Tri-County Bancorp, Inc.

Tri-County Bank

Years Ended December 31, 2022 and 2021

Consolidated Financial Statements

Rehmann

TRI-COUNTY BANCORP, INC.

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INDEPENDENT AUDITORS' REPORT

March 16, 2023

Stockholders and Board of Directors
Tri-County Bancorp, Inc.
Brown City, Michigan

Opinion

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tri-County Bancorp, Inc. as of December 31, 2022 and 2021, and the consolidated results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Consolidated Financial Statements

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 generally accepted auditing standards 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 judgement made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of 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 consolidated 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.

Rehmann Robson LLC

TRI-COUNTY BANCORP, INC.

Consolidated Balance Sheets

	December 31	
	2022	2021
ASSETS		
Cash and due from banks	$ 7,531,348	$ 49,484,811
Federal funds sold	75,000	1,871,000
Cash and cash equivalents	**7,606,348**	**51,355,811**
Certificates of deposit	248,000	1,238,000
Investment securities	133,956,308	136,887,715
Restricted investments	1,382,000	1,011,700
Loans held for sale	-	449,301
Net loans	355,100,671	255,715,869
Accrued interest receivable	2,766,892	2,469,008
Premises and equipment, net	6,919,209	7,154,529
Goodwill, net	141,829	207,513
Bank owned life insurance	10,649,602	10,390,769
Other	5,040,222	1,095,108
Total assets	**$ 523,811,081**	**$ 467,975,323**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 186,261,327	$ 178,935,801
Interest-bearing	267,360,878	236,162,537
Total deposits	**453,622,205**	**415,098,338**
Borrowed funds	24,000,000	-
Accrued interest payable and other liabilities	605,772	209,805
Total liabilities	**478,227,977**	**415,308,143**
Commitments and contingencies (Notes 11, 12, 13, 14, and 16)		
Stockholders' equity		
Common stock, no par value: 4,000,000 shares authorized, 1,010,675 shares issued and outstanding (1,007,479 in 2021)	7,627,495	7,400,136
Retained earnings	52,366,793	46,230,795
Accumulated other comprehensive loss	(14,411,184)	(963,751)
Total stockholders' equity	**45,583,104**	**52,667,180**
Total liabilities and stockholders' equity	**$ 523,811,081**	**$ 467,975,323**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Income

	Year Ended December 31	
	2022	**2021**
Interest income		
Loans (including fees)	$ 17,959,564	$ 16,913,219
Investments	2,158,705	1,378,638
Federal funds sold	40,811	346
Total interest income	**20,159,080**	**18,292,203**
Interest expense		
Deposits	1,176,835	960,428
Borrowed funds	81,068	45,770
Total interest expense	**1,257,903**	**1,006,198**
Net interest income	**18,901,177**	**17,286,005**
Provision for loan losses	955,804	331,274
Net interest income, after provision for loan losses	**17,945,373**	**16,954,731**
Noninterest income		
Service charges on deposit accounts	1,249,445	1,263,036
Net gain on sale of loans	376,343	1,100,835
Other	542,472	759,850
Total noninterest income	**2,168,260**	**3,123,721**
Noninterest expenses		
Compensation and benefits	5,993,699	6,061,986
Occupancy and equipment	1,054,575	1,006,310
Foreclosed assets	43,235	7,140
Data processing	744,573	668,494
Other	2,345,659	2,208,622
Total noninterest expenses	**10,181,741**	**9,952,552**
Income before income taxes	**9,931,892**	**10,125,900**
Income taxes	1,999,000	2,031,000
Net income	**$ 7,932,892**	**$ 8,094,900**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Comprehensive (Loss) Income

	Year Ended December 31	
	2022	**2021**
Net income	**$ 7,932,892**	**$ 8,094,900**
Other comprehensive loss		
Available-for-sale securities		
Unrealized holding losses arising during the year	(17,056,049)	(2,056,681)
Reclassification adjustment for net realized losses included in net income	33,982	-
Other comprehensive loss before income tax benefit	**(17,022,067)**	**(2,056,681)**
Income tax benefit related to other comprehensive loss	3,574,634	431,903
Other comprehensive loss	**(13,447,433)**	**(1,624,778)**
Comprehensive (loss) income	**$ (5,514,541)**	**$ 6,470,122**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Stockholders' Equity

