR swap contracts cannot be entered into after December 31, 2021. In addition, any existing contracts tied to LIBOR were amended to a new index before June 30, 2023. The Bank is utilizing the Secured Overnight Rate (“SOFR”) for existing contracts on or before June 2023.

As of December 31, summary information regarding these derivatives is presented below (in thousands):

2023					
Interest Rate Derivative	Notional Amount	Interest Rate Paid	Interest Rate Received	Maturity Date	Unrealized Gain
Commercial Loan	\$ 2,223	Fixed	1 month SOFR plus margin	2028	\$ -
2022					
Interest Rate Derivative	Notional Amount	Interest Rate Paid	Interest Rate Received	Maturity Date	Unrealized Gain
Commercial Loan	\$ 2,392	Fixed	1 month Libor plus margin	2028	\$ -
90 day wholesale funding	\$ 2,500	Fixed	3 month Libor	2023	\$ 54

The following table presents the fair values of derivative instruments in the balance sheet as of December 31 (in thousands):

Interest rate derivatives	Balance Sheet		Balance Sheet	
	Location	Fair Value	Location	Fair Value
2023	Other assets	\$ 16	Other liabilities	\$ 16
2022	Other assets	\$ 60	Other liabilities	\$ 33

NOTE 11 - DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

The Company maintains a Dividend Reinvestment and Stock Purchase Plan (the “DRP Plan”). Participation is available to all common stockholders. The DRP Plan provides each participant with a simple and convenient method of purchasing additional common shares without payment of any brokerage commission or other service fees.

A participant in the DRP Plan may elect to reinvest dividends on all or part of his or her shares to acquire additional common stock. Participants may also make cash contributions for the purchase of additional shares of common stock. A participant may withdraw from the DRP Plan at any time. The following table represents the number of shares purchased by stockholders through the DRP Plan:

	2023	2022	2021
Shares purchased through dividend reinvestment	25,213	26,564	23,409
Shares purchased through cash contributions	773	1,434	2,076
Total shares	25,986	27,998	25,485

The Company offers an Employee Stock Purchase Plan that allows eligible employees the opportunity through payroll deductions to purchase shares of the Company stock at a discounted rate with no additional fees. Employees purchased 3,637 shares in 2023, 2,582 shares in 2022, and 2,584 shares in 2021 under this program.

NOTE 12 - EMPLOYEE BENEFITS

Retirement Plan

The Bank maintains a section 401(k) employee savings and investment plan for substantially all employees and officers of the Bank. The Bank's contribution to the plan is based on 100 percent matching of voluntary contributions up to 3 percent and 50 percent matching on the next 2 percent of individual compensation. Additionally, the Bank may contribute a discretionary amount each year. For each of the years of 2023, 2022, and 2021, the Board of Directors authorized an additional 3 percent, 4 percent and 4 percent respectively of each eligible employee's compensation. Employee contributions are vested at all times, and Bank contributions are fully vested after five years. Contributions for 2023, 2022, and 2021 to this plan amounted to \$719, \$604, and \$669 thousand, respectively.

Supplemental Retirement Plan

The Bank maintains a Salary Continuation Plan for certain officers of the Bank to provide guaranteed consecutive postretirement payments totaling a predetermined amount over a ten or fifteen-year period. As of December 31, 2023, and 2022 these balances were \$4.9 million and \$4.6 million, respectively. Expenses for the years ended December 31, 2023, 2022, and 2021 amounted to \$545, \$533, and \$496 thousand, respectively, and are included as a component of salaries and employee benefits.

Stock Compensation Plans

On April 25, 2019, the 2019 Equity Incentive Plan was approved by shareholders. A total of 200,000 shares are included for issuance or transfer. The plan will terminate on the day preceding the tenth anniversary of the date of shareholder ratification. These awards may be made as incentive stock options, non-qualified stock options, stock awards are that a maximum of 25,000 shares can be awarded per individual per calendar year. Options are granted at no less than the fair value of the Company's common stock on the date of grant.

