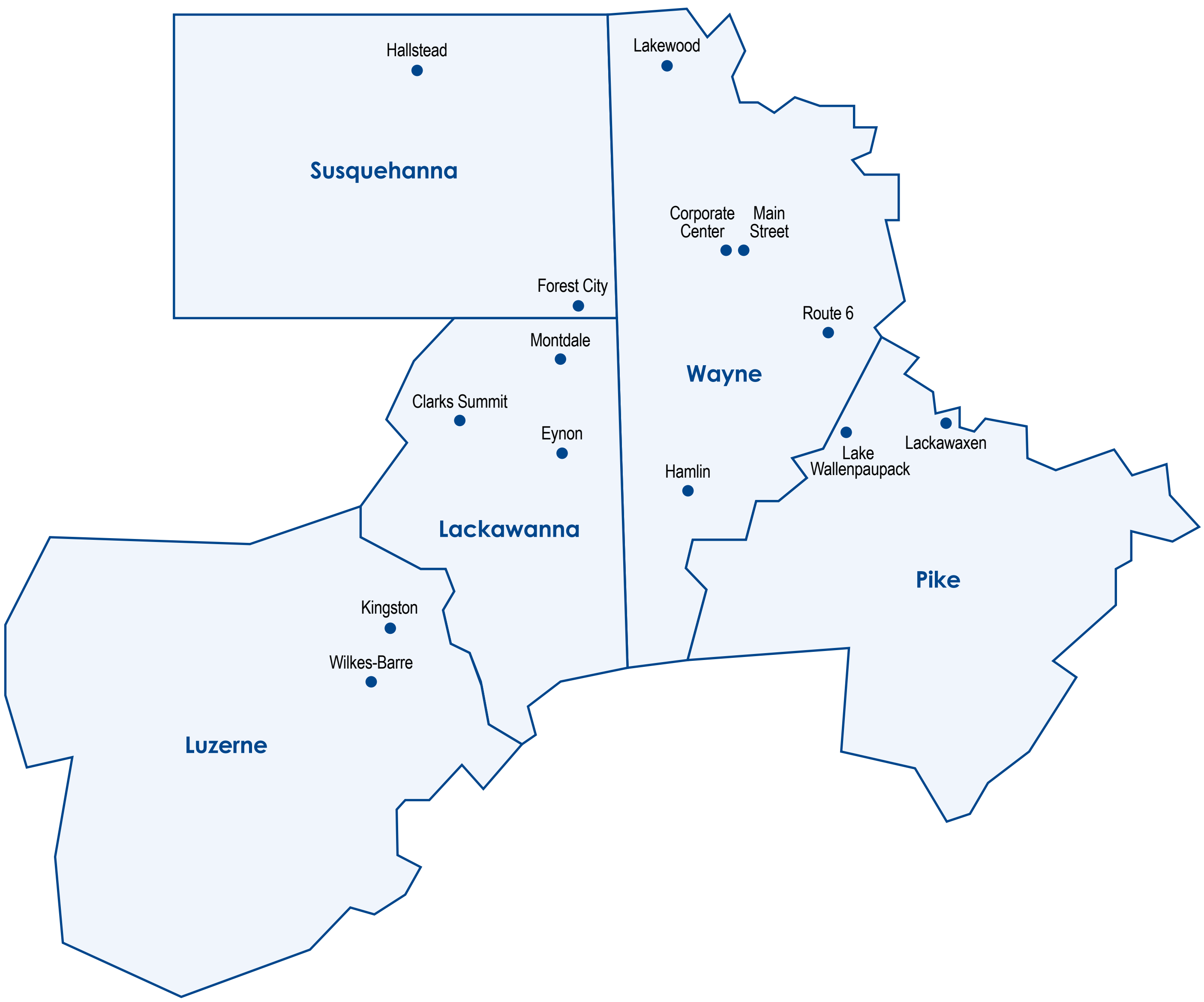
ANNUAL REPORT

HONAT BANCORP, INC.

2023

HNB

LOCATIONS



PERSONAL BANKING • BUSINESS BANKING • WEALTH MANAGEMENT

Consolidated Financial Report

December 31, 2023

Honat Bancorp, Inc. and its Subsidiary,

The Honesdale National Bank

1836-2023

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MESSAGE FROM THE PRESIDENT

Preparation is Our Guide, Change is Our Constant

2023 was nothing short of eventful whether considering the vantage point of Honat Bancorp, Inc., the financial industry, the economic climate, or international affairs. It seemed that nearly all seats were riddled with curiosity, contemplation, the wait, and weight of response.

It always comes down to process and execution. While speed and adaptiveness are measured with scrutiny, confidence in strategy resides in strength of preparation and willingness to transform. I am happy to report that The Honesdale National Bank chartered a successful course in 2023 because of its conservative, steadfast principles, and acknowledgement that the financial institution we were yesterday is not the one we will be tomorrow, and our results are all the better for it.

In early March, the failure of several notable banks thrust the banking industry into national news and public discussion. The strength of the Federal Deposit Insurance Company (FDIC) insurance system was questioned as large deposit withdrawals adversely affected those institutions' liquidity. Decreasing values of the banks' investment portfolios resulted in strain on shareholder equity. As this relates to our own balance sheet, we can confidently share that the Bank's accumulated other comprehensive loss changes were minor in comparison to the failed institutions and showed continuous improvement throughout 2023. In step, our longstanding community banking principles, strong capital position, and good liquidity allowed HNB employees to communicate a message of strength and stability to our customers and positioned us as a reliable partner as the rate environment became opportunistic for depositors.

Up, up, up, and up. The Federal Reserve Bank (FRB) added four additional discount rate increases in 2023 raising interest expense as checking and savings account balances migrated to certificates of deposit. Our financials reflect this shift as we aptly managed the cost of funds. While depositors continue to enjoy elevated rates, with reductions possibly in sight for 2024, the market's shift to more traditional lending rates continues to leave many borrowers struggling with the increases.

These increased rates have the effect of making it more difficult for borrowers to qualify for loans. Our loan department continues to do an outstanding job of supporting our communities and customers to provide financing and grow our loan portfolio without compromising our Bank's historic high level of asset quality. In fact, our loans are up by 9.4% with much of that being funded by a reduction of our investment portfolio.