	Common Stock		Unearned ESOP Compensation	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balances, January 1, 2021	**1,004,802**	**$ 7,236,281**	**$ (171,876)**	**$ 39,425,214**	**$ 661,027**	**$ 47,150,646**
Comprehensive income	-	-	-	8,094,900	(1,624,778)	6,470,122
Dividends ($1.44 per share)	-	-	-	(1,443,524)	-	(1,443,524)
Compensation expense related to ESOP	-	-	171,876	154,205	-	326,081
Issuance of common stock	14,323	964,114	-	-	-	964,114
Issuance of shares upon exercise of common stock options	450	13,163	-	-	-	13,163
Redemption of common stock	(12,096)	(813,422)	-	-	-	(813,422)
Balances, December 31, 2021	**1,007,479**	**7,400,136**	**-**	**46,230,795**	**(963,751)**	**52,667,180**
Comprehensive income	-	-	-	7,932,892	(13,447,433)	(5,514,541)
Dividends ($1.76 per share)	-	-	-	(1,796,894)	-	(1,796,894)
Issuance of common stock	25,371	1,789,550	-	-	-	1,789,550
Redemption of common stock	(22,175)	(1,562,191)	-	-	-	(1,562,191)
Balances, December 31, 2022	**1,010,675**	**$ 7,627,495**	**$ -**	**$ 52,366,793**	**$ (14,411,184)**	**$ 45,583,104**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2022	**2021**
Cash flows from operating activities		
Net income	$ 7,932,892	$ 8,094,900
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	361,306	362,747
Amortization of goodwill	65,684	66,225
Net amortization of premiums on investment securities	430,212	382,520
Net loss on sale of investment securities	33,982	-
Mortgage servicing rights amortization	238,160	317,432
Provision for loan losses	955,804	331,274
Net gain on sale of loans	(376,343)	(1,100,835)
Foreclosed asset losses	34,792	6,424
Loss on sale and disposal of equipment	2,573	-
Increase in cash surrender value of bank owned life insurance	(258,833)	(255,312)
Deferred income tax benefit	(92,000)	(90,000)
Originations of mortgage loans held for sale	(12,781,099)	(32,883,801)
Proceeds from mortgage loan sales	13,606,743	34,435,035
Changes in operating assets and liabilities which (used) provided cash		
Accrued interest receivable	(297,884)	(81,840)
Other assets	(507,220)	(356,855)
Accrued interest payable and other liabilities	487,967	(432,726)
Net cash provided by operating activities	**9,836,736**	**8,795,188**
Cash flows from investing activities		
Net activity in certificates of deposit	990,000	742,000
Activity in held-to-maturity securities		
Purchases	-	(500,000)
Maturities, prepayments and calls	1,465,293	670,376
Activity in available-for-sale securities		
Purchases	(28,925,381)	(108,720,156)
Sales, maturities, prepayments and calls	12,905,234	7,272,429
Purchase of restricted investments	(370,300)	(172,200)
Loan principal (originations) collections, net	(100,671,283)	6,515,543
Purchases of premises and equipment	(141,059)	(96,557)
Proceeds from sale of equipment	12,500	-
Proceeds from sale of foreclosed assets	194,465	11,000
Net cash used in investing activities	**(114,540,531)**	**(94,277,565)**
Cash flows from financing activities		
Acceptances of deposits, net	38,523,867	56,788,322
Proceeds from (repayments of) borrowed funds	24,000,000	(3,000,000)
ESOP shares earned	-	326,081
Proceeds from issuance of common stock	1,789,550	964,114
Proceeds from exercise of common stock options, including tax benefit	-	13,163
Common stock repurchased and redeemed	(1,562,191)	(813,422)
Cash dividends paid	(1,796,894)	(1,443,524)
Net cash provided by financing activities	**60,954,332**	**52,834,734**
Net decrease in cash and cash equivalents	**(43,749,463)**	**(32,647,643)**
Cash and cash equivalents, beginning of year	51,355,811	84,003,454
Cash and cash equivalents, end of year	**$ 7,606,348**	**$ 51,355,811**

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

Notes to Consolidated Financial Statements

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of ***Tri-County Bancorp, Inc.*** , a registered bank holding company (the “Company”), and its wholly owned subsidiary, Tri-County Bank (the “Bank”). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is independently owned and operates a community bank engaged in the business of retail and commercial banking services through its twelve branches located in Sanilac, Lapeer, Macomb, St. Clair, and Tuscola counties in Michigan. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Bank’s primary markets. The Bank’s results of operations can be significantly affected by changes in interest rates or changes in the local economic environment.

The Bank is a state chartered bank and is a member of both the Federal Reserve Bank of Chicago (“FRB”) and the Federal Deposit Insurance Corporation (“FDIC”) Bank Insurance Fund. The Bank is also subject to the regulations and supervision of state regulators and undergoes periodic examinations by these regulatory authorities. The Company is further subject to regulations of the Federal Reserve Bank Board governing bank holding companies.

Concentration Risks

The Bank’s primary deposit products are interest and noninterest-bearing checking accounts, savings accounts and time deposits and its primary lending products are real estate mortgages, commercial, agricultural, and consumer loans. The Bank does not have any significant concentrations to any one industry, customer, or depositor.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and the reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses, and the valuations of impaired loans and other real estate owned.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Company and the Bank are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, and federal funds sold. Generally, federal funds are sold for a one-day period. The Bank maintains deposit accounts in various financial institutions which generally exceed FDIC insured limits or are not insured. Management does not believe the Company is exposed to any significant interest, credit, or other financial risk as a result of these deposits.

Certificates of Deposit

Certificates of deposit held by the Bank are those with original maturities of more than three months. Certificates of deposit are carried at cost. These deposits in other financial institutions may exceed insured limits. Management believes the Bank is not exposed to any significant interest rate or other financial risk on these deposits.

Fair Value Measurements

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2.

Investment Securities

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive loss. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the investment securities. Gains or losses on the sale of debt securities are recorded in investment income on the trade date and are determined using the specific identification method.

Debt securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other-than-temporary impairment exists, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not the Bank will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Bank must recognize an OTTI charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For these debt securities, the Bank separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Bank calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total OTTI related to credit risk is recognized in earnings and is included in noninterest expenses. The amount of the total OTTI related to other risk factors is recognized as a component of other comprehensive loss. For debt securities that have recognized an OTTI through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Restricted Investments

The Bank is a member of the Federal Home Loan Bank System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLB"). The amount of the required investment is based upon the available balance of the Bank's outstanding home mortgage loans or advances from the FHLB and is carried at cost plus the value assigned to stock dividends.

The Bank is also a member of the Federal Reserve Bank System ("FRB"). The amount of the required investment is determined by the FRB at the time the Bank becomes a member. The amount of the investment may be adjusted thereafter and is carried at cost.

Loans

Loans that management has the positive intent and ability to hold for the foreseeable future or until maturity or pay-off are generally reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Except for fees associated with origination of Paycheck Protection Program ("PPP") loans in 2021, management estimates that direct costs incurred in originating loans approximate the origination fees generated on these loans. Therefore, net deferred loan origination fees on loans classified as held-to-maturity are not included on the accompanying consolidated balance sheets, and there were no adjustments to the loan yields for loans originated during the years then ended. As noted above, loan origination fees associated with PPP loans are deferred and amortized over the contractual period of 24 months or 60 months, as applicable.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. Loans that become 180 days past due and are not in the process of collection will be foreclosed, the collateral disposed of, and any deficiency charged off. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on nonaccrual or are charged off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest on these loans is accounted for on the cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans are comprised of those loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more as to interest or principal payments and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses

The allowance for loan losses (“allowance”) is an estimate of loan losses inherent in the Bank’s loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the appropriateness of the total allowance after loan losses and loan growth. Loan losses are charged off against the allowance when the Bank determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

The allowance consists of two primary components: general reserves and specific reserves. For such loans that are classified as impaired, a specific reserve is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent three years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment allowances or disclosures, unless such loans are the subject of a restructuring agreement or in nonaccrual status.