There were no options from the 2019 Equity Incentive Plan granted in 2023, there were 15,150 options granted in 2022 and 16,050 options in 2021. There were no shares of restricted stock from the 2019 Equity Incentive Plan granted in 2023, there were 5,300 shares of shares of restricted stock granted in 2022 and 5,600 in 2021.

Stock options and restricted stock granted to directors vested over two years. Stock options and restricted stock granted to officers vested over five years. All stock options expire ten years after the grant. The weighted average period over which these expenses were recognized was approximately five years for employees and two years for directors.

The Company expenses the fair value of all share-based compensation over the requisite service periods. The fair value of both stock options and restricted stock are expensed on a straight-line basis. The Company classifies share-based compensation for employees within "salaries and employee benefits" and for directors within "other expense" on the Consolidated Statement of Income. Additionally, the Company reports the expense associated with the grants as an adjustment to operating cash flows.

As of December 31, the following was expensed as compensation expense relating to share-based compensation (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Stock options	\$ 64	\$ 47	\$ 39
Restricted stock	\$ 161	\$ 119	\$ 96

As of December 31, 2023, there was tax benefit of \$47 thousand, 2022 there was a tax benefit recognized of \$32 thousand, there was no tax benefit recognized in 2021.

NOTE 12 - EMPLOYEE BENEFITS (continued)

Stock Compensation Plans (continued)

As of December 31, the following was unrecognized compensation related to the plan (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Stock options	\$ 113	\$ 177	\$ 128
Restricted stock	\$ 286	\$ 446	\$ 329

A summary of the Company's stock award activity for the year ended December 31 is as follows:

	<u>2023</u>	<u>Weighted-Average Exercise Price</u>
Stock options:		
Outstanding, beginning of year	62,710	\$ 39.61
Exercised	(730)	\$ 35.93
Forfeited	<u>(1,350)</u>	\$ 38.78
Outstanding, end of year	<u>60,630</u>	\$ 39.67
Restricted stock awards:		
Nonvested, beginning of year	13,437	\$ 39.91
Vested	(4,459)	\$ 39.27
Forfeited	<u>(360)</u>	\$ 39.48
Nonvested, end of year	<u>8,618</u>	\$ 40.25

The following table summarizes characteristics of stock options outstanding at December 31, 2023:

Exercise Price	Outstanding			Exercisable	
	Shares	Average Remaining Life	Average Exercise Price	Shares	Average Exercise Price
\$ 40.30	23,200	5.05	\$ 40.30	20,000	\$ 40.30
\$ 36.00	8,820	6.28	\$ 36.00	5,760	\$ 36.00
\$ 35.90	13,910	7.33	\$ 35.90	5,990	\$ 35.90
\$ 44.44	<u>14,700</u>	8.82	\$ 44.44	<u>3,531</u>	\$ 44.44
Total	<u>60,630</u>		Total	<u>35,281</u>	

NOTE 12 - EMPLOYEE BENEFITS (continued)**Stock Compensation Plans (continued)**

On February 23, 2017, the Company adopted an employee stock bonus plan. Stock is issued at no cost to certain employees. Expense associated with this plan is included in salaries and employee benefits. There were no expenses related to the plan year ended December 31, 2023, 2022, or 2021. A total of 750 shares of common stock are reserved under the plan. There were no shares issued in 2023 or 2022. There were 120 shares with 435 available to be issued as of December 31, 2021.

