STURGIS BANCORP, INC.

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2023 and 2022

STURGIS BANCORP, INC.

FINANCIAL STATEMENTS
December 31, 2023 and 2022

CONTENTS

Rehmann

INDEPENDENT AUDITORS' REPORT

March 28, 2024

Board of Directors and Shareholders
Sturgis Bancorp, Inc.
Sturgis, Michigan

Opinion

We have audited the accompanying consolidated financial statements of Sturgis Bancorp, Inc. (the "Bancorp"), which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (the "financial statements").

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sturgis Bancorp, Inc. as of December 31, 2023 and 2022, 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 Bancorp and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Change in Accounting Principle

As described in Note 1 to the consolidated financial statements, in 2023 the Bancorp adopted Accounting Standards Codification 326, *Financial Instruments – Credit Losses.* Our opinion is not modified with respect to this matter.

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, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

2330 E. Paris Ave SE, Grand Rapids, MI 49546 616.975.4100

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 Bancorp'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 judgment 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 Bancorp's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bancorp's ability to continue as a going concern for a reasonable period of time.

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

Rehmann Robson LLC

STURGIS BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
December 31, 2023 and 2022
(Amounts in thousands, except share and per share data)

	2023	2022
ASSETS		
Cash and due from banks	$ 10,243	$ 14,008
Other short-term investments	29,766	977
Total cash and cash equivalents	40,009	14,985
Securities – available-for-sale	52,658	63,159
Securities – held-to-maturity	20,866	22,070
Federal Home Loan Bank stock	7,295	8,381
Loans held for sale	2,259	664
Loans, net of allowance for credit losses of $10,198 and $7,141 at December 31 2023 and 2022, respectively	739,461	699,443
Premises and equipment, net	19,136	17,431
Goodwill	5,834	5,834
Mortgage servicing rights	2,979	2,967
Real estate owned	130	380
Bank-owned life insurance	15,832	15,988
Accrued interest receivable	3,099	2,691
Other assets	9,914	10,812
Total assets	$ 919,472	$ 864,805
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 159,899	$ 162,978
Interest-bearing	639,039	556,538
Total deposits	798,938	719,516
Federal Home Loan Bank advances and other borrowings	40,000	71,000
Subordinated debentures – $15,000 face amount (less unamortized debt issuance costs of $164 and $245 at December 31, 2023 and 2022)	14,836	14,755
Accrued interest payable	1,654	760
Other liabilities	8,276	6,226
Total liabilities	863,704	812,257
Stockholders' equity		
Common stock - $1 par value: authorized – 9,000,000 shares issued and outstanding 2,150,191 shares at December 31, 2023 and 2,141,191 shares at December 31, 2022	2,150	2,141
Additional paid-in capital	8,556	8,387
Retained earnings	52,029	48,990
Accumulated other comprehensive loss	(6,967)	(6,970)
Total stockholders' equity	55,768	52,548
Total liabilities and stockholders' equity	$ 919,472	$ 864,805

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2023 and 2022
(Amounts in thousands, except share and per share data)

	2023	2022
Interest and dividend income		
Loans (including fees)	$ 37,964	$ 26,548
Investment securities:		
Taxable	1,965	1,582
Tax-exempt	361	500
Dividends	479	281
Total interest and dividend income	40,769	28,911
Interest expense		
Deposits	10,725	2,652
Borrowed funds	1,542	1,835
Total interest expense	12,267	4,487
Net interest income	28,502	24,424
Credit loss expense	1,269	-
Net interest income, after credit loss expense	27,233	24,424
Noninterest income		
Service charges on deposits and other fees	1,356	1,253
Interchange income	1,349	1,286
Investment brokerage commission income	2,203	1,881
Mortgage banking activities	1,484	1,389
Trust fee income	365	411
Earnings on cash value of bank owned life insurance	887	390
Gain on sale of real estate owned, net	56	6
Gain on termination of interest rate swap	793	-
Proportionate net income from unconsolidated subsidiaries	224	352
Other income	190	81
Total noninterest income	8,907	7,049
Noninterest expenses		
Compensation and benefits	17,459	14,450
Occupancy and equipment	3,739	3,139
Interchange expenses	650	578
Data processing	988	490
Professional services	525	348
Advertising	723	525
FDIC premiums	675	364
Other expenses	4,224	3,585
Total noninterest expenses	28,983	23,479
Income before income tax expense	7,157	7,994
Income tax expense	1,139	1,374
Net income	$ 6,018	$ 6,620
Earnings per share	$ 2.81	$ 3.10

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2023 and 2022
(Amounts in thousands, except share and per share data)

	2023	2022
Net income	$ 6,018	$ 6,620
Other comprehensive income (loss)		
Unrealized holding gain (loss) on AFS securities arising during the period	947	(11,390)
Reclassification adjustment for losses recognized on securities	133	-
Tax effect	(227)	2,391
Net of tax	853	(8,999)
Change in post-retirement obligation	681	(190)
Reclassification adjustment for amortization of prior service cost and net loss (gain) included in net periodic pension cost	(613)	45
Tax effect	(14)	31
Net of tax	54	(114)
Unrealized gain on cash flow hedge	388	4,685
Reclassification adjustment for losses recognized in net income	(1,532)	216
Tax effect	240	(1,029)
Net of tax	(904)	3,872
Total other comprehensive income (loss)	3	(5,241)
Comprehensive income	$ 6,021	$ 1,379

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 31, 2023 and 2022
(Amounts in thousands, except share and per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance – January 1, 2022	$ 2,132	$ 8,210	$ 43,823	$ (1,729)	$ 52,436
Comprehensive income	-	-	6,620	(5,241)	1,379
Common stock issued (8,900 shares)	9	177	-	-	186
Cash dividends ($0.68 per share)	-	-	(1,453)	-	(1,453)
Balance – December 31, 2022	2,141	8,387	48,990	(6,970)	52,548
Change in accounting principle (Note 1)	-	-	(1,522)	-	(1,522)
Comprehensive income	-	-	6,018	3	6,021
Common stock issued (9,000 shares)	9	169	-	-	178
Cash dividends ($0.68 per share)	-	-	(1,457)	-	(1,457)
Balance – December 31, 2023	$ 2,150	$ 8,556	$ 52,029	$ (6,967)	$ 55,768

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2023 and 2022
(Amounts in thousands)

	2023	2022
Cash flows from operating activities		
Net income	$ 6,018	$ 6,620
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and software amortization	1,345	1,058
Amortization of mortgage servicing rights	566	478
Amortization of core deposit intangible	-	49
Amortization of subordinated debt issuance costs	81	82
Credit loss expense	1,269	-
Accretion and amortization of securities	303	484
Gain on sale of fixed assets	(109)	-
Gain on sale of loans	(1,348)	(995)
Proceeds from the sale of loans held for sale	43,616	44,770
Loans originated for sale	(44,441)	(37,627)
(Reversal) of mortgage servicing rights valuation allowance	-	(10)
Gain on sale of real estate owned	(49)	(6)
Write-down of real estate owned	50	-
Loss on sale of available for sale securities	133	-
Decrease (increase) in cash value of bank-owned life insurance	156	(390)
Shares issued/expensed	178	186
Changes in assets and liabilities:		
Increase in accrued interest and other assets	(258)	(2,193)
Increase (decrease) in accrued interest and other liabilities	2,715	(469)
Net cash provided by operating activities	10,225	12,037
Cash flows from investing activities		
Net interest-earning time deposits in banks	-	494
Maturities of securities available-for-sale	15	15
Proceeds from sale of securities available for sale	8,008	-
Principal reduction on securities available-for-sale	3,170	8,165
Principal reduction on securities held-to-maturity	1,156	2,198
Purchase of loans	-	(2,838)
Loan principal originations, net	(43,202)	(154,792)
Proceeds from sale of real estate owned	542	-
Sale (purchase) of FHLB stock	1,086	(430)
Proceeds from sales of premises and equipment	296	-
Additions to premises and equipment	(3,237)	(5,258)
Net cash used in investing activities	(32,166)	(152,446)

(Continued)

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2023 and 2022
(Amounts in thousands)

	2023	2022
Cash flows from financing activities		
Net increase in deposits	$ 79,422	$ 135,323
Repayment of FHLB advances and other borrowings	(332,300)	(199,500)
Proceeds from FHLB advances and other borrowings	301,300	181,500
Cash dividends paid on common stock	(1,457)	(1,453)
Net cash provided by financing activities	46,965	115,870
Net change in cash and cash equivalents	25,024	(24,539)
Cash and cash equivalents – beginning of year	14,985	39,524
Cash and cash equivalents – end of year	$ 40,009	$ 14,985
Supplemental information		
Cash paid for:		
Interest	$ 11,372	$ 4,151
Income taxes	1,005	1,153
Noncash investing and financing activities		
Loans transferred to real estate owned	293	374

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation: The accompanying consolidated financial statements include the accounts of Sturgis Bancorp, Inc. (the Bancorp), Sturgis Bank & Trust Company (the Bank) and the Bank's wholly owned subsidiaries. The Bank's wholly owned subsidiaries include Oakleaf Financial Services, Inc., Oak Mortgage, LLC, and First Michiana Development Corporation of Sturgis, Inc. All significant intercompany transactions and balances have been eliminated in consolidation. Oakleaf Financial Services offers a complete range of investment and financial advisory services. Oak Mortgage offers residential mortgages in all markets of the Bank. First Michiana Development Corporation invests in unconsolidated subsidiaries Ayres Insurance Agency, Inc. and Oak Title, LLC. Ayres Insurance Agency, Inc., doing business as Ayres/Oak Insurance, offers various commercial and consumer insurance products. Oak Title, LLC offers commercial and consumer title insurance.