The Bank evaluates the credit quality of loans in the consumer and residential (including construction) loan portfolios, based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans and loans past due as to principal or interest 90 days or more and loans modified under troubled debt restructurings are considered in a nonperforming status for purposes of credit quality evaluation.

Under certain circumstances, the Bank will provide borrowers relief through loan restructurings. A loan restructuring constitutes a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Bank grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Bank's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention (or Watch): Loans classified as special mention (watch) have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date. Special mention (watch) loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They 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 those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and are charged off immediately.

The majority of the Bank's consumer and residential loan portfolios are comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolios is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

The Bank maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, commercial real estate, agricultural, residential construction, residential real estate, and consumer and other, with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Commercial Real Estate: Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for the properties to produce sufficient cash flow to service debt obligations.

Agricultural: Agricultural loans generally possess a lower inherent risk of loss than other portfolio segments as crops are insured, in most cases, at a substantial portion of the crop’s expected income. Economic and environmental trends determined by commodity prices and crop yields can significantly impact the quality of these loans.

Residential Construction: Residential construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within a specified cost and time line. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Residential Real Estate: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer and Other: The consumer and other loan portfolios are usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examinations.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commercial letters of credit and standby letters of credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in the consolidated statements of income. There were no loans held for sale as of December 31, 2022 and $449,301 at December 31, 2021.

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans held-for-sale, as described above, 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 legally isolated from the Bank, 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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Bank has no substantive continuing involvement related to these loans. The Bank sold to an unrelated third party residential mortgage loans with proceeds of $13,606,743 and $34,435,035 in 2022 and 2021, respectively, which resulted in net gains of $376,343 and $1,100,835 in 2022 and 2021, respectively. Servicing fee income earned on such loans was $325,902 and $329,442 for 2022 and 2021, respectively, and is included in other noninterest income on the consolidated statements of income.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on fair value of rights compared to amortized cost at each reporting date. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type.

Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets on the consolidated balance sheets.

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recognized as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income, a component of other noninterest income.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, on the date of transfer, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in expenses from foreclosed assets in the consolidated statements of income. Foreclosed assets were $101,420 at December 31, 2022. There were no foreclosed assets at December 31, 2021.

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 2 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management reviews these assets for impairment whenever events or circumstances indicate the related carrying amount may not be recoverable.

Goodwill

Goodwill consists of amounts paid in excess of the fair value of assets acquired and liabilities assumed in connection with a business combination. The Company amortizes goodwill on a straight line basis over 10 years. Goodwill is also tested for impairment when a triggering event occurs that indicates that the fair value of the Company may be below its carrying amount. Goodwill is tested for impairment at the Company level. Goodwill amortization, which is recorded in other noninterest expenses, is insignificant in 2022 and 2021.

Bank-Owned Life Insurance

The Company holds life insurance policies purchased on the lives of key members of management. In the event of death of one of these individuals, the Company, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the consolidated balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in other noninterest income.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred income tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in federal income tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

Common Stock

Shares of common stock are purchased and redeemed in the ordinary course of business. The cost of common shares purchased and redeemed has been charged entirely to common stock.

Share-Based Compensation Plans

Compensation expense relating to share-based compensation plans is based on the fair value of the awards granted and is recognized on a straight-line basis over the requisite service period of each award.

Reclassification

Certain amounts as reported in the 2021 consolidated financial statements have been reclassified to conform with the 2022 presentation.

Subsequent Events

In preparing these consolidated financial statements, the Company has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2022, the most recent consolidated balance sheet presented herein, through March 16, 2023, the date these consolidated financial statements were available to be issued. No such significant events or transactions were identified, except as disclosed in Note 8.

Pending Accounting Standards, Not Yet Adopted

Accounting Standards Update ("ASU") 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, and all subsequent amendments to the ASU (collectively "ASU 326"). The standard was originally issued in 2016 with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions. The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates. In addition, the ASU amends existing guidance on accounting for credit losses on available-for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures. The ASU on credit losses will take effect for the Bank for fiscal years beginning after December 15, 2022. Management is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Company's consolidated financial statements.

2. FAIR VALUE MEASUREMENTS

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company only has securities available-for-sale which are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as investment securities held-to-maturity, impaired loans, loans held for sale, foreclosed assets, mortgage servicing rights, goodwill and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Investment Securities

Held-to-maturity debt securities are recorded at fair value on a nonrecurring basis, only when an other-than-temporary impairment is recorded. Debt securities classified as available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security’s credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or traded by dealers or brokers in active over-the-counter markets and money market funds.

Level 2 fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include U.S. Treasury and federal agency securities, government sponsored enterprises, collateralized mortgage obligations, mortgage-backed securities issued by government-sponsored entities, states and municipal bonds and corporate bonds.

For Level 3 securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. The Company did not have any securities classified as Level 1 or 3 at December 31, 2022 or 2021.

Impaired Loans

The fair value of impaired loans is measured in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2022 and 2021, a majority of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the impaired loan as nonrecurring Level 3.