Our discipline of preparedness ensured our readiness for the adoption of the regulation of Current Expected Credit Losses (CECL). This methodology issued by the Financial Accounting Standards Board (FASB) estimates allowances for credit losses. It requires forward-looking, or predictive, data and segmentation of assets by risk profiles. The complexity of this new model presented requirements that were accomplished by our Credit and Loan Review area. Their due diligence and focus are what enables our institution to consistently maintain an excellent allowance for credit loss ratio.

Adaptiveness to changes in rates, regulation, and needs of our customers are part of what our team succeeds at day in and day out.

Innovations in technology continue to play an important part in the development of the banking industry. During 2023 we again showed our commitment to improve our methods to help our customers by implementing teller capture software to process lobby transactions more efficiently and provide better deposit availability. This along with the provision of instant issue debit cards and a new credit card processing relationship has made it easier for our tellers and branch staff to service customers. The speed and accessibility of customer service was further amplified with the addition of the HNB & me phone line, which enabled back office and frontline staff to answer incoming calls as a network.

Providing our employees with the right tools to be successful paves a path for continued growth and focus on continued excellence. Last April, the HNB Financial Group upgraded its core trust department accounting system, vastly improving workflows with enhancements focused on its investment and operational capabilities. As the department continues to expand, the software will provide greater scalability and integration, as well as new opportunities for customer engagement.

In a continuing effort to provide advanced security, analytics, and compliance we upgraded our Microsoft 365 platform to E5. This is a best-in-class suite of productivity apps which provides advanced security, compliance, and forensics tools that minimize the severity of cybersecurity threats.

Our commercial loan department was also busy implementing a credit management solution, which supports the review, analysis, and decision-making of commercial credit applications. The efficiency provided by this streamlined solution allows our team members to spend more time in conversation with current and prospective customers. As of the end of the third quarter, all requests were processed through this system.

MESSAGE FROM THE PRESIDENT

Even HNB's community engagement efforts were bolstered with the integration of a community involvement software. The software enables our team to not only better track our donations and sponsorships, but integrate workflows that support operational efficiency, Community Reinvestment Act (CRA) activity management, increased employee engagement, and underscoring of our corporate values. The platform further assisted our organization in increasing our community giving through the management and disbursement of volunteer hour grants and a corporate match program.

We are fortunate for the tenure and contributions of not only our staff, but our Board of Directors. At our annual meeting in April, long time director Dr. John Burlein relinquished his position as Board Vice Chairman but will continue to hold a position on our Board. Director Roger Dirlam was elected as Board Vice Chairman. Our Board provides respected oversight for our institution, and we are grateful for their ongoing guidance as we navigate an ever-changing landscape.

2023 has initiated many undercurrents that we will see play significantly into the year ahead. We are very proud of our results. Although they do not surpass last year's, they were earned through extraordinary effort and not an extraordinary one-time financial event.

We are indeed recognizing the influence of hard work as the market attempts to normalize. In the thick of change, HNB's efforts were the constant that grew total assets to $963 million — an increase of 4.5% over the prior year.

Preparation and collaboration truly are our guideposts as we look ahead. We are constantly evolving to meet the needs of a changing customer base. As technology options increase and our customers show a preference for employing these new options, we are moving to meet these desires. Our steadfast foundation will always be rooted in our history of a safe and sound financial institution. We have built our asset quality and strong capital position and will continue to do so.

HNB's longevity has been the result of our success in constantly changing our processes to improve the delivery of banking services but never deviating from our commitment to providing outstanding service to our communities and customers. Thank you for your continued support in our efforts to constantly improve.

$963
MILLION
TOTAL ASSETS
UP 4.5% OVER PRIOR YEAR

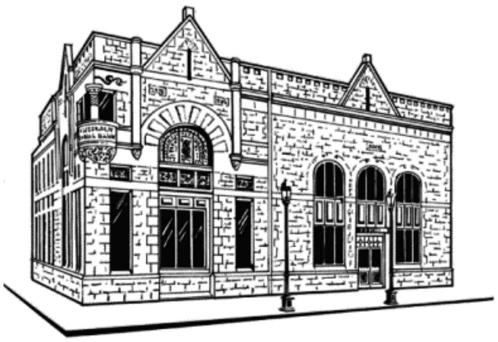
Thomas E. Sheridan Jr

Thomas E. Sheridan, Jr.
President and Chief Executive Officer

FINANCIAL HIGHLIGHTS

	2023	2022	Net Change
	(In Thousands, Except per Share and Ratio Data)		
Assets, Liabilities & Equity			
Total Assets	**$ 963,210**	$ 921,671	$ 41,539
Loans, Net of Allowance	**683,884**	625,348	58,536
Total Deposits	**822,547**	780,035	42,512
Total Shareholder Equity	**124,830**	113,572	11,258
Income & Expense			
Interest Income	**$ 42,721**	$ 32,970	$ 9,751
Interest Expense	**8,694**	1,467	7,227
Net Income	**12,866**	13,147	(281)
Per Share Data			
Book Value per Share	**$ 86.02**	$ 78.26	$ 7.76
Earnings per Share	**$ 8.90**	$ 9.07	$ (0.17)
Cash Dividend per Share	**$ 2.63**	$ 2.51	$ 0.12
Market Value per Share	**$ 117.51**	$ 119.50	$ (1.99)
Select Ratios			
Return on Average Assets	**1.37%**	1.40%	
Return on Average Equity	**10.86%**	11.67%	
Loans, Net to Deposits	**83.14%**	80.17%	
Allowance for Credit Losses to Total Loans	**1.65%**	1.75%	

COMPANY OVERVIEW AND TIMELINE



Company Overview

Honat Bancorp, Inc. (HONT: US OTC) is the parent company of its wholly owned subsidiary, The Honesdale National Bank. Headquartered in Honesdale, Pennsylvania, we strive to achieve unparalleled levels of financial performance through superior service in meeting our customers' personal banking, business banking, and wealth management needs while acting in the best interest of our employees, our customers, our communities, and our shareholders.

The Honesdale National Bank (HNB), established in 1836, holds the distinction of being the area's oldest, independent, community bank headquartered in Northeastern Pennsylvania, with twelve full-service offices across Wayne, Pike, Susquehanna, Lackawanna, and Luzerne Counties. Financial Services and Trust solutions for our customers are serviced through our HNB Financial Group headquartered in Honesdale. The HNB Mortgage Center headquartered in Wilkes-Barre, Pennsylvania supports mortgage operations.