The Bank, which has been in continuous operation since 1905, formed the Bancorp on January 1, 2002 via an equal exchange of common stock of the Bank for common stock of the Bancorp.

Use of Estimates: In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

Nature of Operations: The Bancorp operates predominantly in the southwestern portion of Michigan's Lower Peninsula. Its primary services include accepting deposits, making commercial and mortgage loans, engaging in mortgage banking activities, and providing investment brokerage advisory services.

The Bank is a state-chartered bank and a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations and supervision of the FDIC and state regulators and undergoes periodic examinations by these regulatory authorities. The Bancorp is also subject to regulations of the Federal Reserve Board governing bank holding companies.

Significant Group Concentrations of Credit Risk: Most of the Bancorp's activities are with customers located within southwestern Michigan. Note 2 Securities, discusses the types of securities in which the Bancorp invests. Note 3 Loans, discusses the types of lending in which the Bancorp engages. The Bancorp's loan portfolio is concentrated in residential and commercial mortgage loans. The Bancorp does not have any significant concentrations to any one industry or customer.

Cash Flows: For the purpose of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other short-term time and investment accounts at the Federal Home Loan Bank, all of which mature within 90 days. Net cash flows are reported for customer loan and deposit transactions, interest bearing time deposits in banks, and other short-term investments.

Interest-Earning Deposits in Banks: Interest-earning deposits in banks mature within one year and are carried at cost.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities: Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held-to-maturity are classified as available-for-sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities, which is the earlier of call date or maturity date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

A debt security is placed on nonaccrual status at the time any principal or interest payments become 90 days delinquent. Interest accrued but not received for a security placed on nonaccrual is reversed against interest income.

Allowance for Credit Losses - Available-for-Sale Securities

In estimating the allowance for credit losses of available-for-sale debt securities in an unrealized loss position, management first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet this criteria, management evaluates whether the decline in fair value has resulted from credit losses or other factors. Management also considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. 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, limited by the amount that the fair value is less than the amortized cost basis. 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 credit loss expense (or reversal). Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on available-for-sale debt securities totaled $192 at December 31, 2023 and is excluded from the estimate of credit losses.

Allowance for Credit Losses - Held-to-Maturity Securities

Held-to-maturity debt securities are measured on a collective basis by major security type for expected credit losses, if any. Management classifies the held-to-maturity portfolio into major security types. The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. Accrued interest receivable on held-to-maturity debt securities totaled $37 at December 31, 2023 and is excluded from the estimate of credit losses.

The held-to-maturity securities consist entirely of mortgage-backed residential securities which are government agency issued and are therefore either explicitly or implicitly guaranteed by the U.S. government, highly rated by major rating agencies and have a long history of no credit losses.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Home Loan Bank Stock: The Bank is a member of the Federal Home Loan Bank of Indianapolis (FHLB). Members are required to own a certain amount of stock based on the level of borrowings and other factors and may invest in additional amounts. FHLB stock is carried at cost plus the value assigned to stock dividends, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value. The fair value includes the servicing value of the loans as well as any accrued interest.

Mortgage loans held for sale are generally sold with servicing rights retained. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loans sold. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right.

Loans: The Bancorp grants mortgage, commercial, and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, the allowance for credit losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. The accrued interest related to loans was $2,866 at December 31, 2023, and is excluded from the estimate of credit losses. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to the related loan yield using the interest method. Recorded investment in loans includes unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, unamortized deferred fees and costs, accrued interest receivable, and negative escrow balances.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well-secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, if collection of principal and interest is considered doubtful, loans are placed on nonaccrual, charged off, or charged down to the fair value.

When a loan is placed in nonaccrual status, all interest accrued in the current year but not collected is reversed against interest income, while interest accrued but not collected in prior years is reversed against the allowance for credit losses. Interest payments received on loans in nonaccrual status are accounted for as reductions to the carrying value of the principal. Loans are returned to accrual status when all the 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 of the loan portfolio are comprised of those loans accounted for on a nonaccrual basis (90 days or more past due on commercial loans, 120 days or more past due on secured consumer loans, and 180 days past due on residential real estate loans).

Allowance for Credit Losses: The allowance for credit losses ("allowance") is a valuation account that is deducted from, or added to, the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loan losses are charged against the allowance, when management believes the uncollectability of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management estimates the allowance balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. The Bancorp uses a Discounted Cash Flow model which projects cash flows over the life of the loan. Management has utilized top-down data from prior cycles, using both the institution's own data and peer institution data from FFIEC Call Report filings. The Bancorp uses the Federal Open Market Committee (FOMC) as a source to obtain various forecast scenarios to determine the loan portfolio's expected credit loss. Historical credit loss experience provides the basis for the estimation of expected credit losses. Qualitative adjustments are made to historical loss information that may increase or reduce reserve levels and include adjustments for changes in lending policies, procedures, and strategies, changes in nature and volume of portfolio, staff experience, changes in volume and trends in classified loans, delinquencies, and nonaccruals, concentration risk, trends in underlying collateral value, external factors, such as competition, legal, and regulatory, changes in quality of the loan review system and other economic condition considerations.

The allowance for credit losses is measured on a collective (pool) basis when similar risk characteristics exist. The Bancorp has identified the following portfolio segments:

Commercial – Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes. The risk characteristics of these loans vary based on the borrower's business and industry as repayment is typically dependent on cash flows generated from the underlying business.

Commercial Real Estate, Hotel loans, and Commercial Construction – Loans to individuals or businesses that are secured by improved and unimproved vacant land, farmland, commercial real property, multifamily residential properties, and all other conforming, nonresidential properties. The risk characteristics are similar to commercial loans, but these loan segments may also be dependent on real estate sales or rental income. For commercial construction, proceeds may be used for land acquisition, development or construction.

Consumer – Term loans or lines of credit for the purchase of consumer goods and vehicles. The risk characteristics of this loan segment vary depending on the type of collateral, but general repayment is expected from an individual continuing to generate a cash flow that supports the calculated payment obligation.

Residential and Residential Construction – Loans to purchase or refinance single family residences. The risks associated with these segments are similar to the risks for consumer loans regarding individual payment obligations however the underlying collateral is the real estate. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons. For residential construction, proceeds may be used for land acquisition, development, or construction of residential properties.

Home equity – Loans to purchase consumer goods or home improvements. The risks associated with this segment are similar to residential loans, however typically these loans are secured by second lien positions in real estate.

Loans that do not share risk characteristics are evaluated on an individual basis. A loan is considered impaired, based on current information and events, when it is probable the Bancorp will be unable to collect the scheduled payments of principal or interest in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status,

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls are not generally classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, reasons for the delay, the borrower's prior payment history, and the amount of the shortfall in relation to the amount due compared to the present value of expected future cash flows discounted at the loan's effective interest rate, the loans observable market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral. Impairment on a loan is generally measured on a loan-by-loan basis for commercial, commercial real estate, and residential loans where the borrower has been identified as having financial difficulty.

The majority of the Bancorp's consumer and residential loan portfolio is 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 Bancorp'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 portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

For the commercial and commercial real estate portfolio segments, the historical loss is tracked by year of charge off. Grades are assigned to each commercial and commercial real estate loan by accessing information about the specific borrower's situation and the estimated collateral values. The description of the loan grade criteria is included in Note 3 *Loans*.

For borrowers that are in financial distress, the Bancorp may provide relief to the borrower by modifying the loan through principal forgiveness, term extension, interest rate reduction or an other-than-significant payment delay. When principal forgiveness is provided, the amount of the forgiveness is charged off against the allowance for credit losses.

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 Bancorp'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 examination.

<u>Transfers of Financial Assets</u>: Transfers of financial assets, including mortgage loans held for sale, are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bancorp, 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 the Bancorp does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as discussed in Note 5 *Mortgage Servicing Rights*, the Bancorp has no substantive continuing investment related to these loans.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Originated Mortgage Servicing Rights: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. 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. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for individual groupings, to the extent that fair value is less than the carrying amount. Changes in valuation allowances are reported with mortgage banking activities on the consolidated statements of income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the consolidated statements of income as mortgage banking activities, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled $842 and $834 for the years ended December 31, 2023 and 2022, respectively, and is included in mortgage banking activities on the consolidated statements of income. Late fees and ancillary fees related to loan servicing were not material for presentation.

Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. Buildings and related components are depreciated with useful lives ranging from 5 to 40 years. Furniture, fixtures, and equipment are depreciated with useful lives ranging from 3 to 15 years. Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Lease Arrangements: The Bancorp enters into leases in the normal course of business primarily for various operating equipment. Leases are classified as operating or finance leases at the lease commencement date. The Bancorp has elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the consolidated balance sheet. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of use assets represent the Bancorp's right to use an underlying asset for the lease term and lease liability represent the Bancorp's obligation to make lease payments arising from the lease. Right-of-use assets and lease liability are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term. As of December 31, 2023 and 2022, there was no material identified right-of-use asset or liability on the consolidated balance sheets.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate Owned: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, less costs to sell when acquired, 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 carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in real estate owned expense, net, on the consolidated statements of income.

Bank-Owned Life Insurance: The Bancorp has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. 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 noninterest income on the consolidated statements of income.

Goodwill: Generally, intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill with indefinite lives are not amortized, but are evaluated for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value. There has been no impairment of goodwill.

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

The allowance for credit losses on off-balance-sheet credit exposures is a liability account, calculated in accordance with ASC 326, representing expected credit losses over the contractual period for which the Bancorp is exposed to credit risk resulting from a contractual obligation to extend credit. No allowance is recognized if the Bancorp has the unconditional right to cancel the obligation. Adjustments to the allowance are reported in the consolidated statement of income as a component of credit loss expense. For the period of exposure, the estimate of expected credit losses considers both the likelihood that funding will occur and the amount expected to be funded over the estimated remaining life of the commitment or other off-balance-sheet exposure. The likelihood and expected amount of funding are based on historical utilization rates. The amount of the allowance represents management's best estimate of expected credit losses on commitments expected to be funded over the contractual life of the commitment. Estimating credit losses on amounts expected to be funded uses the same methodology as described for loans as if such commitments were funded.

Derivatives: The Bancorp periodically enters into cash flow hedge agreements. For each cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same period during which the hedged transaction affects earnings. Changes in the fair value of derivatives that are not highly effective in hedging the changes in expected cash flows of the hedged item are recognized immediately in current earnings.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Bancorp formally documents the relationship between hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking cash flow hedges to specific liabilities on the consolidated balance sheet or to specific firm commitments or forecasted transactions. The Bancorp also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in cash flows of the hedged items. The Bancorp discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a cash flow hedge is discontinued but the hedged cash flow or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

Income Taxes: Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and the tax bases of the various balance sheet assets and liabilities. This method gives current recognition to changes in tax rates and laws. When necessary, valuation allowances are established to reduce deferred tax assets to the amount expected 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.

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

The Bancorp recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Share: Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes outstanding additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. As of December 31, 2023 and 2022, there were no dilutive common shares. For the years ended December 31, 2023 and 2022, weighted average shares used in computing earnings per share were 2,144,723 and 2,135,654, respectively.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Common and Preferred stock issuances: The Bancorp issues common stock to directors for their board service. Shares are issued on a quarterly basis in accordance with the amount of director fees established annually. Shares of 9,000 and 8,900 were issued for directors' fees in 2023 and 2022, respectively, and vested immediately upon issuance. Expense associated with the issuance of stock for director fees is reflected in the consolidated income statement in other noninterest expense and was $178 and $186 for 2023 and 2022, respectively. The Bancorp also has authorized 1,000,000 shares of preferred stock. No preferred shares have been issued or are outstanding.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, changes in the fair value of cash flow hedges, and changes in the post retirement benefit obligation, which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal action arising in the normal course of business, are recorded as liabilities when the likelihood of loss is probable, and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the Bancorp's consolidated financial statements.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. For more information, see Note 14 *Fair Value of Financial Instruments*.

Revenue Recognition: The majority of the Bancorp's revenues come from interest income and other sources, including loans, securities, and derivatives, that are outside of the scope of ASC 606 *Revenue from Contracts with Customers*. The Bancorp's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Bancorp satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposits, interchange income, wealth management fees, investment brokerage fees, and the sale of real estate owned.

Deposit service charges include transaction-related fee income, such as NSF fees or ATM fees, and are recognized as income when the service is performed. Deposit service charges also include recurring charges for the account, which are recognized as income at the time the charges are assessed. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are deducted from the customer's account balance. Interchange income is recognized on a monthly basis on a one-month delay, so the Bancorp accrues an estimate of interchange income receivable.

The Bancorp earns wealth management (and investment brokerage) fees from its contracts with trust (and brokerage) customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Bancorp provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided include (financial planning services) and the fees the Bancorp earns, which are based on a fixed fee schedule, are recognized when the services are rendered.

The Bancorp earns fees from investment brokerage services provided to its customers by a third-party service provider. The Bancorp receives commissions from the third-party service provider on a monthly basis based

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

upon customer activity for the month. The fees are recognized quarterly, and a receivable is recorded until commissions are generally paid by the 25th of the following quarter. Because the Bancorp (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers, investment brokerage fees are presented net of related costs.

Gain on sale of real estate owned is calculated and recognized as income upon sale of the real estate.

Reclassifications: Certain amounts as reported on the 2022 consolidated financial statements have been reclassified to conform with the 2023 presentation.

Adoption of New Accounting Standard

Accounting Standards Update ("ASU") 2016-13, *Financial Instruments - Credit Losses* (Accounting Standards Codification ("ASC") Topic 326): Measurement of Credit Losses on Financial Instruments, as amended, replaces the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss ("CECL") methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to certain off-balance sheet credit exposures not accounted for as insurance (including loan commitments, standby letters of credit, and other similar instruments) and net investments in leases recognized by a lessor in accordance with Topic 842 on leases. Prior to ASU No. 2016-13, GAAP required an "incurred loss" methodology for recognizing credit losses that delayed recognition until it was probable a loss had been incurred. Under the incurred loss approach, entities were limited to a probable initial recognition threshold when credit losses were measured; an entity generally only considered past events and current conditions when measuring the incurred loss. ASC 326 also updated the accounting for available-for-sale debt securities to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities management does not intend to sell or believes that it is more likely than not they will be required to sell as well as other changes.

The Bancorp adopted ASC 326 on January 1, 2023, using the modified retrospective method for all financial assets measured at amortized cost, and off-balance-sheet credit exposures. Results for reporting periods beginning after January 1, 2023, are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP.

The transition adjustment of the CECL adoption included an increase in the allowance for credit losses of $1,615, which included a $1,276 decrease to the retained earnings account to reflect the cumulative effect of adopting CECL on the consolidated balance sheet, with the $339 tax impact portion being recorded as part of the deferred tax asset in other assets on the consolidated balance sheet. The transition adjustment of the CECL adoption included an additional allowance for credit losses on unfunded commitments of $312, which included a $246 decrease to the retained earnings account to reflect the cumulative effect of adopting CECL on the consolidated balance sheet, with the $66 tax impact portion being recorded as part of the deferred tax asset in other assets on the consolidated balance sheet.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following table details the impact of the adoption of ASC 326 on January 1, 2023:

Assets:	Pre-Adoption Allowance	Impact of Adoption	Post-Adoption Allowance	Cumulative Effect on Retained Earnings
Allowance for credit losses on loans				
Commercial and industrial	$ 709	$ (278)	$ 431	$ 220
Commercial real estate	2,638	216	2,854	(171)
Real estate construction	450	223	673	(176)
Residential real estate	2,615	1,604	4,219	(1,267)
Consumer and other	94	19	113	(15)
Home equity	635	(169)	466	134
Total	**$ 7,141**	**$ 1,615**	**$ 8,756**	**$ (1,276)**
Liabilities:				
Allowance for credit losses on off-balance-sheet credit exposures	$ -	$ 312	$ 312	$ (246)

Subsequent Events: In preparing these consolidated financial statements, the Bancorp has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2023, the most recent balance sheet presented herein, through March 28, 2024, the date these consolidated financial statements were available to be issued.

On January 26, 2024, the Bancorp terminated an interest rate swap with notional amount of $17.5 million. The swap termination generated a gain of $1,070 that was recorded after year end 2023. No other subsequent events were identified.