Foreclosed Assets

Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the foreclosed asset as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the foreclosed asset as nonrecurring Level 3.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets Recorded at Fair Value on a Recurring Basis

The following tables set forth by level, within the fair value hierarchy, the recorded amount of investment securities measured at fair value on a recurring basis as of December 31:

	Assets at Fair Value			
2022	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale				
U.S. Treasury and federal agency	$ -	$ 55,313,750	$ -	$ 55,313,750
Government sponsored enterprises	-	28,564,062	-	28,564,062
Corporate bonds	-	1,237,008	-	1,237,008
Mortgage-backed securities	-	12,429,076	-	12,429,076
Collateralized mortgage obligations	-	3,839,956	-	3,839,956
States and municipal	-	32,113,795	-	32,113,795
Total assets at fair value	**$ -**	**$ 133,497,647**	**$ -**	**$ 133,497,647**

	Assets at Fair Value			
2021	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale				
U.S. Treasury and federal agency	$ -	$ 51,227,344	$ -	$ 51,227,344
Government sponsored enterprises	-	33,859,779	-	33,859,779
Corporate bonds	-	1,036,010	-	1,036,010
Mortgage-backed securities	-	16,720,257	-	16,720,257
Collateralized mortgage obligations	-	2,187,701	-	2,187,701
States and municipal	-	29,991,233	-	29,991,233
Total assets at fair value	**$ -**	**$ 135,022,324**	**$ -**	**$ 135,022,324**

Assets Recorded at Fair Value on a Nonrecurring Basis

Assets recorded at fair value on a nonrecurring basis for which impairment was recognized in the current period consist only of impaired loans.

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans, are classified as Level 3, and had carrying amounts of $157,749 and $788,742 as of December 31, 2022 and 2021, respectively, resulting in an allowance for loan losses allocation of $26,790 and $447,423 as of December 31, 2022 and 2021, respectively.

Quantitative information about Level 3 fair value measurements is as follows as of December 31:

2022	**Level 3 Instruments**				
Instrument		**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$	157,749	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	0% - 25%

2021	**Level 3 Instruments**				
Instrument		**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$	87,982	Discounted Cash Flow	Duration of Cash Flows	300 months
		700,760	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	0% - 25%

3. INVESTMENT SECURITIES

The amortized cost and fair value of debt securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
States and municipal	$ 458,661	$ 23	$ 47,744	$ 410,940
Available-for-Sale				
U.S. Treasury and federal agency	$ 60,724,912	$ -	$ 5,411,162	$ 55,313,750
Government sponsored enterprises	32,413,618	-	3,849,556	28,564,062
Corporate bonds	1,500,000	-	262,992	1,237,008
Mortgage-backed securities	14,493,489	-	2,064,413	12,429,076
Collateralized mortgage obligations	4,179,778	-	339,822	3,839,956
States and municipal	38,428,332	-	6,314,537	32,113,795
Total available-for-sale	**151,740,129**	**-**	**18,242,482**	**133,497,647**
Total	**$ 152,198,790**	**$ 23**	**$ 18,290,226**	**$ 133,908,587**

2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
States and municipal	$ 1,865,391	$ 24,137	$ 7,067	$ 1,882,461
Available-for-Sale				
U.S. Treasury and federal agency	$ 51,777,935	$ 35,548	$ 586,139	$ 51,227,344
Government sponsored enterprises	34,449,600	71,224	661,045	33,859,779
Corporate bonds	1,000,000	44,462	8,452	1,036,010
Mortgage-backed securities	16,892,801	78,338	250,882	16,720,257
Collateralized mortgage obligations	2,152,280	35,421	-	2,187,701
States and municipal	29,970,123	217,866	196,756	29,991,233
Total available-for-sale	**136,242,739**	**482,859**	**1,703,274**	**135,022,324**
Total	**$ 138,108,130**	**$ 506,996**	**$ 1,710,341**	**$ 136,904,785**

Investment securities with carrying values of approximately $25,500,000 and $1,000,000 at December 31, 2022 and 2021, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair value of held-to-maturity and available-for-sale debt securities grouped by contractual maturity at December 31, 2022, are summarized as follows:

	Maturing					
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Due After Ten Years	Securities With Variable Monthly Payments Or No Contractual Maturity	Total
Held-to-maturity						
States and municipal	$ 7,000	$ 451,661	$ -	$ -	$ -	$ 458,661
Available-for-Sale						
U.S. Treasury and federal agency	$ 3,019,298	$ 44,869,506	$ 12,836,108	$ -	$ -	$ 60,724,912
Government sponsored enterprises	-	25,409,793	7,003,825	-	-	32,413,618
Corporate bonds	-	-	1,000,000	500,000	-	1,500,000
Mortgage-backed securities	-	-	-	-	14,493,489	14,493,489
Collateralized mortgage obligations	-	-	-	-	4,179,778	4,179,778
States and municipal	-	5,759,660	27,159,606	5,509,066	-	38,428,332
Total available-for-sale	**3,019,298**	**76,038,959**	**47,999,539**	**6,009,066**	**18,673,267**	**151,740,129**
Total amortized cost	**$ 3,026,298**	**$ 76,490,620**	**$ 47,999,539**	**$ 6,009,066**	**$ 18,673,267**	**$ 152,198,790**
Total fair value	**$ 2,946,997**	**$ 69,464,226**	**$ 40,508,843**	**$ 4,719,489**	**$ 16,269,032**	**$ 133,908,587**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

Gross realized losses from calls, maturities, and sales amounted to $33,982 in 2022, which resulted in reclassifications from accumulated other comprehensive loss to noninterest expense. There were no gross realized gains or losses from calls, maturities, and sales in 2021.