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Available shares to be issued	435	435	555
Granted	-	-	-
Shares issued	<u>-</u>	<u>-</u>	<u>120</u>
Remaining shares	<u><u>435</u></u>	<u><u>435</u></u>	<u><u>435</u></u>

NOTE 13 - INCOME TAXES

Income tax expense at December 31 consists of the following (in thousands):

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Currently payable-federal	\$ 2,182	\$ 1,886	\$ 2,348
Currently payable-state	128	212	142
Deferred taxes	<u>(111)</u>	<u>389</u>	<u>(334)</u>
Total provision	<u><u>\$ 2,199</u></u>	<u><u>\$ 2,487</u></u>	<u><u>\$ 2,156</u></u>

The components of the net deferred tax assets and liabilities at December 31 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Deferred tax assets:		
Allowance for credit losses	\$ 2,375	\$ 2,223
Salary continuation plan	1,040	970
Nonaccrual loans	207	241
Stock options and grants	54	47
Right of use-leases	415	428
Accrued compensation	84	84
Partnership investment	497	459
Deferred Fees-PPP	-	16
Unrealized loss on investment securities	<u>4,247</u>	<u>5,330</u>
Total	<u><u>8,919</u></u>	<u><u>9,798</u></u>
Deferred tax liabilities:		
Premises and equipment	453	317
Deferred loan origination fees, net	115	126
Prepaid contribution	64	86
Lease liability	395	417
Derivative	<u>-</u>	<u>6</u>
Total	<u><u>1,027</u></u>	<u><u>952</u></u>
Net deferred tax assets	<u><u>\$ 7,892</u></u>	<u><u>\$ 8,846</u></u>

NOTE 13 - INCOME TAXES (continued)

Included in the allowance for credit losses portion of the deferred tax assets is \$13 thousand that is attributed to the adoption of ASC 326.

No valuation allowance was established at December 31, 2023, and 2022, in view of the Company's ability to carryback taxes paid in previous years and certain tax strategies and anticipated future taxable income as evidenced by the Company's earnings potential.

A reconciliation between the expected statutory income tax rate and the effective income tax rate follows (in thousands):

	2023		2022		2021	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 2,736	21.0 %	\$ 3,114	21.0 %	\$ 2,963	21.0 %
State tax, net of federal tax benefit	101	.8	168	1.1	112	.8
Tax-exempt income	(451)	(3.4)	(448)	(3.0)	(436)	(3.1)
BOLI earnings	(129)	(1.0)	(123)	(.8)	(110)	(.8)
Nondeductible interest	161	1.2	43	.3	34	.2
Partnership investment tax credit	(271)	(2.1)	(343)	(2.3)	(371)	(2.6)
Stock options	-	-	-	-	(48)	(.3)
Other, net	52	.4	76	.5	12	.1
Effective income tax and rate	<u>\$ 2,199</u>	<u>16.9 %</u>	<u>\$ 2,487</u>	<u>16.8 %</u>	<u>\$ 2,156</u>	<u>15.3 %</u>

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 Statement of Income. The Company's federal and state income tax returns for taxable years through 2019 have been closed for purposes of examination by the Internal Revenue Service and the Pennsylvania Department of Revenue.

NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

In the normal course of business, there are outstanding commitments and contingent liabilities such as commitments to extend credit, financial guarantees and letters of credit that are not reflected in the accompanying Consolidated Financial Statements. The Company does not anticipate any losses as a result of these transactions. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The contractual or notional amounts of those instruments reflect the extent of involvement the Company has in the particular classes of financial instruments.

Financial instruments whose contractual amounts represent credit risk at December 31 are as follows (in thousands):

	<u>2023</u>	<u>2022</u>
Commitments to extend credit	\$ 84,875	\$ 93,602
Standby letters of credit	\$ 7,318	\$ 9,093

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby 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 at the expiration of the coverage period.

As of December 31, 2023, the Bank recorded an increase of \$505 thousand to the provision for credit losses related to unfunded loan commitments.

On September 28, 2016, the Company entered into an Agreement of Limited Partnership which generates low-income housing credits for use in future periods. The agreement states the Company will acquire a 33.33% interest in the partnership at a cost of \$2,500. The final installment of this investment of \$29 thousand was paid in 2020.