Timeline

1836 Honesdale Bank opens at 1011 Main Street, Honesdale, PA on December 26.

1851 The Bank relocates to a new building at 10th & Main Streets, Honesdale, PA.

1864 With a national currency and banking system established, the Bank begins operations under The Honesdale National Bank.

1886 HNB celebrates its 50th anniversary.

1896 Main Street Office relocates to a new building and present location at 733 Main Street, Honesdale, PA.

1914 HNB joins the Federal Reserve System (FRS).

1917 Alice Ward becomes first female employee of HNB.

1929 During the Great Depression as other banks close or suspend operations, HNB continues to serve the community, even paying a dividend.

1934 HNB deposits insured by the new Federal Deposit Insurance Corporation (FDIC) up to $2,500.

1936 HNB celebrates its 100th anniversary.

1957 HNB undergoes renovation, removing wooden teller cages of the past and installing a new lobby floor with a customer service area.

1962 Erected as a public service, HNB installs the time and temperature sign on the corner of 8th & Main Streets in Honesdale; it has become a familiar landmark for visitors and residents alike.

1968 TV Auto Bank Drive-Up Banking System opens on September 12. The system includes closed circuit TV, voice communication, and a pneumatic tube system linking the Bank and Drive-Up lanes through a tunnel under Main Street – the first such service in the area.

1974 HNB opens an office at the Route 6 Plaza, just east of Honesdale, allowing customers to transact their business conveniently at either location. The facility also provides an employee meeting space and the inclusion of a new Board of Directors room.

1986 As HNB celebrates its 150th anniversary, the Bank expands into the adjacent building (formerly owned by the Honesdale Dime Bank), opening on September 22. In November and December, HNB installs the area's first ATMs at the Route 6 Plaza and adjacent to the Main Street Drive-Up banking lanes.

1987 In July, the Bank creates Honat Bancorp, Inc., a bank holding company, which then acquires The Honesdale National Bank as its wholly owned subsidiary.

1995 HNB purchases United Security Mortgage Corporation in Wilkes-Barre, PA and opens it as HNB Mortgage on January 3.

1996 HNB purchases offices in Forest City and Montdale, PA from PNC Bank, and opens them as HNB Offices on June 17.

COMPANY OVERVIEW AND TIMELINE

1998 HNB purchases offices at Lake Wallenpaupack and in Lackawaxen, PA from LA Bank and opens them as HNB Offices on December 14. HNB launches its first website.

2001 HNB opens a temporary office in the Citgo Plaza on Route 590 in Hamlin, PA and relocates to its current location at 559 Hamlin Highway on August 1.

2003 The Commonwealth of PA approves HNB for Educational Improvement Tax Credits (EITC) to contribute to the growth and development of educational opportunities throughout our local area.

2005 HNB opens its Corporate Center at 724 Main Street in Honesdale, also serving as headquarters for Honat Bancorp, Inc.

2007 On June 1, HNB opens its newly constructed Kingston Office at 786 Wyoming Avenue, Kingston, PA.

2011 HNB celebrates its 175th anniversary. HNB begins offering Online Banking services.

2012 HNB launches its Mobile Banking App. On November 13, HNB opens its Lakewood Office at 18 Como Road, Lakewood, PA.

2013 On December 11, HNB opens its Eynon Office at 202 Betty Street, Archbald, PA.

2015 HNB begins offering Mobile Wallet and Person-to-Person Payment services.

2018 On January 24, HNB opens its Clarks Summit Office at 651 Northern Boulevard, Clarks Summit, PA.

2019 On May 14, HNB opens a temporary Loan Production Office in Hallstead, PA and relocates to its newly constructed, full-service office on December 18 at 313 Main Street. On July 5, HNB relocates its Lackawaxen Office to 100 LCPL Jacob Beisel Road, Lackawaxen, PA. During the summer, HNB completes a full exterior renovation to the Route 6 Office. The Honesdale National Bank Foundation is established with formal announcement in October.

2020 HNB maintains continuous access to banking services and provides extensive financial support to the customers and community as the Coronavirus (COVID-19) pandemic causes catastrophic global impact.

2021 HNB celebrates its 185th anniversary.

2022 HNB installs Teller Cash Recyclers (TCRs) in offices to support our advancement of Bank operations, security, and customer service.

INDEPENDENT AUDITOR'S REPORT

SNODGRASS
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

Board of Directors and Stockholders
Honat Bancorp, Inc.
Honesdale, Pennsylvania

Opinion

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

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Change in Accounting Principle

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

Responsibilities of Management for the Financial Statements

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

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

S.R. Snodgrass, P.C. • 2009 Mackenzie Way, Suite 340 • Cranberry Township, Pennsylvania 16066 • Phone: 724-934-0344 • Fax: 724-934-0345

INDEPENDENT AUDITOR'S REPORT

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information Included in Annual Report

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

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

S.R. Snodgrass, P.C.

Cranberry Township, Pennsylvania
March 1, 2024

CONSOLIDATED BALANCE SHEET

	Years Ended December 31, 2023	2022
	(In Thousands, Except Share Data)	
Assets		
Cash and Due from Banks	**$ 8,984**	$ 11,908
Interest-Bearing Deposits	**26,910**	5,372
Short-Term Investments	**689**	274
Total Cash and Cash Equivalents	**36,583**	17,554
Securities Available for Sale at Fair Value, Net of Allowance for Credit Losses 2023: $0	**189,870**	224,160
Equity Securities at Fair Value	**-**	435
Mortgage Loans Held for Sale	**1,337**	114
Loans Receivable, Net of Allowance for Credit Losses 2023 and 2022: $11,453 and $11,166	**683,884**	625,348
Investment in Restricted Stock, at Cost	**874**	1,615
Premises and Equipment:		
Operating Lease Right-of-Use Asset	**1,085**	599
Other Premises and Equipment	**6,943**	6,931
Accrued Interest Receivable	**4,260**	3,902
Bank-Owned Life Insurance	**26,513**	25,944
Other Assets	**11,861**	15,069
Total Assets	**$ 963,210**	$ 921,671
Liabilities		
Deposits		
Non-Interest-Bearing	**$ 257,351**	$ 288,743
Interest-Bearing	**565,196**	491,292
Total Deposits	**822,547**	780,035
Short-Term Borrowings	**-**	16,000
Operating Lease Liabilities	**1,096**	609
Accrued Interest Payable	**4,892**	424
Other Liabilities	**9,845**	11,031
Total Liabilities	**$ 838,380**	$ 808,099
Stockholders' Equity		
Common Stock, Par Value $.20 Per Share; Authorized 5,000,000 Shares Issued 1,800,000 Shares; Outstanding 2023 and 2022: 1,434,625 and 1,457,893 Shares	**360**	360
Surplus	**2,543**	2,543
Retained Earnings	**148,976**	139,406
Accumulated Other Comprehensive Loss	**(10,318)**	(14,784)
Treasury Stock, at Cost, 2023 and 2022: 365,375 and 342,107 Shares	**(16,731)**	(13,953)
Total Stockholders' Equity	**124,830**	113,572
Total Liabilities and Stockholders' Equity	**$ 963,210**	$ 921,671