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

	Less Than 12 Months		Over 12 Months			
2022	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Held-to-maturity						
States and municipal	$ 120,019	$ 643	$ 282,899	$ 47,101	$ 402,918	$ 47,744
Securities available-for-sale						
U.S. Treasury and federal agency	$ 8,720,156	$ 371,757	$ 46,593,594	$ 5,039,405	$ 55,313,750	$ 5,411,162
Government sponsored enterprises	-	-	28,564,062	3,849,556	28,564,062	3,849,556
Corporate bonds	858,282	141,718	378,726	121,274	1,237,008	262,992
Mortgage-backed securities	2,484,446	193,879	9,944,629	1,870,534	12,429,076	2,064,413
Collateralized mortgage obligations	3,598,554	323,621	241,402	16,201	3,839,956	339,822
States and municipal	12,748,163	2,144,962	19,365,632	4,169,575	32,113,795	6,314,537
Total securities available-for-sale	**$ 28,409,601**	**$ 3,175,937**	**$ 105,088,045**	**$ 15,066,545**	**$ 133,497,647**	**$ 18,242,482**

2021	Less Than 12 Months Fair Value	Less Than 12 Months Gross Unrealized Loss	Over 12 Months Fair Value	Over 12 Months Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
States and municipal	$ 407,933	$ 7,067	$ -	$ -	$ 407,933	$ 7,067
Securities available-for-sale						
U.S. Treasury and federal agency	$ 44,200,000	$ 586,139	$ -	$ -	$ 44,200,000	$ 586,139
Government sponsored enterprises	27,888,464	559,350	2,895,267	101,695	30,783,731	661,045
Corporate bonds	491,548	8,452	-	-	491,548	8,452
Mortgage-backed securities	11,147,021	177,615	1,910,716	73,267	13,057,737	250,882
States and municipal	15,073,304	182,262	485,505	14,494	15,558,809	196,756
Total securities available-for-sale	**$ 98,800,337**	**$ 1,513,818**	**$ 5,291,488**	**$ 189,456**	**$ 104,091,825**	**$ 1,703,274**

At December 31, 2022 and 2021, management conducted an analysis to determine whether all securities currently in an unrealized loss position should be considered other-than-temporarily-impaired (“OTTI”). Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Company will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

As of December 31, 2022, the Company’s investment security portfolio consisted of 136 securities in an unrealized loss position. Because the decline in the market value is attributable to changes in interest rates, and not credit quality, and because management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Company will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2022.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial and industrial, commercial real estate, agricultural, residential construction, residential real estate and consumer and other loans to customers located primarily in the Sanilac, Lapeer, Macomb, St. Clair, and Tuscola counties of Michigan. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate values and general economic conditions in this region. Substantially all of the consumer, agricultural, commercial real estate, and residential loans are secured by various items of property, while commercial and industrial loans are secured primarily by business assets and personal guarantees; a portion of loans are unsecured.

Loans are summarized by portfolio segment as follows at December 31:

	2022	2021
Commercial and industrial	$ 17,536,051	$ 18,606,919
Commercial real estate	230,152,744	145,909,416
Agricultural	89,915,675	72,927,883
Residential construction	3,193,200	3,720,267
Residential real estate	13,261,644	13,884,065
Consumer and other	4,284,615	3,494,621
Total loans	358,343,929	258,543,171
Allowance for loan losses	(3,243,258)	(2,827,302)
Loans, net	**$ 355,100,671**	**$ 255,715,869**

The changes in the allowance for loan losses and recorded investment in loans are as follows for the year ended December 31, 2022:

	Commercial and Industrial	Commercial Real Estate	Agricultural	Residential Construction	Residential Real Estate	Consumer and Others	Total
Allowance for loan losses:							
Balance at beginning of year	$ 731,736	$ 1,313,851	$ 571,765	$ 63,617	$ 114,942	$ 31,391	$ 2,827,302
Provision for loan losses	351,352	567,795	37,442	(16,677)	(3,228)	19,120	955,804
Loans charged off	(514,442)	-	(13,628)	-	-	(12,990)	(541,060)
Recoveries	-	890	-	-	-	322	1,212
Balance at end of year	$ 568,646	$ 1,882,536	$ 595,579	$ 46,940	$ 111,714	$ 37,843	$ 3,243,258
Allowance for loan losses attributable to:							
Individually evaluated for impairment	$ 26,790	$ -	$ -	$ -	$ -	$ -	$ 26,790
Collectively evaluated for impairment	541,856	1,882,536	595,579	46,940	111,714	37,843	3,216,468
Total allowance for loan losses	$ 568,646	$ 1,882,536	$ 595,579	$ 46,940	$ 111,714	$ 37,843	$ 3,243,258
Recorded investment in loans:							
Individually evaluated for impairment	$ 62,268	$ 72,321	$ -	$ -	$ 23,160	$ -	$ 157,749
Collectively evaluated for impairment	17,473,783	230,080,423	89,915,675	3,193,200	13,238,484	4,284,615	358,186,180
Total loans ending balance	17,536,051	230,152,744	89,915,675	3,193,200	13,261,644	4,284,615	358,343,929
Accrued interest receivable	16,406	789,988	1,346,466	8,671	42,288	17,905	2,221,724
Total recorded investment in loans	$ 17,552,457	$ 230,942,732	$ 91,262,141	$ 3,201,871	$ 13,303,932	$ 4,302,520	$ 360,565,653

The changes in the allowance for loan losses and recorded investment in loans are as follows for the year ended December 31, 2021:

	Commercial and Industrial	Commercial Real Estate	Agricultural	Residential Construction	Residential Real Estate	Consumer and Others	Total
Allowance for loan losses:							
Balance at beginning of year	$ 253,490	$ 1,214,910	$ 611,914	$ 110,223	$ 181,053	$ 41,837	$ 2,413,427
Provision for loan losses	478,246	98,151	(40,149)	(46,606)	(156,522)	(1,846)	331,274
Loans charged off	-	-	-	-	-	(8,600)	(8,600)
Recoveries	-	790	-	-	90,411	-	91,201
Balance at end of year	$ 731,736	$ 1,313,851	$ 571,765	$ 63,617	$ 114,942	$ 31,391	$ 2,827,302
Allowance for loan losses attributable to:							
Individually evaluated for impairment	$ 420,704	$ 26,719	$ -	$ -	$ -	$ -	$ 447,423
Collectively evaluated for impairment	311,032	1,287,132	571,765	63,617	114,942	31,391	2,379,879
Total allowance for loan losses	$ 731,736	$ 1,313,851	$ 571,765	$ 63,617	$ 114,942	$ 31,391	$ 2,827,302
Recorded investment in loans:							
Individually evaluated for impairment	$ 358,294	$ 232,958	$ 109,508	$ 87,982	$ -	$ -	$ 788,742
Collectively evaluated for impairment	18,248,625	145,676,458	72,818,375	3,632,285	13,884,065	3,494,621	257,754,429
Total loans ending balance	18,606,919	145,909,416	72,927,883	3,720,267	13,884,065	3,494,621	258,543,171
Accrued interest receivable	27,724	524,591	1,436,410	7,699	42,110	12,576	2,051,110
Total recorded investment in loans	$ 18,634,643	$ 146,434,007	$ 74,364,293	$ 3,727,966	$ 13,926,175	$ 3,507,197	$ 260,594,281

Notes to Consolidated Financial Statements

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2022:

	Risk Rating				
	Pass	Special Mention (or Watch)	Substandard	Doubtful	Total
Commercial credit risk profile by risk rating					
Commercial and industrial	$ 17,536,051	$ -	$ -	$ -	$ 17,536,051
Commercial real estate	229,570,351	390,668	191,725	-	230,152,744
Agricultural	88,532,268	-	1,383,407	-	89,915,675
Total	**$ 335,638,670**	**$ 390,668**	**$ 1,575,132**	**$ -**	**$ 337,604,470**

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2021:

	Risk Rating				
	Pass	Special Mention (or Watch)	Substandard	Doubtful	Total
Commercial credit risk profile by risk rating					
Commercial and industrial	$ 17,826,995	$ -	$ 779,924	$ -	$ 18,606,919
Commercial real estate	145,205,280	391,224	312,912	-	145,909,416
Agricultural	71,325,495	1,087,706	514,682	-	72,927,883
Total	**$ 234,357,770**	**$ 1,478,930**	**$ 1,607,518**	**$ -**	**$ 237,444,218**

The following table shows homogeneous loans allocated by payment activity as of December 31, 2022:

	Consumer Credit Risk Profile by Payment Activity			
	Residential Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 3,193,200	$ 13,238,484	$ 4,284,615	$ 20,716,299
Non-performing	-	23,160	-	23,160
Total	**$ 3,193,200**	**$ 13,261,644**	**$ 4,284,615**	**$ 20,739,459**

The following table shows homogeneous loans allocated by payment activity as of December 31, 2021:

	Consumer Credit Risk Profile by Payment Activity			
	Residential Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 3,720,267	$ 13,884,065	$ 3,494,621	$ 21,098,953
Non-performing	-	-	-	-
Total	**$ 3,720,267**	**$ 13,884,065**	**$ 3,494,621**	**$ 21,098,953**

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2022:

	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 17,463,315	$ 10,468	$ -	$ 62,268	$ 17,536,051
Commercial real estate	230,080,423	-	-	72,321	230,152,744
Agricultural	89,915,675	-	-	-	89,915,675
Residential construction	3,193,200	-	-	-	3,193,200
Residential real estate	13,102,616	135,868	-	23,160	13,261,644
Consumer and other	4,275,311	9,304	-	-	4,284,615
Total	**$ 358,030,540**	**$ 155,640**	**$ -**	**$ 157,749**	**$ 358,343,929**

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2021:

	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 18,219,424	$ 90,668	$ -	$ 296,827	$ 18,606,919
Commercial real estate	145,421,809	254,649	-	232,958	145,909,416
Agricultural	72,818,375	-	-	109,508	72,927,883
Residential construction	3,720,267	-	-	-	3,720,267
Residential real estate	13,825,962	58,103	-	-	13,884,065
Consumer and other	3,493,129	1,492	-	-	3,494,621
Total	**$ 257,498,966**	**$ 404,912**	**$ -**	**$ 639,293**	**$ 258,543,171**

The following table presents information related to impaired loans as of December 31, 2022:

	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial real estate	$ 72,321	$ 72,321	$ -	$ 106,611	$ 2,018
Residential real estate	23,160	23,160	-	24,023	1,438
Total	**95,481**	**95,481**	**-**	**130,634**	**3,456**
Loans with an allowance recorded					
Commercial and industrial	62,268	62,268	26,790	211,232	3,611
Total impaired loans					
Commercial and industrial	62,268	62,268	26,790	211,232	5,629
Commercial real estate	72,321	72,321	-	106,611	1,438
Residential real estate	23,160	23,160	-	24,023	-
Total	**$ 157,749**	**$ 157,749**	**$ 26,790**	**$ 341,866**	**$ 7,067**

Notes to Consolidated Financial Statements

The following table presents information related to impaired loans as of December 31, 2021:

	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 61,467	$ 61,467	$ -	$ 64,604	$ 2,756
Commercial real estate	132,639	132,639	-	87,803	7,396
Agricultural	109,508	109,508	-	146,992	-
Residential construction	87,982	87,982	-	139,059	3,410
Total	**391,596**	**391,596**	**-**	**438,458**	**13,562**
Loans with an allowance recorded					
Residential construction	296,827	296,827	420,704	99,319	-
Residential real estate	100,319	100,319	26,719	699,523	11,268
Total	**397,146**	**397,146**	**447,423**	**798,842**	**11,268**
Total impaired loans					
Commercial and industrial	358,294	358,294	420,704	163,923	2,756
Commercial real estate	232,958	232,958	26,719	787,326	18,664
Agricultural	109,508	109,508	-	146,992	-
Residential construction	87,982	87,982	-	139,059	3,410
Total	**$ 788,742**	**$ 788,742**	**$ 447,423**	**$ 1,237,300**	**$ 24,830**

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

There were no loans modified in troubled debt restructurings (TDRs) during 2022 or 2021.