Operating leases in which the Company is the lessee are recorded as operating lease Right of Use (“ROU”) assets and operating lease liabilities, included in other assets and other liabilities, respectively, on the consolidated balance sheets. The Company does not currently have any finance leases. Operating lease ROU assets represent the right to use an underlying asset during the lease term and operating lease liabilities represent the obligation to make lease payments arising from the lease. The Company elected to adopt the transition method, which uses a modified retrospective transition approach. ROU assets and operating lease liabilities are recognized as of the date of adoption based on the present value of the remaining lease payments using a discount rate that represents the Company’s incremental borrowing rate at the date of initial application.

Operating lease expense, which is comprised of amortization of the ROU asset and the implicit interest accreted on the operating lease liability, is recognized on a straight-line basis over the lease term and is recorded in occupancy and equipment expense in the consolidated statements of income and other comprehensive income. The leases relate to Company branches with remaining lease terms of generally 1 to 5 years. Certain lease arrangements contain extension options which are typically 5 years at the then fair market rental rates. As these extension options are generally considered reasonably certain of exercise, they are included in the lease term.

At December 31, 2023, operating lease ROU assets were \$1.9 million, and operating lease liabilities were \$2 million.

December 31, 2023

Weighted average remaining lease term- operating leases in years	17.8
Weighted average discounted rate-operating leases	3.58%

NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES (continued)

The following table summarizes aggregate lease maturities and obligations as of December 31, 2023 (in thousands):

2024	\$	177
2025		182
2026		182
2027		182
2028		183
2029 and thereafter		<u>1,809</u>
Total lease payments		<u>2,715</u>
Less: interest		<u>740</u>
Present value of lease liability	\$	<u><u>1,975</u></u>

Rental expense amounted to \$241, \$333, and \$290 thousand for the years ended December 31, 2023, 2022, and 2021, respectively.

Contingent Liabilities

The Company and its subsidiary are involved in various legal actions from the normal course of business activities. Management believes the liability, if any, arising from such actions will not have a material adverse effect on the Company's financial position.

NOTE 15 - REGULATORY RESTRICTIONS

Cash and Due From Banks

The Bank is no longer required to maintain reserved funds in cash or on deposit with Fed.

Dividends

The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by all state-chartered banks to the surplus of the Bank. Accordingly, at December 31, 2023, the balance in the capital surplus account totaling approximately \$1.8 million is unavailable for dividends.

NOTE 16 - REGULATORY CAPITAL REQUIREMENTS

Federal regulations require the Company and the Company to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts of ratios of Common Equity Tier 1, Total, and Tier 1 Capital to Risk-Weighted Assets and of Tier 1 Capital to Average Assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Insurance 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, 2023, and 2022, the FDIC categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well-capitalized financial institution, Common Equity Tier 1 Risk-Based, Tier 1 Risked-Based, Total Risk-Based, and Tier 1 Leverage Capital ratios must be at least 6.5%, 8%, 10%, and 5%, respectively.

The Company's capital position does not differ significantly from the Company's capital position. The Company's actual capital ratios (using the definitions from the prompt corrective action rules) are presented in the following tables, which shows the Company met all regulatory capital requirements.

NOTE 16 - REGULATORY CAPITAL REQUIREMENTS (continued)

At December 31, 2023, and 2022, the Company's capital levels were as follows (in thousands):

	2023		2022	
	Amount	Ratio	Amount	Ratio
<u>Total Capital</u>				
<u>(to Risk-Weighted Assets)</u>				
Actual	\$ 125,420	14.44%	\$ 118,480	14.19%
For capital adequacy purposes	\$ 79,316	8.00%	\$ 66,783	8.00%
To be well capitalized	\$ 99,145	10.00%	\$ 83,479	10.00%
<u>Tier I Capital</u>				
<u>(to Risk-Weighted Assets)</u>				
Actual	\$ 114,554	13.18%	\$ 108,043	12.94%
For capital adequacy purposes	\$ 52,131	6.00%	\$ 50,087	6.00%
To be well capitalized	\$ 69,508	8.00%	\$ 66,783	8.00%
<u>Tier I Capital</u>				
<u>(to Average Assets)</u>				
Actual	\$ 114,554	11.55%	\$ 108,043	11.07%
For capital adequacy purposes	\$ 39,658	4.00%	\$ 39,046	4.00%
To be well capitalized	\$ 49,573	5.00%	\$ 48,808	5.00%
<u>Common Equity Tier 1</u>				
<u>(to Risk-Weighted Assets)</u>				
Actual	\$ 114,554	13.18%	\$ 108,043	12.94%
For capital adequacy purposes	\$ 39,098	4.50%	\$ 37,565	4.50%
To be well capitalized	\$ 56,475	6.50%	\$ 54,261	6.50%