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES

The amortized cost and fair value of securities with gross unrealized / unrecognized gains and losses follow as of December 31:

	Amortized Cost	Gross Unrealized/ Unrecognized Gains	Gross Unrealized/ Unrecognized Losses	Fair Value
2023				
Available-for-sale securities:				
U. S. government sponsored entities and agencies	$ 9,994	$ -	$ (2,090)	$ 7,904
State and political subdivisions	11,508	-	(1,315)	10,193
Mortgage-backed securities-residential	18,079	-	(2,827)	15,252
Mortgage-backed securities-commercial	13,826	-	(1,921)	11,905
Collateralized mortgage obligations (“CMO”)	9,114	-	(1,710)	7,404
Total available-for-sale	62,521	-	(9,863)	52,658
Held-to-maturity securities:				
Mortgage-backed securities-residential	20,866	-	(3,931)	16,935
Total securities	$ 83,387	$ -	$ (13,794)	$ 69,593
2022				
Available-for-sale securities:				
U. S. government sponsored entities and agencies	$ 10,027	$ -	$ (2,310)	$ 7,717
State and political subdivisions	19,755	5	(1,624)	18,136
Mortgage-backed securities-residential	19,633	-	(3,201)	16,432
Mortgage-backed securities-commercial	14,483	-	(1,890)	12,593
Collateralized mortgage obligations (“CMO”)	10,202	-	(1,921)	8,281
Total available-for-sale	74,100	5	(10,946)	63,159
Held-to-maturity securities:				
Mortgage-backed securities-residential	22,070	-	(4,209)	17,861
Total securities	$ 96,170	$ 5	$ (15,155)	$ 81,020

Securities with amortized cost of $8,432 (fair value of $7,102) were pledged at December 31, 2023 to secure FRB borrowings. No securities were pledged for borrowings at December 31, 2022.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES (Continued)

No securities were pledged at December 31, 2023 to secure derivatives. Securities with an amortized cost of $5,180 (fair value of $4,162) were pledged at December 31, 2022 to secure derivatives.

Securities with fair value of $8,008 were sold in the year ended December 31, 2023, generating a $133 loss on sale. There were no securities sales during the year ended December 31, 2022.

The amortized cost and fair value of securities by contractual maturity at December 31, 2023 are shown below. Actual and expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ 20	$ 20
Due after one through five years	-	-	946	902
Due after five through ten years	-	-	8,457	7,342
Due after ten years	-	-	12,079	9,833
Mortgage-backed securities-residential	20,866	16,935	18,079	15,252
Mortgage-backed securities-commercial	-	-	13,826	11,905
Collateralized mortgage obligations ("CMO")	-	-	9,114	7,404
	$ 20,866	$ 16,935	$ 62,521	$ 52,658

Available-for-sale securities with unrealized losses at year end, aggregated by investment category for which an allowance for credit losses has not been recorded and length of time that individual securities have been in a continuous unrealized loss position, are as follows as of December 31:

	Less than 12 Months		12 Months or More		Total	
Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2023						
Available-for-sale securities:						
U. S. government sponsored entities and agencies	$ -	$ -	$ 7,904	$ (2,090)	$ 7,904	$ (2,090)
State and political subdivisions	-	-	8,650	(1,315)	8,650	(1,315)
Mortgage-backed securities – residential	-	-	15,252	(2,827)	15,252	(2,827)
Mortgage-backed securities – commercial	-	-	11,905	(1,921)	11,905	(1,921)
CMO	-	-	7,404	(1,710)	7,404	(1,710)
Total available-for-sale	$ -	$ -	$51,115	$ (9,863)	$ 51,115	$ (9,863)

There were 67 securities in an unrealized loss position on December 31, 2023.

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES (Continued)

The following table summarizes with unrealized and unrecognized losses aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position at December 31:

	Less than 12 Months		12 Months or More		Total	
Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2022						
Available-for-sale securities:						
U. S. government sponsored entities and agencies	$ -	$ -	$ 7,717	$ (2,310)	$ 7,717	$ (2,310)
State and political subdivisions	16,421	(1,545)	501	(79)	16,922	(1,624)
Mortgage-backed securities – residential	3,026	(347)	13,406	(2,854)	16,432	(3,201)
Mortgage-backed securities – commercial	2,818	(240)	9,775	(1,650)	12,593	(1,890)
CMO	1,115	(135)	7,166	(1,786)	8,281	(1,921)
Total available-for-sale	$ 23,380	$ (2,267)	$38,565	$ (8,679)	$ 61,945	$(10,946)
Held-to-maturity securities:						
Mortgage-backed securities – residential	$ -	$ -	$17,861	$ (4,209)	$ 17,861	$ (4,209)

There were 83 securities in an unrealized loss position on December 31, 2022.

Allowance for Credit Losses – Available-for-Sale Securities

As of December 31, 2023, no allowance for credit losses has been recognized on available-for-sale securities in an unrealized loss position as Management does not believe any of the securities are impaired due to reasons of credit quality. This is based upon Management's analysis of the underlying risk characteristics, including credit ratings, and other qualitative factors related to our available for sale securities and in consideration of our historical credit loss experience and internal forecasts. The issuers of these securities continue to make timely principal and interest payments under the contractual terms of the securities. Furthermore, Management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline.

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES (Continued)

Allowance for Credit Losses – Held-to-Maturity Securities

The allowance for credit losses on held-to-maturity securities is a contra-asset valuation account that is deducted from the amortized cost basis of held-to-maturity securities to present the net amount expected to be collected. Management measures expected credit losses on held-to-maturity securities on a collective basis by major security type with each type sharing similar risk characteristics, and considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. With regard to securities issued by local municipal entities, Management considers (i) whether issuers continue to make timely principal and interest payments under the contractual terms of the securities, (ii) internal forecasts and (iii) whether or not such securities are guaranteed or pre-refunded by the issuers.

The Bancorp monitors the credit quality of debt securities held-to-maturity through review of the annual financial statements, ongoing interest payments, their historical experience with applicable municipal entities.

At December 31, 2023, the Bancorp had no securities held-to-maturity that were past due 30 days or more as to principal or interest payments. The Bancorp had no securities held-to-maturity classified as nonaccrual for the year ended December 31, 2023.

NOTE 3 – LOANS

A summary of the balances of loans follows:

	2023	2022
Residential loans:		
Residential	$ 361,286	$ 316,378
Home equity	69,859	63,284
Residential construction	21,117	24,279
Total residential loans	452,262	403,941
Commercial real estate loans:		
Commercial real estate	225,692	225,660
Commercial construction	6,237	14,047
Total commercial real estate loans	231,929	239,707
Commercial loans	53,123	51,950
Consumer loans	10,961	10,034
	748,275	705,632
Less:		
Allowance for credit losses	(10,198)	(7,141)
Add:		
Deferred loan origination and other costs, net of fees	1,384	952
Loans, net	$ 739,461	$ 699,443

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

The following table presents the activity in the allowance for credit losses by portfolio segment under the CECL methodology for the year ended December 31, 2023:

	Residential	Home Equity	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial	Consumer	Total
December 31, 2023								
Allowance for credit losses:								
Beginning balance, prior to adoption of ASC 326	$ 2,615	$ 635	$ 275	$ 2,638	$ 175	$ 709	$ 94	$ 7,141
Impact of adopting ASC 326	1,604	(169)	136	216	87	(278)	19	1,615
Credit loss expense	856	18	(78)	(316)	(262)	928	129	1,275
Loans charged-off	-	(15)	-	(5)	-	(30)	(138)	(188)
Recoveries collected	334	-	1	-	-	16	4	355
Total ending allowance balance	$ 5,409	$ 469	$ 334	$ 2,533	$ -	$ 1,345	$ 108	$ 10,198

Prior to adoption of ASC 326 on January 1, 2023, the Bancorp calculated the allowance for loan losses under the incurred loss methodology. The following table presents the activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2022:

	Residential	Home Equity	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial	Consumer	Total
December 31, 2022								
Allowance for loan losses:								
Beginning balance	$ 2,261	$ 656	$ 240	$ 3,106	$ 187	$ 502	$ 79	$ 7,031
Provision for loan losses	335	(72)	36	(499)	(12)	191	21	-
Loans charged-off	-	-	(1)	-	-	-	(7)	(8)
Recoveries	19	51	-	31	-	16	1	118
Total ending allowance balance	$ 2,615	$ 635	$ 275	$ 2,638	$ 175	$ 709	$ 94	$ 7,141

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

(continued)

	Residential	Home Equity	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial	Consumer	Total
December 31, 2022								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 30	$ -	$ -	$ 75	$ -	$ -	$ -	$ 105
Collectively evaluated for impairment	2,585	635	275	2,563	175	709	94	7,036
Total ending allowance balance	$ 2,615	$ 635	$ 275	$ 2,638	$ 175	$ 709	$ 94	$ 7,141
Loans:								
Loans individually evaluated for impairment	$ 1,686	$ 10	$ -	$ 2,936	$ -	$ 164	$ -	$ 4,796
Loans collectively evaluated for impairment	315,932	64,112	24,415	223,417	14,093	52,146	10,048	704,163
Total ending recorded investment in loans	$ 317,618	$ 64,122	$ 24,415	$ 226,353	$ 14,093	$ 52,310	$ 10,048	$ 708,959