See Notes to Consolidated Financial Statements, pages 13-44

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31, 2023	2022
	(In Thousands, Except Share and Per Share Data)	
Interest Income		
Loans Receivable, Including Fees	$ 37,111	$ 27,991
Securities:		
Taxable	3,058	2,766
Tax Exempt	1,850	1,642
Other	702	571
Total Interest Income	42,721	32,970
Interest Expense		
Deposits	8,622	1,410
Short-Term Debt and Other	72	57
Total Interest Expense	8,694	1,467
Net Interest Income	34,027	31,503
Provision for Credit Losses		
Provision for Credit Loss – Loans	650	300
Provision for Credit Loss – Off-Balance Sheet Commitments	-	-
Total Provision for Credit Losses	650	300
Net Interest Income After Provision for Credit Losses	33,377	31,203
Other Income		
Customer Service Fees	2,785	2,564
Mortgage Banking	548	882
Income from Fiduciary Accounts	693	654
Loss on Sale of Securities Available for Sale	-	(562)
Gain (Loss) on Equity Securities	395	(40)
Gain on Sale of Credit Card Portfolio	118	-
Bank-Owned Life Insurance Earnings	554	539
Employee Retention Credit	-	3,480
Other	604	877
Total Other Income	5,697	8,394
Other Expenses		
Salaries and Wages	9,495	9,436
Employee Benefits	4,743	4,303
Occupancy	1,296	1,372
Data Processing	1,079	1,003
Furniture and Equipment	752	675
Advertising and Promotion	668	613
Legal and Professional	457	968
Donations	573	1,331
State Tax	897	978
Federal Deposit Insurance	409	256
Other	3,128	2,785
Total Other Expenses	23,497	23,720
Income Before Federal Income Tax Expense	15,577	15,877
Federal Income Tax Expense	2,711	2,730
Net Income	$ 12,866	$ 13,147
Earnings Per Share	$ 8.90	$ 9.07
Average Shares Outstanding	1,445,008	1,449,211

See Notes to Consolidated Financial Statements, pages 13-44

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Years Ended December 31, 2023	2022
	(In Thousands)	
Net Income	**$ 12,866**	$ 13,147
Other Comprehensive Income (Loss)		
Unrealized Income (Loss) on Securities Available for Sale	**5,653**	(20,810)
Tax Effect	**(1,187)**	4,370
Reclassification Adjustment for Loss on Securities Available for Sale Recognized in Net Income	**-**	562
Tax Effect	**-**	(118)
Total Other Comprehensive Income (Loss)	**4,466**	(15,996)
Comprehensive Income (Loss)	**$ 17,332**	$ (2,849)

See Notes to Consolidated Financial Statements, pages 13-44

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share and Per Share Data)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total
Balance: December 31, 2021	$ 360	$ 1,807	$ 129,885	$ 1,212	$ (13,952)	$ 119,312
Net Income	-	-	13,147	-	-	13,147
Other Comprehensive Loss	-	-	-	(15,996)	-	(15,996)
Purchase of Treasury Stock, 3,088 Shares	-	-	-	-	(398)	(398)
Sale of Treasury Stock for ESOP, 9,730 Shares	-	790	-	-	397	1,187
ESOP Valuation Adjustment	-	(54)	-	-	-	(54)
Dividends Declared ($2.51 Per Share)	-	-	(3,626)	-	-	(3,626)
Balance: December 31, 2022	$ 360	$ 2,543	$ 139,406	$ (14,784)	$ (13,953)	$ 113,572
Net Income	**-**	**-**	**12,866**	**-**	**-**	**12,866**
Cumulative Effect of Adoption of ASU 2016-13	**-**	**-**	**505**	**-**	**-**	**505**
Other Comprehensive Income	**-**	**-**	**-**	**4,466**	**-**	**4,466**
Purchase of Treasury Stock, 23,268 Shares	**-**	**-**	**-**	**-**	**(2,778)**	**(2,778)**
Dividends Declared ($2.63 Per Share)	**-**	**-**	**(3,801)**	**-**	**-**	**(3,801)**
Balance: December 31, 2023	**$ 360**	**$ 2,543**	**$ 148,976**	**$ (10,318)**	**$ (16,731)**	**$ 124,830**