NOTE 17 – FAIR VALUE MEASUREMENTS

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

- Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include 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 III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

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

The following is a description of the valuation methodologies the Company uses for financial instruments recorded at fair value on either a recurring or nonrecurring basis:

Securities Available for Sale

Securities available for sale consists of debt securities. These securities are recorded at fair value on a recurring basis. At December 31, all of these securities used valuation methodologies involving market-based or market derived information, collectively Level I and Level II measurements, to measure fair value.

The Company closely monitors market conditions involving assets that have become less actively traded. If the fair value measurement is based upon recent observable market activity of such assets or comparable assets (other than forced or distressed transactions) that occur in sufficient volume, and do not require significant adjustment using unobservable inputs, those assets are classified as Level I or Level II; if not, they are classified as Level III. Making this assessment requires significant judgment.

The Company uses prices from independent pricing services and, to a lesser extent, indicative (non-binding) quotes from independent brokers to measure securities.

Equity Securities

Equity securities are recorded at fair value on a recurring basis. At December 31, these securities used valuation methodologies involving market-based information as Level 1 measurements to measure fair value.

Derivative Instruments

Derivates are recorded at fair value on a recurring basis. At December 31, these derivatives used valuation methods involving discounted net present value of the fixed and floating cash flow streams.

NOTE 17 – FAIR VALUE MEASUREMENTS (continued)

The following tables present the assets reported on the Consolidated Balance Sheet at their fair value as of December 31, 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):

	2023			
	Level 1	Level II	Level III	Total
Assets:				
U.S. government agencies	\$ -	\$ 4,425	\$ -	\$ 4,425
Mortgage-backed securities of government-sponsored entities	-	19,346	-	19,346
Collateralized mortgage obligations of government-sponsored entities	-	73,083	-	73,083
Obligations of states and political subdivisions:				
Taxable	-	12,382	-	12,382
Tax-exempt	-	62,726	-	62,726
Asset backed securities	-	9,923	-	9,923
Corporate securities	-	13,285	1,916	15,201
	-	-	-	-
Total debt securities	\$ -	\$ 195,170	\$ 1,916	\$ 197,086
Equity securities of financial institutions	\$ 52	\$ -	\$ -	\$ 52
Derivatives	\$ -	\$ 16	\$ -	\$ 16
Liabilities:				
Derivatives	\$ -	\$ 16	\$ -	\$ 16
	2022			
	Level 1	Level II	Level III	Total
Assets:				
U.S. government agencies	\$ -	\$ 5,382	\$ -	5,382
Mortgage-backed securities of government-sponsored entities	-	21,203	-	21,203
Collateralized mortgage obligations of government-sponsored entities	-	84,877	-	84,877
Obligations of states and political subdivisions:				
Taxable	-	11,788	-	11,788
Tax-exempt	-	69,501	-	69,501
Asset backed securities	-	9,103	-	9,103
Corporate securities	-	14,964	1,950	16,914
Total debt securities	\$ -	\$ 216,818	\$ 1,950	\$ 218,768
Equity securities of financial institutions	\$ 55	\$ -	\$ -	\$ 55
Derivatives	\$ -	\$ 60	\$ -	\$ 60
Liabilities:				
Derivatives	\$ -	\$ 33	\$ -	\$ 33

NOTE 17 – FAIR VALUE MEASUREMENTS (continued)