The recorded investment in loans includes accrued interest receivable and loan origination fees, net. For purposes of this disclosure, unpaid principal balance has been reduced by partial charge offs, if any.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2022:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash basis Interest Income Recognized
December 31, 2022						
With no related allowance recorded:						
Residential	$ 1,413	$ 1,416	$ -	$ 1,449	$ 77	$ 77
Commercial real estate	2,586	2,613	-	2,708	116	116
Commercial	161	164	-	188	10	10
Subtotal	4,160	4,193	-	4,345	203	203
With an allowance recorded:						
Residential	269	270	30	272	12	12
Commercial real estate	322	323	75	335	19	19
Home equity	9	10	-	10	1	1
Subtotal	600	603	105	617	32	32
Total	$ 4,760	$ 4,796	$ 105	$ 4,962	$ 235	$ 235

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

The following table presents the amortized cost basis of loans on nonaccrual status and loans past due over 89 days and still accruing as of December 31, 2023:

	Nonaccrual With No Allowance For Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing
Residential	$ 31	$ 777	$ 320
Home equity	-	7	82
Commercial real estate	1,001	1,501	-
Commercial	-	8,467	-
Total	$ 1,032	$ 10,752	$ 402

The Company recognized $459 of interest income on nonaccrual loans during the year ended December 31, 2023.

The following table presents the recorded investment in nonaccrual and loans past due over 89 days still on accrual by class of loans as of December 31, 2022:

	Nonaccrual	Loans Past Due Over 89 Days Still Accruing
Residential	$ 147	$ -
Commercial real estate	-	73
Total	$ 147	$ 73

The following table presents the amortized cost basis of individually evaluated or nonaccrual loans or loans otherwise designated as having a higher credit risk and are collateral-dependent loans by class of loans as of December 31, 2023:

	Real Estate	Reserve
Commercial real estate	$ 80	$ 20

(Continued)

(Amounts in thousands, except share and per share data)

The following table presents the aging of the amortized cost basis in past-due loans as of December 31, 2023 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans not Past Due	Total
December 31, 2023						
Residential	$ 1,154	$ 786	$ 568	$ 2,508	$ 359,385	$ 361,893
Home equity	311	272	82	665	69,862	70,527
Residential construction	-	-	-	-	21,133	21,133
Commercial real estate	1,453	-	-	1,453	224,241	225,694
Commercial construction	-	-	-	-	6,222	6,222
Commercial	787	-	-	787	52,465	53,252
Consumer	68	-	-	68	10,870	10,938
Total amortized cost	$ 3,773	$ 1,058	$ 650	$ 5,481	$ 744,178	$ 749,659

The following table presents the aging of the recorded investment in past due loans as of December 31, 2022 by class of loan:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans not Past Due	Total
December 31, 2022						
Residential	$ 1,428	$ 648	$ 147	$ 2,223	$ 315,395	$ 317,618
Home equity	206	15	-	221	63,901	64,122
Residential construction	-	-	73	73	24,342	24,415
Commercial real estate	313	16	-	329	226,024	226,353
Commercial construction	-	-	-	-	14,093	14,093
Commercial	-	-	-	-	52,310	52,310
Consumer	50	37	-	87	9,961	10,048
Total recorded investment	$ 1,997	$ 716	$ 220	$ 2,933	$ 706,026	$ 708,959

(Continued)

NOTE 3 – LOANS (Continued)

Occasionally, the Bancorp modifies loans to borrowers in financial distress by providing modifications, such as principal forgiveness, term extension, or other-than-insignificant payment delay or interest rate reduction. When principal forgiveness is provided, the amount of forgiveness is charged-off against the allowance for credit losses.

The Bancorp may provide multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted.

During the years ended December 31, 2023 and 2022, no such loan modifications were offered for borrowers in financial distress.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

There were no loans modified for borrowers experiencing financial difficulty for which there was a payment default within the twelve months following the modification during the years ended December 31, 2023 and 2022.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Bancorp's internal underwriting policy.

Credit Quality Indicators:

The Bancorp categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bancorp analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $250 and non-homogeneous loans, such as commercial and commercial real estate loans, unless such loans have a government guaranty. This analysis is performed on a quarterly basis. The Bancorp uses the following definitions for risk ratings:

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

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bancorp's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bancorp 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 liquidation in full, on the basis of currently existing facts, condition, and values, highly questionable and improbable.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than $250 or are included in groups of homogeneous loans. Management monitors loans reported to be not rated by segregating between performing and nonperforming loans, which generally uses delinquency statistics.

Based on the most recent analysis performed, the risk category of loans by class of loans by origination year is as follows:

As of December 31, 2023	2023	2022	2021	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Commercial loans							
Risk rating							
Pass	$ 4,304	$ 7,575	$ 3,986	$ 8,675	$ 18,310	$ 1,258	$ 44,108
Special mention	-	-	-	5	594	-	599
Substandard	-	4,467	69	9	4,000	-	8,545
Doubtful	-	-	-	-	-	-	-
Total commercial loans	$ 4,304	$ 12,042	$ 4,055	$ 8,689	$ 22,904	$ 1,258	$ 53,252
Commercial loans							
Current period gross write offs	$ -	$ 30	$ -	$ -	$ -	$ -	$ 30
Commercial real estate							
Risk rating							
Pass	$ 25,350	$ 49,279	$ 50,039	$ 93,851	$ -	$ -	$ 218,519
Special mention	-	-	-	4,506	-	-	4,506
Substandard	-	907	463	1,299	-	-	2,669
Doubtful	-	-	-	-	-	-	-
Total commercial real estate	$ 25,350	$ 50,186	$ 50,502	$ 99,656	$ -	$ -	$ 225,694
Commercial real estate							
Current period gross write offs	$ 5	$ -	$ -	$ -	$ -	$ -	$ 5
Construction loans - Commercial							
Risk rating							
Pass	$ -	$ -	$ -	$ -	$ 6,222	$ -	$ 6,222
Special mention	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-
Total construction loans – Commercial	$ -	$ -	$ -	$ -	$ 6,222	$ -	$ 6,222
Construction loans – Commercial							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -

(Continued)

(Amounts in thousands, except share and per share data)

As of December 31, 2023 (cont)	2023	2022	2021	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Residential							
Payment performance							
Performing	$ 50,133	$119,118	$ 90,499	$101,095	$ -	$ -	$ 360,845
Nonperforming	-	520	315	213	-	-	1,048
Total residential	$ 50,133	$119,638	$ 90,814	$101,308	$ -	$ -	$ 361,893
Residential							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Home equity							
Payment performance							
Performing	$ 6,345	$ 2,825	$ 1,229	$ 2,501	$ 56,582	$ 1,037	$ 70,519
Nonperforming	-	-	8	-	-	-	8
Total home equity	$ 6,345	$ 2,825	$ 1,237	$ 2,501	$ 56,582	$ 1,037	$ 70,527
Home equity							
Current period gross write offs	$ -	$ -	$ -	$ 15	$ -	$ -	$ 15
Construction loans – Residential							
Payment performance							
Performing	$ -	$ -	$ -	$ -	$ 21,133	$ -	$ 21,133
Nonperforming	-	-	-	-	-	-	-
Total construction loans - Residential	$ -	$ -	$ -	$ -	$ 21,133	$ -	$ 21,133
Construction loans - Residential							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer							
Payment performance							
Performing	$ 4,594	$ 3,412	$ 1,405	$ 1,067	$ 460	$ -	$ 10,938
Nonperforming	-	-	-	-	-	-	-
Total consumer	$ 4,594	$ 3,412	$ 1,405	$ 1,067	$ 460	$ -	$ 10,938
Consumer							
Current period gross write offs	$ -	$ 50	$ 40	$ 48	$ -	$ -	$ 138

(Continued)

(Amounts in thousands, except share and per share data)

Based on the most recent analysis performed, the risk category of loans by class is as follows:

	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
December 31, 2022						
Residential	$ 15,750	$ 30	$ 160	$ -	$ 301,678	$ 317,618
Home equity	1,701	-	-	-	62,421	64,122
Residential construction	-	-	73	-	24,342	24,415
Commercial real estate	223,085	438	2,830	-	-	226,353
Commercial construction	14,093	-	-	-	-	14,093
Commercial	52,120	94	96	-	-	52,310
Consumer	191	-	-	-	9,857	10,048
Total	$ 306,940	$ 562	$ 3,159	$ -	$ 398,298	$ 708,959

NOTE 4 – PREMISES AND EQUIPMENT

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

	2023	2022
Land	$ 2,983	$ 2,811
Land improvements	1,176	580
Office buildings	16,548	17,078
Furniture, fixtures, and equipment	9,856	10,761
Leasehold improvements	1,031	113
Construction in progress	10	44
Total premises and equipment	31,604	31,387
Less accumulated depreciation	(12,468)	(13,956)
Net carrying amount	$ 19,136	$ 17,431

Depreciation expense and software amortization for the years ended December 31, 2023 and 2022 amounted to $1,345 and $1,058, respectively.