See Notes to Consolidated Financial Statements, pages 13-44

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2023	2022
	(In Thousands)	
Cash Flows from Operating Activities		
Net Income	$ 12,866	$ 13,147
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Provision for Credit Losses	650	300
Provision for Depreciation and Amortization	583	495
Net Amortization of Securities Premiums and Discounts	762	1,119
Loss on Securities Available for Sale	-	562
(Gain) Loss on Equity Securities	(395)	40
Amortization of Deferred Loan Fees	(445)	(505)
Amortization of Mortgage Servicing Rights, Net of Change in Valuation Allowance	277	236
Amortization of Equity Investment in Partnership	503	503
Deferred Income Taxes	47	(533)
Loans Originated for Sale	(10,828)	(11,746)
Proceeds from Sale of Mortgage Loans	9,829	15,014
Net Gains on Sale of Loans	(224)	(524)
Gain on Sale of Credit Card Portfolio	(118)	-
Bank-Owned Life Insurance Earnings	(554)	(539)
(Decrease) Increase in Escrow Payable	(329)	687
Increase in Accrued Interest Receivable	(358)	(603)
Increase in Accrued Interest Payable	4,468	106
Other, Net	1,642	694
Net Cash Provided by Operating Activities	18,376	18,453
Cash Flows from Investing Activities		
Purchase of Investment Securities Available for Sale	-	(142,333)
Proceeds from Maturities or Principal Repayments	38,184	32,066
Proceeds from Maturities of Certificates of Deposit	-	1,739
Proceeds from Sale of Investment Securities Available for Sale	-	14,346
Proceeds from Sale of Equity Securities	829	-
Proceeds from Sale of Credit Card Portfolio	972	-
Net Increase in Loans	(59,205)	(76,043)
Purchase of Restricted Stock, at Cost	(2,534)	(1,702)
Redemption of Restricted Stock, at Cost	3,274	753
Purchase of Premises, Equipment, Software, and Licensing	(785)	(294)
Purchase of Bank-Owned Life Insurance	(15)	(15)
Net Cash Used for Investing Activities	(19,280)	(171,483)
Cash Flows from Financing Activities		
Net Increase (Decrease) in Deposits	42,512	(35,148)
Net (Paydowns) Advances on Short-Term Borrowings	(16,000)	16,000
Purchase of Treasury Stock	(2,778)	(398)
ESOP Purchase of Shares from Treasury Stock	-	1,133
Dividends Paid	(3,801)	(3,626)
Net Cash (Used for) Provided by Financing Activities	19,933	(22,039)
Net Increase (Decrease) in Cash and Cash Equivalents	19,029	(175,069)
Cash and Cash Equivalents: Beginning	17,554	192,623
Cash and Cash Equivalents: Ending	$ 36,583	$ 17,554
Supplementary Cash Flows Information		
Interest Paid	$ 4,226	$ 1,361
Income Taxes Paid	$ 1,520	$ 2,425
Supplementary Schedule of Noncash Investing and Financing Activities		
Investment Securities Matured Not Yet Settled	$ 1,000	$ 2,000
Initial Recognition of Right-of-Use Asset	$ 580	$ 153
Initial Recognition of Lease Liability	$ 580	$ 153
Impact of CECL Adoption	$ 505	$ -

See Notes to Consolidated Financial Statements, pages 13-44

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Honat Bancorp, Inc. (Company), a bank holding company, and its wholly owned subsidiary, The Honesdale National Bank (Bank). All intercompany accounts and transactions have been eliminated.

Nature of Operations

The Bank operates under a national bank charter and provides full banking services, including trust services. As a national bank, the Bank is subject to regulation of the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). The bank holding company is subject to regulation of the Federal Reserve Bank (FRB). The areas served by the Bank are principally Lackawanna, Luzerne, Pike, Susquehanna, and Wayne Counties, in Pennsylvania.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Balance Sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are most immediately susceptible to significant change are: the determination of the allowance for credit losses, determination of other-than-temporary impairment of securities, impairment of mortgage servicing rights, fair values of financial instruments and the valuation of deferred tax assets.

Significant Group Concentrations of Credit Risk

Most of the Bank’s activities are with customers located within Northeastern Pennsylvania. Notes 4 and 5 discuss the types of securities that the Bank and Company invest in, respectively. Note 6 discusses the types of lending that the Bank engages in. The Bank does not have any significant concentrations in any one industry or customer. Although the Bank has a diversified loan portfolio at December 31, 2023 and 2022, its debtors' ability to honor their contracts is influenced by the region's economy.

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits, and short-term investments, all of which have original maturities of 90 days or less.

Trust Assets

Assets of the Trust Department are not included in these financial statements because they are not assets of the Bank. Revenues of the Trust Department are included in income from fiduciary accounts on the Consolidated Statements of Income.

Short-Term Investments

Short-term investments consist of federal funds sold investments.

Securities

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period, but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank’s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as increases or decreases in other comprehensive income, net of the related deferred tax effect. The Bank amortizes premiums and discounts to the call date, maturity date, or based on average life factoring in prepayment assumptions as applicable. Management determines the appropriate classification of securities at the time of purchase and reevaluates such designation as of each Consolidated Balance Sheet date.

Allowance for Credit Losses – Available for Sale Securities

The Bank measures expected credit losses on available for sale securities when the Bank intends to sell or when 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.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

For available for sale securities that do not meet these criteria, the Bank will evaluate whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, the Bank considers the extent to which fair value is less than amortized cost, changes to the security's rating by rating agencies, and adverse conditions specifically related to the security, among other factors. If this evaluation 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 (ACL) is recorded equal to the amount that the fair value is less than the amortized cost basis. Any impairment not recorded through the ACL is recognized in other comprehensive income.

The ACL on available for sale securities is included within the securities available for sale on the Consolidated Balance Sheet. Changes in the ACL are recorded within the provision for credit losses on the Consolidated Statements of Income. Losses are charged against the allowance when the Bank believes collectability of an available for sale security is in jeopardy or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on the available for sale securities totaled $1,103,000 at December 31, 2023 and is included within accrued interest receivable on the Consolidated Balance Sheet. This amount is excluded from the estimate of expected credit losses. Available for sale securities are typically classified as nonaccrual when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about the collectability of principal or interest. When an available for sale security is placed on nonaccrual, unpaid interest previously credited to income is reversed.

Credit Losses on Investment Securities – Prior to Adopting ASC 326

The Bank adopted ASU No. 2016-13, Financial Instruments – Credit Losses Topic 326: Measurement of Credit Losses on Financial Instruments effective January 1, 2023. Financial statement amounts related to securities recorded as of December 31, 2022 are presented in accordance with the accounting policies described in the following sections. The following sections were carried forward from the annual report for the year ended December 31, 2022.

Securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. For debt securities, management considers whether the present value of future cash flows expected to be collected is less than the security's amortized cost basis (the difference defined as the credit loss). The magnitude and duration of the decline and the reasons underlying the decline will be evaluated.

To determine whether the loss in value is other than temporary, the Bank's intent to sell the security or whether it is more likely than not that the Bank would be required to sell the security before its anticipated recovery in market value will be assessed. Once a decline in value is determined to be other than temporary, if the investor does not intend to sell the security and it is more likely than not that it will not be required to sell the security before recovery of the security's amortized cost basis, the change to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings.

Certificates of Deposit

The Bank may hold certificates of deposit issued by other FDIC insured financial institutions in increments of $250,000 with maturities of two years or less.