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value as of December 31 by level within the fair value hierarchy. Other real estate fair value is determined by current appraisal less management estimate of market volatility or by a current market offering adjusted for volatility, both classified as Level III inputs. Individually evaluated loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the individually evaluated loan include quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. Mortgage servicing rights fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value. Those valuations are as follows (in thousands):

	2023			
	Level 1	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Individually evaluated loans	\$ -	\$ -	\$ 770	\$ 770
Other real estate owned	\$ -	\$ -	\$ 224	\$ 224
Mortgage servicing rights	\$ -	\$ -	\$ 678	\$ 678

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value as of December 31 by level within the fair value hierarchy. Other real estate fair value is determined by current appraisal less management estimate of market volatility or by a current market offering adjusted for volatility, both classified as Level III inputs. Individually evaluated loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the individually evaluated loan include quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. Mortgage servicing rights fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value. Those valuations are as follows (in thousands):

	2022			
	Level 1	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans	\$ -	\$ -	\$ 708	\$ 708
Other real estate owned	\$ -	\$ -	\$ 224	\$ 224
Mortgage servicing rights	\$ -	\$ -	\$ 685	\$ 685

NOTE 17 – FAIR VALUE MEASUREMENTS (continued)

The following tables provide information describing the valuation processes used to determine nonrecurring fair value measurements categorized within Level III of the fair value hierarchy as follows (in thousands):

2023				
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Individually evaluated loans	\$ 770	Appraised values	Management discount for property type and recent market volatility	29.99%-39.73% discount (33.42%)
Other real estate owned	\$ 224	Appraised values/tax assessment	Management discount for property type and recent market volatility	42.72% discount
Mortgage servicing rights	\$ 678	Discounted cash flows	Market rates	10.5% - 11.5% discount (10.81%)
2022				
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 708	Appraised values	Management discount for property type and recent market volatility	29.99% - 39.75% discount (33.27%)
Other real estate owned	\$ 224	Appraised values/tax assessment	Management discount for property type and recent market volatility	12.92% discount
Mortgage servicing rights	\$ 685	Discounted cash flows	Market rates	10% - 11% discount (10.30%)

NOTE 18 - FAIR VALUE DISCLOSURE

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

2023					
	Carrying Value	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	\$ 8,708	\$ 8,708	\$ -	\$ -	\$ 8,708
Net loans	\$ 711,639	\$ -	\$ -	\$ 691,935	\$ 691,935
Accrued interest receivable	\$ 3,788	\$ 3,788	\$ -	\$ -	\$ 3,788
Regulatory stock	\$ 4,060	\$ 4,060	\$ -	\$ -	\$ 4,060
Fixed annuity	\$ 2,993	\$ 2,993	\$ -	\$ -	\$ 2,993
Bank-owned life insurance	\$ 27,345	\$ 27,345	\$ -	\$ -	\$ 27,345
Financial liabilities:					
Deposits	\$ 826,540	\$ 553,924	\$ -	\$ 270,749	\$ 824,673
Short-term borrowings	\$ 15,677	\$ 15,677	\$ -	\$ -	\$ 15,677
Other borrowed funds	\$ 34,466	\$ -	\$ -	\$ 34,354	\$ 34,354
Accrued interest payable	\$ 759	\$ 759	\$ -	\$ -	\$ 759
2022					
	Carrying Value	Level I	Level II	Level III	Total Fair Value
Financial assets:					
Cash and cash equivalents	\$ 7,997	\$ 7,997	\$ -	\$ -	\$ 7,997
Net loans	\$ 668,484	\$ -	\$ -	\$ 643,421	\$ 643,421
Accrued interest receivable	\$ 3,308	\$ 3,308	\$ -	\$ -	\$ 3,308
Regulatory stock	\$ 4,850	\$ 4,850	\$ -	\$ -	\$ 4,850
Fixed annuity	\$ 3,091	\$ 3,091	\$ -	\$ -	\$ 3,091
Bank-owned life insurance	\$ 26,732	\$ 26,732	\$ -	\$ -	\$ 26,732
Financial liabilities:					
Deposits	\$ 787,574	\$ 623,172	\$ -	\$ 160,606	\$ 783,778
Short-term borrowings	\$ 65,164	\$ 65,164	\$ -	\$ -	\$ 65,164
Other borrowed funds	\$ 14,890	\$ -	\$ -	\$ 14,195	\$ 14,195
Accrued interest payable	\$ 214	\$ 214	\$ -	\$ -	\$ 214