NOTE 5 – MORTGAGE SERVICING RIGHTS

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgages and other loans serviced for others were $341,154 and $335,851 at December 31, 2023 and 2022, respectively.

The fair values of the rights to service these loans were $4,607 and $4,306 at December 31, 2023 and 2022, respectively. The fair value of servicing rights at December 31, 2023 was determined using a discount rate of 11% and prepayment speeds ranging from 6.00 to 15.29 Conditional Prepayment Rate (“CPR”), depending on the stratification of the servicing right. The fair value of servicing rights at December 31, 2022 was determined using a discount rate of 10% and prepayment speeds ranging from 6.00 to 33.58 CPR, depending on the stratification of the servicing right.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 5 – MORTGAGE SERVICING RIGHTS (Continued)

The following summarizes the activity in mortgage servicing rights and the related valuation allowance as of December 31:

	2023	2022
Mortgage servicing rights:		
Balance at beginning of year	$ 2,967	$ 2,963
Mortgage servicing rights capitalized	578	472
Mortgage servicing rights amortized	(566)	(478)
Change in valuation allowance	-	10
Balance at end of year	$ 2,979	$ 2,967
Valuation allowance:		
Balance at beginning of year	$ -	$ 10
Additions	-	14
Reductions credited to operations	-	(24)
Balance at end of year	$ -	$ -

NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS

Limited Partnerships

The following table summarizes the Bancorp's limited partnership investments recorded as of December 31:

			2023			2022		
Investment	Year Invested	Ownership %	Asset (a)	Unfunded Commitment (b)	Amortization/ Impairment (c)	Asset (a)	Unfunded Commitment (b)	Amortization/ Impairment (c)
TGap 2	2008	0.950	$ 95	$ -	$ 1	$ 96	$ -	$ 1
Great Lakes XX	2010	4.878	23	14	9	32	14	18
Great Lakes XX-2	2012	4.546	22	9	13	35	13	49
Great Lakes XX-3	2014	7.692	243	23	86	329	25	74
Cinnaire Michigan Fund for Housing LP 20-6	2020	6.250	772	74	98	870	441	84
Totals			$ 1,155	$ 120	$ 207	$ 1,362	$ 493	$ 226

NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS (Continued)

(a) Investments are included in other assets on the consolidated balance sheets at December 31, 2023 and 2022.

(b) Unfunded commitments are included in other liabilities on the consolidated balance sheets at December 31, 2023 and 2022.

(c) Amortization / impairment expense of $1 is included in other noninterest expense on the consolidated statements of income for both the years ended December 31, 2023 and 2022. Amortization / impairment expense of $206 and $225 for the years ended December 31, 2023 and 2022, respectively, is included in income tax expense on the consolidated statements of income.

The TGap 2 investment represents investments in venture capital limited partnerships that mostly invest in medical research companies. The Bancorp anticipates receiving income in the future from the sale of these medical research companies to a third party. There were no distributions from the venture capital limited partnerships in 2023. There were distributions from the venture capital limited partnerships of $8 in 2022.

The Great Lakes and Cinnaire investments represent interests in limited partnerships operating in southwest Michigan. The limited partnerships were formed to rehabilitate and operate multi-family housing units. All income, expenses and tax credits will be allocated to the Bancorp based upon ownership percentage. As an investor, the Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreements that require a majority approval of the limited partners. At such time as the projects are sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreements, the Bancorp is allocated tax losses and affordable housing federal income tax credits.

The Bancorp's share of tax credits generated by the above partnerships totaled $212 in 2023 and $215 in 2022.

<u>Equity Investments</u>

The Bancorp has a 49% partnership interest in Ayres Insurance Agency, Inc., an insurance company, with 51% owned by a director. The Bancorp's investment in Ayres Insurance Agency, Inc. of $2,665 and $1,864 as of December 31, 2023 and 2022, respectively is recorded in other assets on the consolidated balance sheets. The Bancorp recorded income of $165 in 2023 and $240 in 2022 on Ayres Insurance Agency, Inc., respectively, in the consolidated statements of income. For more information, see Note 13 *Related Party Transactions*.

The Bancorp has a 35% partnership interest in Oak Title, LLC, a title insurance company, with unrelated parties owning 65% as of December 31, 2023 and 2022. The Bancorp's investment of $90 and $115 as of December 31, 2023 and 2022, respectively, is recorded in other assets on the consolidated balance sheets. The Bancorp recorded income of $59 and $112 in the consolidated statements of income in 2023 and 2022, respectively.

(Amounts in thousands, except share and per share data)

NOTE 7 – DEPOSITS

Interest-bearing deposit balances at December 31 are summarized as follows:

	2023	2022
Savings accounts	$ 150,973	$ 168,083
NOW accounts	195,030	202,334
Time:		
$250 and over	149,068	91,002
Under $250	143,968	95,119
	$ 639,039	$ 556,538

At December 31, 2023, the scheduled maturities of time deposits are as follows:

Maturing in the Year Ending December 31,	Under $250	$250 and Over
2024	$ 129,318	$ 106,005
2025	9,398	39,383
2026	3,568	3,680
2027	1,004	-
2028	655	-
Thereafter	25	-
	$ 143,968	$ 149,068

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

The Bancorp had advances from the Federal Home Loan Bank of Indianapolis (FHLB) of $40,000 at December 31, 2023, with maturity dates through 2024. The Bancorp had advances from the FHLB of $71,000 at December 31, 2022, with maturity dates through 2024. At December 31, 2023, the interest rates on the advances ranged from 2.42% to 5.52%. At December 31, 2022, the interest rates on the advances ranged from 2.42% to 4.28%. These advances are subject to prepayment penalties as defined in the credit policy of the FHLB.

The Bancorp has an available six-month line of credit with the FHLB which provides for advances up to $25,000 and matures in 2024. There were no balances outstanding on this line of credit at December 31, 2023 or 2022.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS (Continued)

The advances and 6-month line of credit are collateralized by certain performing non-employee residential and commercial mortgage loans. The unpaid principal balance of pledged loans was approximately $382,065 and $201,000 at December 31, 2023 and 2022, respectively.

Contractual maturities of FHLB advances are as follows for the years following December 31:

	2023	2022
2023	$ -	$ 61,000
2024	40,000	10,000
	$ 40,000	$ 71,000

On December 30, 2020, the Bancorp issued subordinated debt for $15,000, maturing in 2030. The interest rate is fixed at 5% until 2024, payable on June 30 and December 30 each year. For the subsequent five years, the interest rate is floating at 4.73% over SOFR with quarterly resets. Beginning in 2025, the Bancorp may redeem the debt at par, in whole or in part. Costs recorded in 2020 to issue the debt were $400 with $81 amortized in 2023 and $82 amortized in 2022. The Bancorp invested $3,000 from the proceeds of the subordinated debt in the Bank in 2021 and $10,000 in 2020, which qualifies for Tier 1 capital for the Bank. The Bancorp itself has no minimum capital requirements.

NOTE 9 – INCOME TAXES

The following is a summary of the provision for income taxes for the years ended December 31:

	2023	2022
Current expense	$ 1,707	$ 1,045
Deferred (benefit) expense	(568)	329
Income taxes	$ 1,139	$ 1,374

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 9 – INCOME TAXES (Continued)

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

	2023	2022
Amount computed at statutory rate	$ 1,503	$ 1,679
Tax-exempt income from Bank-owned life insurance	(186)	(82)
Tax-exempt interest income	(151)	(173)
Amortization of low-income housing investments	206	224
Low-income housing tax credits	(212)	(215)
Other, net	(21)	(59)
Income taxes	$ 1,139	$ 1,374

The components of the net deferred tax asset (liability) were as follows as of December 31:

	2023	2022
Deferred tax assets:		
Allowance for loan losses	$ 2,169	$ 1,378
Unfunded pension liability	111	125
Deferred compensation	832	470
Unrealized loss on available-for-sale securities	2,071	2,298
Other	290	170
	5,473	4,441
Deferred tax liabilities:		
Deferred loan fees	$ (295)	$ (204)
Mortgage servicing rights	(633)	(629)
Amortization of goodwill	(1,149)	(1,133)
Depreciation	(1,060)	(903)
FHLB stock dividends	(19)	(55)
Cash flow hedge	(330)	(570)
Other	(253)	(185)
	(3,739)	(3,679)
Net deferred tax asset	$ 1,734	$ 762

The Bancorp and its subsidiaries are subject to U.S. federal income tax as well as income tax to the State of Indiana. The Bancorp is no longer subject to examination by taxing authorities for years before 2020.