Equity Securities

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

Investment in Restricted Stock, at Cost

The Bank holds restricted stock in the Federal Reserve Bank (FRB), the Federal Home Loan Bank (FHLB) of Pittsburgh, and the Atlantic Community Bankers Bank (ACBB) which is carried at cost. The Bank holds $110,000 and $74,000 of FRB stock at December 31, 2023 and 2022. The Bank holds $10,000 of ACBB stock at December 31, 2023 and 2022. The Bank holds $755,000 and $1,531,000 of FHLB stock at December 31, 2023 and 2022, respectively.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investment in Restricted Stock, at Cost (Continued)

The FHLB stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost, and evaluated for impairment as necessary. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance; (3) the impact of legislative and regulatory changes on the customer base of the FHLB; and (4) the liquidity position of the FHLB. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein.

Mortgage Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lowest of either cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through charges to income.

Mortgage Servicing Rights

An asset is recognized for mortgage servicing rights acquired through purchase or origination. Amounts capitalized are reported in other assets on the Consolidated Balance Sheet and are amortized in proportion to, and over the period of, estimated net servicing income. If mortgage loans are sold with servicing retained, the total cost of the mortgage loans is allocated to the loans and servicing rights based on their relative fair values. The Bank performs a periodic review for impairment in the fair value of mortgage servicing rights. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment is recognized through a valuation allowance, with a corresponding charge on the Consolidated Statements of Income, to the extent the fair value is less than the capitalized amount.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future until maturity or payoff are stated at their outstanding unpaid principal balances, net of any ACL and any deferred fees or costs. Accrued interest receivable on loans receivable totaled $3,157,000 at December 31, 2023 and was reported in accrued interest receivable on the Consolidated Balance Sheet and is excluded from the estimate of credit losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the related loans. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loans receivable portfolio is segmented into commercial and retail loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, and commercial real estate construction loans. Retail loans consist of the following classes: residential real estate, home equity lines of credit, and consumer loans.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due for commercial loans, or 180 days past due for residential loans, or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against the principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Allowance for Credit Losses – Loans

The ACL is a valuation reserve established and maintained by charges against income and is deducted from the amortized cost basis of loans to present the net amount expected to be collected on the loans. Loans, or portions thereof, are charged off against the ACL when they are deemed uncollectible. Expected recoveries do not exceed the aggregate of amounts previously charged off and expected to be charged off.

The ACL is an estimate of expected credit losses, measured over the contractual life of a loan, that considers our historical loss experience as well as the historical loss experience of other banks, current conditions, and forecast of future economic conditions. Determination of an appropriate ACL is inherently subjective and may have significant changes from period to period.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Credit Losses – Loans (Continued)

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

The ACL is measured on a collective pool basis when similar risk characteristics exist. The Bank has identified the following portfolio segments and measures the ACL using the following methods. Loans are classified into three high-level segments: commercial and industrial, commercial real estate, and retail. These segments are analyzed in smaller cohort groupings based on similar risk characteristics.

The commercial and industrial portfolio is further segmented by the North American Industry Classification System (NAICS) and risk rating. Lifetime loss rates are determined using national historic loss data collected from financial institutions. By tracking the history of the individual loans in the data consortium, lifetime loss rates are calculated, and the model applies these realized lifetime loss rates to the commercial and industrial portfolio.

The commercial real estate portfolio is further segmented based on loan-to-value (LTV) and property details. Lifetime loss rates are determined using peer data from a select local peer group consisting of twenty-one financial institutions. This methodology was chosen since the Bank's geographic footprint typically lags national trends, therefore, utilizing a local peer group will be more indicative of loss rates. Expected prepayments are figured in the calculations using bank historical data. In accordance with the standard, reasonable supportable forecasts are followed by a mean-reverting pattern for the remaining term of the loan, adjusted for expected prepayments.

The retail segment includes loans issued to consumers that are secured by residential real estate, home equity lines of credit, and other consumer loans. The retail portfolio is further segmented by vintage (origination year), initial credit score, loan term, and geography (borrower state). Lifetime loss rates are determined based on Equifax industry-level retail credit performance data and applied to the loans in the retail portfolio.

Quantitative results are augmented with qualitative factor adjustments which are determined based on specific conditions present in the portfolio. The qualitative adjustments for current conditions are based upon delinquency trends, loan growth, changes in lending policies and practices, experience and ability of lending staff, quality of the Bank's loan review system, the existence of and changes in concentrations, and other external factors.

The Bank has elected to exclude accrued interest receivable from the measurement of its ACL. When a loan is placed on non-accrual status, any outstanding accrued interest is reversed against interest income.

The ACL for individual loans begins with the use of normal credit review procedures to identify whether a loan no longer shares similar risk characteristics with other pooled loans and therefore, should be individually assessed. The Bank evaluates commercial loans that have become 90 days past due, residential loans that have become 180 days past due, or when management has serious doubts about further collectability of principal or interest, even if the loan may be performing.

A financial asset is considered collateral-dependent when the debtor is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. For all classes of loans and leases deemed collateral-dependent, the Bank elected the practical expedient to estimate expected credit losses based on the collateral's fair value less cost to sell. In most cases, the Bank records a partial charge-off to reduce the loan's carrying value to the collateral's fair value less cost to sell. Substantially all of the collateral consists of various types of real estate including residential properties; commercial properties such as retail centers, office buildings, and lodging; agriculture land; and vacant land.

Specific reserves are established based on the fair value of the collateral when the loan is collateral dependent for measuring the ACL. Collateral values are discounted to consider disposition costs when appropriate. A specific reserve is established or a charge off is taken if the fair value of the loan is less than the loan balance.

Allowance for Loan Losses – Prior to Adopting ASC 326

Prior to the adoption of ASU 2016-13 Financial Instruments – Credit Losses Topic 326: Measurement of Credit Losses on Financial Instruments, the Bank calculated our allowance for loan losses (ALL) using an incurred loan loss methodology. The following policy related to the ALL in prior periods.

The ALL is established through provisions for loan losses charged against income. Loans deemed to be uncollectable are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses – Prior to Adopting ASC 326 (Continued)

The ALL is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective, since it requires material estimates that may be susceptible to significant revision as more information becomes available. The allowance consists of specific, general, and unallocated components.

The specific component relates to loans that are classified as Doubtful, Substandard, or Other Assets Especially Mentioned (OAEM). For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value for that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including: the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral-dependent. Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Transfers of Financial Assets

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

Premises and Equipment

Land is stated at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets, which range from three to fifteen years for furniture and equipment. Buildings are amortized over their estimated useful lives, which is over a 40-year period. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Leases

The Bank recognizes the assets and liabilities that arise from leases in the balance sheet. The Bank recognized lessees of operating right-of-use assets but did not have any finance right-of-use assets in 2023 or 2022. The additional lease disclosures can be found in Note 7.