There were no TDRs that had payment defaults during 2022 or 2021.

5. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2022 and 2021, approximated $135,814,000 and $134,877,000, respectively; such loans are not included on the accompanying consolidated balance sheets.

The fair value of mortgage servicing rights was $1,764,400 and $1,107,085 at December 31, 2022 and 2021, respectively. The fair value of servicing rights was determined using discount rates of 5.97% and 1.99% at December 31, 2022 and 2021, respectively, and average prepayment speeds ranging from 5.0% to 10.0% and 11.6% to 31.2% at December 31, 2022 and 2021, respectively.

The following summarizes the carrying value and the changes therein of mortgage servicing rights included in other assets on the accompanying consolidated balance sheets at December 31:

	2022	2021
Mortgage servicing rights		
Balance at beginning of year	$ 886,188	$ 813,553
Mortgage servicing rights originated	159,877	390,067
Mortgage servicing rights amortized	(238,160)	(317,432)
Balance at end of year	**$ 807,905**	**$ 886,188**

There were no valuation allowances related to mortgage servicing rights as of December 31, 2022 and 2021.

6. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following components at December 31:

	2022	2021
Land	$ 2,012,558	$ 2,012,558
Buildings and improvements	6,564,496	6,545,668
Furniture and equipment	5,027,100	5,229,851
Construction in process	3,224	16,358
Total	13,607,378	13,804,435
Less accumulated depreciation	6,688,169	6,649,906
Premises and equipment, net	**$ 6,919,209**	**$ 7,154,529**

Depreciation expense was $361,306 and $362,747 for 2022 and 2021, respectively.

7. DEPOSITS

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

	2022	2021
Interest-bearing		
Money market and NOW accounts	$ 108,375,547	$ 88,192,712
Savings	113,297,567	105,409,847
Time, $250,000 and over	3,314,884	3,847,751
Other time	42,372,880	38,712,227
Total interest-bearing	267,360,878	236,162,537
Noninterest-bearing demand	186,261,327	178,935,801
Total deposits	**$ 453,622,205**	**$ 415,098,338**

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2022, are summarized as follows:

Year	Amount
2022	$ 26,773,135
2023	5,664,807
2024	5,439,628
2025	3,771,858
2026	4,038,336
Total	**$ 45,687,764**

8. BORROWED FUNDS (INCLUDING SUBSEQUENT EVENT)

At December 31, 2022, the Bank has approximately $21,000,000 available under a long-term line of credit with the Federal Home Loan Bank. Under the terms of this agreement, the Bank may borrow at a mutually agreed-upon interest rate at the time of borrowing. The Federal Home Loan Bank ("FHLB") borrowings are collateralized by a blanket lien on all qualified 1-to-4 family whole mortgage loans with a carrying value of approximately $187,000,000. Outstanding borrowings amounted to $16,000,000 at rates ranging from 4.19% - 4.35%, due beginning January 6, 2023, at December 31, 2022; such borrowings were renewed and/or paid off in 2023. There were no outstanding borrowings at December 31, 2021.

The FHLB advances and their contractual maturities are as follows at December 31:

		2022
Putable fixed rate advances:		
January 6, 2023	4.19%	$ 13,000,000
January 18, 2023	4.35%	3,000,000
Total FHLB advances		**$ 16,000,000**

The Bank may also borrow funds on a short-term basis with the Federal Reserve, through the FRB Discount Window advance program. FRB Discount Window advances generally mature within one to four days from the transaction date. Advances through the FRB Discount Window amounted in $8,000,000 at December 31, 2022. There were no such advances at December 31, 2021.

The Bank also has a $5,000,000 line-of-credit available from another financial institution. Under the terms of this agreement, the Bank may borrow at a mutually agreed upon interest rate at the time of the borrowing. No such borrowings were outstanding at December 31, 2022 and 2021.

9. FEDERAL INCOME TAXES

The provision for federal income taxes consists of the following components for the years ended December 31:

	2022	2021
Currently payable	$ 2,091,000	$ 2,121,000
Deferred benefit	(92,000)	(90,000)
Income taxes	**$ 1,999,000**	**$ 2,031,000**

A reconciliation between income tax expense reported and the amount computed by applying the statutory federal income tax rate of 21% to income before income taxes is as follows for the years ended December 31:

	2022	2021
Income tax provision at statutory rate	$ 2,086,000	$ 2,126,000
Effect of tax-exempt interest income	(30,000)	(54,000)
Other - net	(57,000)	(41,000)
Income tax expense	**$ 1,999,000**	**$ 2,031,000**

Significant components of the Company's deferred income tax asset, included in other assets in the accompanying consolidated balance sheets, are comprised of the following amounts at December 31:

	2022	2021
Deferred tax assets		
Allowance for loan losses	$ 681,000	$ 448,000
Accrued vacation	26,000	20,000
Unrealized loss on available-for-sale securities	3,831,000	256,000
Other	2,000	39,000
Total deferred tax assets	**4,540,000**	**763,000**
Deferred tax liabilities		
Premises and equipment	394,000	413,000
Mortgage servicing rights	170,000	186,000
Intangible assets	30,000	44,000
Allowance for loan loss recapture	130,000	-
Other	63,000	34,000
Total deferred tax liabilities	787,000	677,000
Net deferred tax asset	**$ 3,753,000**	**$ 86,000**

The Company concluded that there are no significant uncertain tax positions requiring recognition in these consolidated financial statements based on the evaluation performed for 2019 through 2022, the years which remain subject to examination by major tax jurisdictions as of December 31, 2022. The Company does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Company does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2022 and 2021, and it is not aware of any claims for such amounts by federal or state income tax authorities.

10. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated approximately $2,680,000 and $2,770,000 at December 31, 2022 and 2021, respectively.

Deposits

Deposits of Company directors, executive officers and their affiliates were approximately $3,760,000 and $3,642,000 at December 31, 2022 and 2021, respectively.

11. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making commitments, including requirements for collateral, as it does for on-balance sheet instruments; no significant losses are anticipated as a result of these commitments.

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

	Contract Amount	
	2022	**2021**
Unfunded commitments under lines of credit	$ 45,150,000	$ 40,587,000
Commitments to grant loans	6,542,000	15,353,000
Commercial and standby letters of credit	437,500	191,500

Unfunded commitments under commercial and consumer lines of credit, revolving lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit may be uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

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

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2022 and 2021.

12. DERIVATIVE FINANCIAL INSTRUMENTS

Interest Rate Risk Management – Derivative Instruments Not Designated As Hedging Instruments

Certain derivative instruments do not meet the criteria for hedging requirements. These derivative instruments are generally recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in other noninterest income.

Derivative Loan Commitments

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Bank enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Bank to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of mortgage loan commitments was overall insignificant at December 31, 2022 and 2021.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments and mortgage loan held for sale, the Bank utilizes "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a "best efforts" contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Bank expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of forward loan sale commitments was overall insignificant at December 31, 2022 and 2021.

The fair value of the rate lock loan commitments related to the origination of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recorded in these consolidated financial statements.

13. REGULATORY REQUIREMENTS

Capital Requirements

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

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (CBLR framework), for qualifying community banking organizations, consistent with Section 201 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* . The final rule became effective on January 1, 2021 and was elected by the Bank as of December 31, 2021. In April 2021, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* , and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rules the community bank leverage ratio minimum requirement is 8.5% as of December 31, 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the bank maintains a leverage ratio of 7.5% as of December 31, 2021, 8.5% for calendar year 2022, and 9% for calendar year 2022 and beyond.

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2022 and 2021, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

Actual and required capital amounts (in thousands) and ratios are presented below at year end.

	Actual		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2022	**Amount**	**Ratio**	**Amount**	**Ratio**
(Dollars in thousands)				
Tier 1 (Core) Capital to Average Assets				
Tri-County Bank	$ 59,707	11.69%	$ 45,968	9.00%

	Actual		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2021	**Amount**	**Ratio**	**Amount**	**Ratio**
(Dollars in thousands)				
Tier 1 (Core) Capital to Average Assets				
Tri-County Bank	$ 53,355	11.26%	$ 40,283	8.50%

Restrictions on Cash and Amounts Due from Banks

The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2022 or 2021.

Restrictions on Dividends, Loans and Advances

Federal and state banking regulations place certain restrictions on the amount of loans or advances that can be extended to the Company by the Bank and dividends that can be paid to the Company by the Bank. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10% of the Bank's capital stock and surplus on a secured basis. In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

14. CONTINGENCIES

Litigation

The Company is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Company is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2022.

15. EMPLOYEE BENEFIT PLANS

ESOP Plan

The Company has an Employee Stock Ownership Plan ("ESOP") covering substantially all of its employees. Discretionary cash contributions to the Plan are recorded as compensation expense and was approximately $275,000 and $612,000 in 2022 and 2021, respectively. Distributions from the Plan may be in the form of whole shares of stock, cash, or a combination of both, based on the estimated fair value of the stock on the date of distribution. All ESOP shares are treated as issued and outstanding for earnings per share calculations. As of December 31, 2022, the ESOP held 141,484 total shares, of which all shares were allocated.

401(k) Plan

The Bank sponsors a defined contribution savings plan qualified under Section 401(k) of the Internal Revenue Code. Substantially all full-time employees of the Bank are covered under the Plan. The Bank matches the employee contributions equally up to 5% of the participant's compensation. Contributions to the Plan were $107,053 and $103,276, respectively in 2022 and 2021.

16. SHARE-BASED COMPENSATION

Share-based compensation expense related to employee stock options is measured on the grant date, based on the fair value of the award calculated at that date, and is recognized over the employee's requisite service period, which generally is the options' vesting period. Fair value is calculated using the Black-Scholes option pricing model.

Under the Company's Employee Stock Option Plan, the Company may grant options to its directors, officers and employees for the purchase of up to a maximum lifetime limit of 10,000 shares of common stock per participant, and up to a maximum of 150,000 shares under this plan. The exercise of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is ten years. The options are immediately vested upon grant date.

The expected volatility is based on the historical volatility of American Community Bankers' Association Index. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected term is based on historical exercise experience.

Prior to 2018, the Company's policy was to issue new shares upon performance of the Bank's return on average assets as defined in the Plan; during 2018 the Board of Directors elected to cease issuance of options in the future, therefore, no options were granted during 2022 or 2021. A summary of the changes in the status of the Company's stock option plan is presented below.

	Common Shares Subject to Option	Weighted Average Exercise Price	Average Remaining Contractual Term (years)
Outstanding at January 1, 2021	**1,950**	**$ 28.00**	**4.62**
Exercised	(450)	29.25	
Outstanding at December 31, 2021	1,500	27.63	3.50
Exercised	-	-	
Outstanding at December 31, 2022	**1,500**	**$ 27.63**	**3.50**

Of the options exercised in 2021, 450 shares of common stock were issued. As of December 31, 2021, 1,500 options under the plan are outstanding at a weighted average exercise price of $27.63 (range of $26.00 – $29.25), all of which are exercisable. There were no options exercised in 2022.

17. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	2022	2021
Interest	$ 1,264,000	$ 1,020,242
Income taxes	$ 1,888,760	$ 2,208,000

Non-Cash Investing Activities

Collateral repossessed on loans having carrying values in the amount of $330,677 and $17,424 on the date of transfer was transferred to foreclosed assets in 2022 and 2021, respectively.

18. REVENUE FROM CONTRACTS WITH CUSTOMERS

A description of the Company's revenue streams accounted for under ASC 606 follows:

The Bank earns fees from its deposit customers for transaction-based fees, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Bank fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Bank satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance. The Bank also earns interchange fees from debit and credit cardholder transactions conducted through merchant payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

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