The Bancorp is qualified under provisions of the Internal Revenue Code to deduct from taxable income a provision for bad debts in excess of such provision charged to income in the consolidated financial statements. Accordingly, retained earnings at December 31, 2023 and 2022 included approximately $918 for which no provision for federal income taxes has been made. Unrecognized deferred taxes on this amount are approximately $193. In the future, if this portion of retained earnings is used for any purpose other than to absorb bad debt losses, federal income taxes would be imposed at the then applicable rates.

(Continued)

NOTE 9 – INCOME TAXES (Continued)

There were no unrecognized tax benefits at December 31, 2023 and the Bancorp does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

For the years ended 2023 and 2022, interest and penalties related to income tax matters were not material.

NOTE 10 – RETIREMENT BENEFITS

Multi-Employer Defined Benefit Pension Plan: The Bancorp participated in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra DB Plan), which is a tax-qualified, multi-employer defined benefit pension plan, covering substantially all of the officers and employees of the Bank and its subsidiaries. The defined benefit plan provided benefits to all full-time employees with one year of service, based on basic compensation and years of service. The Bancorp contributions are determined by the Plan and generally represent the normal cost of the Plan. Specific Plan assets and accumulated benefit information for the Bancorp's portion of the fund are not available. Under the Employee Retirement Income Security Act (ERISA), a contributor to a multi-employer pension plan may be liable in the event of complete or partial withdrawal for the benefit payments guaranteed under ERISA. The plan is administered by the trustees of the Financial Institutions Retirement Fund ("FIRF"). The Bancorp froze future benefits to participants effective March 1, 2011. The Pentegra DB Plan's Employee Identification Number is 13-5645888 and the Plan Number is 333.

The Pentegra DB Plan is a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, under the Pentegra DB Plan, contributions made by a participating employer may be used to provide benefits to participants of other participating employers. Annually, the FIRF determines the contributions required to be made by each participating plan sponsor, and these contributions are expensed during the year to which they relate.

In 2022, the Bancorp notified Pentegra of its intent to withdraw from the Pengegra DB Plan, with an effective date in 2023. Annuities were be purchased in 2023 by the Bancorp to replace the Plan liabilities. Plan assets were sufficient to purchase the annuities. The Bancorp contributed $0 to the Plan in 2023 and no additional contributions to Plan assets are expected. Employer contributions and administrative expenses for the year ended December 31, 2022 totaled $90.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 10 – RETIREMENT BENEFITS (Continued)

Supplemental Retirement Plan: The Bancorp sponsors a non-qualified defined benefit (DB) plan to provide supplemental retirement benefits for certain executives. These benefits include pre-retirement disability and death benefits, as well as post-retirement payments for 15 years. In 2023, the Bancorp recognized a settlement gain from a forfeiture in connection with an early retirement. The amount of the forfeiture is netted with service and interest cost components, resulting in a settlement gain of $882 for the year ended December 31, 2023. The following table sets forth the DB activity and other information as of and for the years ended December 31:

	2023	2022
Changes in benefit obligation:		
Benefit obligation, January 1	$ 2,810	$ 2,457
Service cost	80	64
Interest cost	170	99
Gain	80	190
Benefits paid	(46)	-
Forfeiture	(992)	-
Benefit obligation, December 31	$ 2,102	$ 2,810
Funded status at end of year	$ 2,102	$ 2,810
Accumulated benefit obligation	$ 1,617	$ 1,858

The projected benefit obligation of $2,102 in 2023 and $2,810 in 2022 was included in other liabilities on the consolidated balance sheets as of December 31, 2023 and 2022, respectively.

	2023	2022
Components of Net Periodic Benefit Cost:		
Service cost	$ 80	$ 64
Interest cost	130	99
Amortization of prior service cost	26	26
Amortization of net loss	33	19
Settlement gain	(882)	-
Net periodic benefit cost	(613)	208
Net (gain) loss	(108)	190
Amortization of prior service cost and net loss (gain)	40	(145)
Total recognized in other comprehensive income	68	(45)
Total recognized in net periodic benefit cost and other comprehensive income	$ (545)	$ 163

Amounts reported in accumulated other comprehensive income at December 31, consist of:

	2023	2022
Net actuarial loss	$ 237	$ 247
Prior service cost	289	348
	$ 526	$ 595

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 10 – RETIREMENT BENEFITS (Continued)

Actuarial assumptions used in determining the benefit obligation and the net periodic pension costs are as follows at December 31,:

Weighted average discount rate	4.39%	4.39%
Increase in future compensation levels	2.25%	2.25%

Bank-Owned Life Insurance: To fund the DB obligation and other employee benefits, the Bancorp has purchased insurance policies on the lives of certain officers of the Bank. The Bancorp is owner and beneficiary of these policies. At December 31, 2023 and 2022, the cash value of all bank-owned life insurance policies was $15,832 and $15,988, respectively. The cash value is available to fund future benefit obligations.

The DB paid $46 of supplemental retirement benefits in 2023. There were no supplemental retirement benefits paid by the DB during 2022. The Bancorp anticipates paying $46 of benefits in connection with this plan annually through 2026.

401(k) Plan: A 401(k) benefit plan allows employee contributions up to 17% of their compensation, which are matched 50% on the first 10% of the compensation contributed. Expense of the 401(k) plan for the years ended December 31, 2023 and 2022 was $430 and $392, respectively.

NOTE 11 – MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate regulatory action. The net unrealized gains or losses carried in other comprehensive income is not included in computing regulatory capital. Management believes, as of December 31, 2023, the Bank met all capital adequacy requirements to which the Bank is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these items are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2023 and 2022, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Basel III Capital Rules: The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The capital conservation buffer for 2023 and 2022 was 2.50%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 11 – MINIMUM REGULATORY CAPITAL REQUIREMENTS (Continued)

The Bank's actual capital amounts and ratios at December 31, 2023 and 2022 were as follows:

	Actual		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio
2023				
Tier 1 (Core) Capital to average Total assets	$ 73,181	8.0%	$ 45,463	5.0%
Tier 1 (Core) Capital to Risk-weighted assets	$ 73,181	11.2%	$ 52,508	8.0%
Total capital to Risk-weighted assets	$ 81,395	12.4%	$ 65,640	10.0%
Common equity Tier 1 Capital to Risk-weighted assets	$ 73,181	11.2%	$ 42,663	6.5%
2022				
Tier 1 (Core) Capital to average Total assets	$ 69,194	8.1%	$ 42,751	5.0%
Tier 1 (Core) Capital to Risk-weighted assets	$ 69,194	11.3%	$ 49,082	8.0%
Total capital to Risk-weighted assets	$ 76,335	12.4%	$ 61,352	10.0%
Common equity Tier 1 Capital to Risk-weighted assets	$ 69,194	11.3%	$ 38,879	6.5%

NOTE 12 – OFF-BALANCE-SHEET ACTIVITIES

Credit-Related Financial Instruments: The Bancorp 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. To various degrees, such commitments involve elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheets.

The Bancorp's exposure to credit loss is represented by the contractual amount of the commitments. The Bancorp follows the same credit policies in making commitments as it does for on-balance-sheet instruments; no significant losses are anticipated as a result of these commitments.

At December 31, 2023 and 2022, the following financial instruments with credit risk were outstanding:

	2023	2022
Commitments to grant loans	$ 18,188	$ 49,995
Unfunded commitments under lines of credit	121,662	92,831
Commercial and standby letters of credit	9,790	9,883

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 12 – OFF-BALANCE-SHEET ACTIVITIES (Continued)

The following table presents the balance and activity for the allowance for credit losses for unfunded loan commitments for 2023:

Balance, December 31, 2022	$ -
Adjustment for allowance for credit losses on off-balance sheet credit expostures – adoption of ASU 2016-13	312
Credit loss (reversal)	(7)
Balance, December 31, 2023	$ 305

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of fees. These commitments, especially related to equity lines of credit, may expire without being drawn. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral secured by the Bancorp is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The equity and commercial lines of credit are collateralized, may not have a specified maturity date, and may not be drawn to the full extent of the Bancorp's commitment. A majority of such commitments are at fixed rates; a portion is unsecured.

Commercial and standby letters of credit are conditional commitments issued by the Bancorp to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit issued by the Bancorp 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 collateral held as collateral is not material. Guarantees that are not derivative contracts have been recorded on the Bancorp's consolidated balance sheets at their fair value at inception. The Bancorp 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 was not recorded at December 31, 2023 or 2022.

NOTE 13 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bancorp has granted loans to principal officers, directors and affiliates. Related party loans were $933 and $1,195 at December 31, 2023 and 2022, respectively.

Deposits from related parties held by the Bancorp at December 31, 2023 and 2022 were $3,495 and $8,158, respectively.