Foreclosed Assets

Foreclosed assets consist of property acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure and loans classified as in-substance foreclosure (ISF). A loan is classified as ISF when the Bank has taken possession of the collateral, regardless of whether formal proceedings take place. Foreclosed assets initially are recorded at fair value, net of estimated selling costs, at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value minus estimated costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other expenses. In addition, any gain or loss realized upon disposal is included in other income or expense. There were no foreclosed assets at December 31, 2023 or 2022. As of December 31, 2023, the Bank had $612,000 in loans that were in the process of foreclosure although the Bank did not have possession of the property.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Bank-Owned Life Insurance

The Bank invests in bank-owned life insurance (BOLI) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Bank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies is included in other income on the Consolidated Statements of Income, net of expenses.

Split Dollar Life Insurance

The Bank recognizes a liability related to the post-retirement benefits covered by an endorsement split dollar life insurance arrangement. The employer, who is also the policy holder, has a liability for the benefit it is providing to its employees. As such, the liability recognized during the employee's active service period is based on the future cost of insurance to be incurred during the employee's retirement. As of December 31, 2023 and 2022, the liability benefit balance is $737,000 and $704,000, respectively, and is included in other liabilities on the accompanying Consolidated Balance Sheet. The related benefit expense is recorded as a component of employee benefits expense on the Consolidated Statements of Income. The Bank reported related benefits expense of $33,000 for 2023. The Bank reported a credit of $13,000 to related benefits expense for 2022.

Equity Investment in Partnerships

Equity investment in partnerships represents the Bank's limited partnership investment in low-income housing projects. The projects are owned by the partnerships, and the housing units developed qualify for federal low-income housing tax credits. The Bank elects to participate in these investments to aid in offering affordable housing in our communities and to reach the objective of the Community Reinvestment Act (CRA).

The investments are accounted for under the proportional amortization method unless the requirements are not met, in which case, the equity method is used. The investment's amortized balance is $2,548,000 and $3,051,000 at December 31, 2023 and 2022, respectively, and is included in other assets on the accompanying Consolidated Balance Sheet. The Bank amortized $503,000 and $502,000 of this equity investment during 2023 and 2022, respectively. The Bank recognized a credit to federal income tax expense of $117,000 during 2023 and 2022 due to federal low-income housing tax credits.

Treasury Stock

Purchases are accounted for under the cost method whereby the entire cost of the acquired stock is recorded as treasury stock. Gains and losses on the subsequent reissuance of shares are credited or charged to surplus in excess of par value using the average-cost method.

Advertising and Promotion

The Bank follows the policy of charging the costs of advertising to expense as incurred.

Income Taxes

Deferred income taxes are provided on the liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Honat Bancorp, Inc. and its subsidiary file a consolidated federal income tax return.

Earnings per Share

The Company currently maintains a simple capital structure; thus, there are no dilutive effects on earnings per share. Earnings per share are calculated by dividing net income by the weighted average number of shares outstanding for the periods.

Comprehensive Income (Loss)

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, are reported as a separate component of the Stockholders' Equity section of the Consolidated Balance Sheet. Such items, along with net income, are the components of comprehensive income as presented on the Consolidated Statements of Comprehensive Income (Loss).

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded on the Consolidated Balance Sheet when they are funded.

Allowance for Credit Loss on Off-Balance Sheet Exposures

The Bank estimates expected credit losses over the contractual period in which the Bank is exposed to credit risk through a contractual obligation to extend credit, unless the obligation is unconditionally cancellable by the Bank. The allowance for credit losses on off-balance sheet credit exposures is adjusted through the provision for credit losses. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life.

Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on prior year net income and stockholders' equity.

Accounting Pronouncements Adopted in 2023

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

The Bank adopted this guidance, and subsequent related updates, using the modified retrospective approach for all financial assets measured at amortized cost, including loans, available for sale debt securities, and unfunded commitments. On January 1, 2023, the Bank recorded a cumulative effect increase to retained earnings of $505,000, net of tax, of which $290,000 related to loans and $215,000 related to unfunded commitments.

The impact of the change from the incurred loss model is detailed below:

January 1, 2023	Pre-Adoption	Adoption Impact	As Reported
		(In Thousands)	
Assets			
ACL on Loans			
Commercial and Industrial	$ 1,208	$ (67)	$ 1,141
Commercial Real Estate	6,553	364	6,917
Commercial Real Estate Construction	488	335	823
Home Equity Lines of Credit	809	(235)	574
Residential Real Estate	1,492	(648)	844
Residential Real Estate Construction	138	(37)	101
Consumer	478	(79)	399
Liabilities			
ACL for Unfunded Commitments	400	(272)	128
	$ 11,566	$ (639)	$ 10,927

On January 1, 2023, the Bank adopted ASU 2022-02, Financial Instruments - Credit Losses Topic 326: Troubled Debt Restructurings and Vintage Disclosures, which eliminated the accounting guidance for troubled debt restructurings (TDRs) while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. This guidance was applied on a prospective basis. Upon adoption of this guidance, the Bank no longer establishes a specific reserve for modifications made on January 1, 2023 and forward to borrowers experiencing financial difficulty. Instead, these modifications are included in their respective collective pool and a historical loss rate is applied to the current loan balance to arrive at the quantitative baseline portion of the ACL.

NOTE 2: REVENUE RECOGNITION

The Bank generates revenue associated with financial instruments including interest on loans and investments and certain other non-interest sources including: investment security gains or losses, loan servicing charges, gain on the sale of loans and bank-owned life insurance (BOLI) income. These forms of revenue are not subject to the scope of ASU 2014-09 Topic 606. Revenues previously described accounted for 92% of revenue generated in 2023 and 82% of revenue generated in 2022.

Non-interest income generated by the Bank, which is subject to the guidelines established in Topic 606, includes the following:

- Customer service fees are generated from transactions or services such as: an account analysis fee, monthly service fee, overdraft fee, transaction fee, merchant services fee, or other deposit account related fee. Fees are charged when the service or transaction is completed or on an ongoing monthly basis as earned.

- Income from fiduciary accounts is comprised of the fees earned from managing and administering trusts and customers' investment portfolios. Fees are typically collected on a monthly basis as a percentage of the assets under management.