NOTE 18 - FAIR VALUE DISCLOSURE (continued)

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which 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 or simulation modeling.

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.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

NOTE 19 – ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The following table presents the changes in accumulated other comprehensive (loss) income by component net of tax for the years ended December 31, 2023, 2022, and 2021 (in thousands):

	Unrealized (losses) gains on available for sale securities ⁽¹⁾	Cash Flow Hedge	Total
Balance as of December 31, 2020	\$ 4,244	\$ (18)	\$ 4,226
Other comprehensive (loss) gain before reclassification	\$ (2,344)	\$ 16	\$ (2,328)
Amount reclassified from accumulated other comprehensive (loss) income	(178)	6	(172)
Total other comprehensive loss	(2,522)	22	(2,500)
Balance as of December 31, 2021	\$ 1,722	\$ 4	\$ 1,726
Other comprehensive (loss) gain before reclassification	\$ (22,453)	\$ 43	\$ (22,410)
Amount reclassified from accumulated other comprehensive income (loss)	679	(25)	654
Total other comprehensive loss	(21,774)	18	(21,756)
Balance as of December 31, 2022	\$ (20,052)	\$ 22	\$ (20,030)
Other comprehensive gain before reclassification	\$ 4,043	\$ -	\$ 4,043
Amount reclassified from accumulated other comprehensive income (loss)	32	(22)	10
Total other comprehensive gain	4,075	(22)	4,053
Balance as of December 31, 2023	\$ (15,977)	\$ -	\$ (15,977)

⁽¹⁾ All amounts are net of tax. Amounts in parentheses indicate debits.

NOTE 19 – ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME (continued)

The following table presents amounts reclassified out of each component of other comprehensive (loss) income for the years ended December 31, 2023, 2022, and 2021 (in thousands):

Components of accumulated other comprehensive (loss) income	Amount reclassified from accumulated other comprehensive (loss) income ⁽¹⁾			Affected line item in the consolidated statement of income
	2023	2022	2021	
Unrealized (losses) gains on available for sale securities	\$ (40)	\$ (860)	\$ 225	Investment securities (losses) gains, net
Unrealized gain (loss) on hedging activity	28	32	(8)	Interest expense
	<u>2</u>	<u>174</u>	<u>(45)</u>	Income taxes
	<u>\$ (10)</u>	<u>\$ (654)</u>	<u>\$ 172</u>	Net of taxes

⁽¹⁾ Amounts in parentheses indicate debits.

NOTE 20 – QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Bank invests in qualified affordable housing projects. At December 31, 2023, and 2022, the balance of the investment for qualified affordable housing projects was \$1.2 million and \$1.5 million. These balances are reflected in the other assets line on the consolidated balance sheet. There were no unfunded commitments related to the investments in qualified affordable housing projects at December 31, 2023, or 2022.

During the years ended December 31, 2023, 2022 and 2021, the Bank recognized investment loss with respect to its investment in qualified affordable housing projects of \$346 thousand, \$990 thousand, and \$811 thousand, respectively, which was included within pretax income on the consolidated statement of income. Additionally, during the years ended December 31, 2023, 2022 and 2021, the Bank recognized tax credits and other benefits from its investment in affordable housing tax credits of \$271 thousand, \$343 thousand, and \$371 thousand, respectively.

NOTE 21 – SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2023, through March 14, 2024, for potential recognition and disclosure in the consolidated financial statements. No other events have occurred that would require adjustment to or disclosure in the consolidated financial statements.