As of December 31, 2023 and 2022, the Bancorp had 49% interest in Ayres Insurance Agency, Inc., an insurance agency, with 51% owned by a director. The Bancorp's investment of $2,665 and $1,864 as of December 31, 2023 and 2022, respectively, is included in other assets on the consolidated balance sheets. The Bancorp recorded income of $165 and $240 in 2023 and 2022, respectively, from the insurance agency investment, and is included in the proportionate net income from unconsolidated subsidiaries in the consolidated statements of income.

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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.

Securities: Held-to-maturity debt securities are recorded at fair value on a nonrecurring basis and involve the application of lower of cost or market or writing down of individual assets. Debt securities classified as available-for-sale are recorded at fair value on a recurring basis. The fair values of securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities and include such model valuation techniques (Level 2 inputs).

Loans held for sale: The fair value of loans held for sale is based upon binding quotes from third party investors (Level 2 inputs).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bancorp. Once received, an officer reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Bancorp compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Derivatives (Cash Value Hedges): The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2). The Bancorp's derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices, and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Mortgage Servicing Rights: Mortgage servicing rights are subject to impairment testing. To test for impairment, the Bancorp utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and discount rates. If the valuation model reflects a value less than the carrying value, the asset is adjusted to fair value through a valuation allowance as determined by the model. As such, the Bancorp classifies mortgage servicing rights subject to nonrecurring fair value adjustments as Level 2.

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 Bancorp 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.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Bancorp has elected the fair value option, are summarized below:

		Fair Value Measurements at December 31, 2023 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
U. S. government sponsored entities and agencies	$ 7,904	$ -	$ 7,904	$ -
State and political subdivisions	10,193	-	10,193	-
Mortgage-backed securities – residential	15,252	-	15,252	-
Mortgage-backed securities – commercial	11,905	-	11,905	-
Collateralized mortgage obligations	7,404	-	7,404	-
Total investment securities available-for-sale	$ 52,658	$ -	$ 52,658	$ -
Loans held for sale	$ 2,259	$ -	$ 2,259	$ -
Cash flow hedges	$ 1,569	$ -	$ 1,569	$ -

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

		Fair Value Measurements at December 31, 2022 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
U. S. government sponsored entities and agencies	$ 7,717	$ -	$ 7,717	$ -
State and political subdivisions	18,136	-	18,136	-
Mortgage-backed securities – residential	16,432	-	16,432	-
Mortgage-backed securities – commercial	12,593	-	12,593	-
Collateralized mortgage obligations	8,281	-	8,281	-
Total investment securities available-for-sale	$ 63,159	$ -	$ 63,159	$ -
Loans held for sale	$ 664	$ -	$ 664	$ -
Cash flow hedges	$ 2,714	$ -	$ 2,714	$ -

Financial Instruments Recorded Using Fair Value Option

The Bancorp has elected the fair value option for loans held for sale. These loans are intended for sale and the Bancorp believes the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Bancorp's policy on loans held for investment. None of these loans are 90 days or more past due or on nonaccrual as of December 31, 2023 and 2022.

As of December 31, 2023 and 2022, the aggregate fair value, contractual balance (including accrued interest), and gain or loss was as follows:

	2023	2022
Aggregated fair value	$ 2,259	$ 664
Contractual balance	2,191	633
Gain	68	31

The total amount of gains and losses from changes in fair value included in earnings for the years ended December 31, 2023 and 2022 for loans held for sale were:

	2023	2022
Interest income	$ 47	$ 36
Change in fair value	37	(166)

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a nonrecurring basis are summarized below:

		Fair Value Measurements at December 31, 2023 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned, net:				
Residential	$ 105	$ -	$ -	$ 105
Commercial real estate	25	-	-	25
Impaired loans:				
Commercial real estate	$ 80	$ -	$ -	$ 80

		Fair Value Measurements at December 31, 2022 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial real estate	$ 241	$ -	$ -	$ 241

Impaired loans, which were measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying value of $100 with $20 of valuation allowance and a gross carrying value of $315 with $74 of valuation allowance at December 31, 2023 and 2022, respectively. Credit loss expense related to impaired loans measured using fair value of collateral was $0 for 2023 and 2022.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The carrying amounts and estimated fair values of financial instruments not carried in their entirety at fair value, at December 31, 2023 and 2022 are as follows:

		Fair Value Measurements at December 31, 2023 Using:			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 40,009	$ 40,009	$ -	$ -	$ 40,009
Securities held-to-maturity	20,866	-	16,935	-	16,935
FHLB stock	7,295	-	-	7,295	7,295
Loans, net	739,461	-	-	731,562	731,562
Mortgage servicing rights	2,979	-	4,607	-	4,607
Accrued interest receivable	3,099	-	-	3,099	3,099
Financial liabilities					
Deposits: noninterest-bearing	$ 159,899	$ 159,899	$ -	$ -	$ 159,899
Deposits: interest-bearing	639,039	346,003	292,214	-	638,217
FHLB advances and other borrowings	40,000	-	-	39,906	39,906
Subordinated debentures	14,836	-	-	13,506	13,506
Accrued interest payable	1,654	-	-	1,654	1,654

		Fair Value Measurements at December 31, 2022 Using:			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 14,985	$ 14,985	$ -	$ -	$ 14,985
Securities held-to-maturity	22,070	-	17,861	-	17,861
FHLB stock	8,381	-	-	8,381	8,381
Loans, net	699,443	-	-	649,918	649,918
Mortgage servicing rights	2,967	-	4,306	-	4,306
Accrued interest receivable	2,691	-	-	2,691	2,691
Financial liabilities					
Deposits: noninterest-bearing	$ 162,978	$ 162,978	$ -	$ -	$ 162,978
Deposits: interest-bearing	556,538	370,416	180,634	-	551,050
FHLB advances and other borrowings	71,000	-	-	70,663	70,663
Subordinated debentures	14,755	-	-	13,967	13,967
Accrued interest payable	760	-	-	760	760

NOTE 15 – GOODWILL AND INTANGIBLE ASSETS

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through an impairment test that is performed at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Bancorp performed a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeds its carrying value, including goodwill, at December 31, 2023. The results of the qualitative assessment indicated that the fair value of the reporting unit exceeded its carrying amount. Consequently, no additional impairment testing was necessary.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 16 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Unrealized Gains and (Losses) On Cash Flow Hedges	Unrealized Gains and (Losses) On Available-for-Sale Securities	Defined Benefit Pension Items	Total
2023				
Beginning balance	$ 2,114	$ (8,644)	$ (470)	$ (6,970)
Other comprehensive income (loss) before reclassification	306	749	-	1,055
Amounts reclassified from accumulated other comprehensive income, net of tax	(1,210)	104	54	(1,052)
Net current period other comprehensive income (loss)	(904)	853	54	3
Ending balance	$ 1,240	$ (7,791)	$ (416)	$ (6,967)
2022				
Beginning balance	$ (1,728)	$ 355	$ (356)	$ (1,729)
Other comprehensive income (loss) before reclassification	3,701	(8,999)	-	(5,298)
Amounts reclassified from accumulated other comprehensive income, net of tax	171	-	(114)	57
Net current period other comprehensive income (loss)	3,872	(8,999)	(114)	(5,241)
Ending balance	$ 2,144	$ (8,644)	$ (470)	$ (6,970)

Amounts reclassified from accumulated other comprehensive income for cash flow hedges, available-for-sale securities and the pension are recorded in interest expense, gain (loss) on securities, and salaries and employee benefits in the consolidated statements of income, respectively.

NOTE 17 - DERIVATIVES

The Bancorp utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 17 – DERIVATIVES (Continued)

The Bancorp had four interest rate swaps with notional amounts aggregating $77,500 as of December 31, 2023. The Bancorp had two interest rate swaps with notional amounts aggregating $37,500 as of December 31, 2022. All interest rate swaps were designated as cash flow hedges of quarterly repricing liabilities (Federal Home Loan Bank advances or brokered CDs) and were determined to be highly effective during all periods presented. There was no ineffectiveness at December 31, 2023 or 2022. The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedges no longer be considered effective or should the Bancorp no longer utilize these funding sources. The Bancorp expects the hedges to remain highly effective during the remaining term of the swaps.

Summary information about the interest-rate swaps designated as a cash flow hedges as of year-end is as follows:

	2023	2022
Notional amounts	$ 77,500	$ 37,500
Weighted average pay rates	3.27268%	2.3558%
Weighted average receive rates	3-mth avg daily SOFR+0.0904%	3-mth avg daily SOFR+0.2547%
Weighted average maturity	3.3 years	4.8 years
Unrealized gains (losses)	$1,569	($2,187)

Interest expense recorded on these hedge transactions during 2023 totaled ($1,532) as a component of interest expense on deposits. Interest expense recorded on these hedge transactions during 2022 totaled $109 as a component of interest expense on borrowed funds and $107 as a component of interest expense on deposits.

During the year ended December 31, 2023, the Bancorp partially terminated an interest rate swap before the contractual maturity and recorded a $793 gain on the termination in the consolidated statements of income.