- Brokerage and insurance fees are comprised of commissions on the sale of investment products including: stocks, bonds, mutual funds, annuities, and life insurance products, which are realized at the time the underlying investment product is bought or sold.

- On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law providing numerous tax provisions and other stimulus measures, including an Employee Retention Credit (ERC), which is a refundable tax credit against certain employment taxes. The Taxpayer Certainty and Disaster Tax Relief (TCDTR) Act of 2020 and the American Rescue Plan (ARP) Act of 2021 extended and expanded the availability of the ERC. During 2022, the Bank recorded an ERC benefit received for the second, third and fourth quarters of 2020 and the first, second and third quarters of 2021, for a total of $3,407,000 plus $73,000 in interest in our Consolidated Statements of Income.

- Other non-interest income or expenses include revenues generated from the gain or loss on the sale of other real estate owned and other assets. These gains or losses are realized at the time of sale or in response to some additional factor which triggers a reduction in the realized value of the underlying property such as a reduction in an appraised value. If the sale of a property is financed by the Bank, revenue is generally recognized when control of the property has been transferred to the buyer.

The following table represents those revenue streams identified that are the result of a contract with the customer or a service or transaction provided:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Customer Service Fees		
ATM/Debit Card Fees	**$ 1,530**	$ 1,357
Overdraft Fees, Net	**686**	641
Merchant Services	**201**	184
Account Activity Service Fees	**241**	253
Other	**127**	129
Total Customer Service Fees	**2,785**	2,564
Income from Fiduciary Activities	**693**	654
Brokerage and Insurance Fees	**473**	478
Employee Retention Credit	**-**	3,480
Other	**118**	397
Total Revenue Subject to Topic 606	**$ 4,069**	$ 7,573

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3: MORTGAGE BANKING ACTIVITIES

HNB Mortgage, a division of the Bank, originates mortgage loans for portfolio investment or for sale in the secondary market. Loans sold to the Federal National Mortgage Association (FNMA) are made without recourse. Loans sold to the Federal Home Loan Bank System (FHLB) include a credit enhancement resulting in shared credit risk. HNB Mortgage also services loans for the benefit of others, consisting of: collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors, and foreclosure processing. Loan servicing income is recorded upon receipt and includes servicing fees from investors and certain charges collected from borrowers.

The total cost of mortgage loans originated for sale is allocated between the mortgage servicing rights and the mortgage loans based on their relative fair values. The mortgage servicing rights are capitalized as assets and amortized over the period of estimated net servicing income. Additionally, they are subject to an impairment analysis based on their fair value in future periods. The Bank recorded an increase in fair value of $23,000 and $141,000 during 2023 and 2022, respectively, resulting in a valuation reserve against the mortgage servicing rights of $23,000 and $46,000 at December 31, 2023 and 2022, respectively.

Activity in mortgage servicing rights for the years ended are as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Beginning Balance	**$ 1,343**	$ 1,373
Amounts Capitalized	**92**	205
Amortization	**(300)**	(376)
Increase in Valuation Allowance	**23**	141
Ending Balance	**$ 1,158**	$ 1,343

Mortgage servicing rights are included in other assets on the accompanying Consolidated Balance Sheet. Mortgage loans serviced for others totaled $218,359,000 and $230,958,000 at December 31, 2023 and 2022, respectively. In connection with loans serviced for others, the Bank held borrowers' escrow balances of $2,811,000 and $2,929,000 at December 31, 2023 and 2022, respectively.

NOTE 4: SECURITIES

The following table presents the amortized cost, gross unrealized gains and losses, approximate fair value, and allowance for credit losses (ACL) of investment securities available for sale as of December 31, 2023:

December 31, 2023	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
			(In Thousands)		
Available for Sale					
U.S. Treasury Securities	**$ 31,085**	**$ -**	**$ (637)**	**$ -**	**$ 30,448**
U.S. Government Agency Securities	**15,500**	**-**	**(653)**	**-**	**14,847**
States and Political Subdivisions	**76,552**	**132**	**(3,746)**	**-**	**72,938**
U.S. Government-Sponsored Agency Mortgage-Backed Securities	**69,758**	**-**	**(6,723)**	**-**	**63,035**
U.S. Government-Sponsored Agency Collateralized Mortgage Obligations	**10,035**	**-**	**(1,433)**	**-**	**8,602**
Total	**$ 202,930**	**$ 132**	**$ (13,192)**	**$ -**	**$ 189,870**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4: SECURITIES (CONTINUED)

The amortized cost and fair value of the securities available for sale portfolio for prior year are summarized below:

December 31, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available for Sale				
U.S. Treasury Securities	$ 55,654	$ -	$ (1,460)	$ 54,194
U.S. Government Agency Securities	17,388	-	(1,176)	16,212
States and Political Subdivisions	79,057	56	(5,845)	73,268
U.S. Government-Sponsored Agency Mortgage-Backed Securities	79,523	-	(8,656)	70,867
U.S. Government-Sponsored Agency Collateralized Mortgage Obligations	11,252	-	(1,633)	9,619
Total	$ 242,874	$ 56	$ (18,770)	$ 224,160

The amortized cost and fair value of securities available for sale by contractual maturity are shown below, excluding mortgage-backed securities and collateralized mortgage obligations, which are shown gross. Expected maturities may differ from contractual maturities because the securities may be called or prepaid with or without any penalties.

	December 31, 2023 Amortized Cost	December 31, 2023 Fair Value
	(In Thousands)	
Available for Sale		
Due in One Year or Less	**$ 15,524**	**$ 15,270**
Due after One Year through Five Years	**35,243**	**34,028**
Due after Five Years through Ten Years	**9,761**	**9,624**
Due after Ten Years	**62,609**	**59,311**
	123,137	**118,233**
U.S. Government-Sponsored Agency Mortgage-Backed Securities	**69,758**	**63,035**
U.S. Government-Sponsored Agency Collateralized Mortgage Obligations	**10,035**	**8,602**
Total	**$ 202,930**	**$ 189,870**

There were no proceeds from sales received during the year ended December 31, 2023. During the year ended December 31, 2022, there were $14,346,000 in proceeds from the sale of securities available for sale with gross realized losses of $562,000.

The following table shows securities gross unrealized losses and fair value for which an allowance for credit losses has not been recorded, aggregated by security category and length of time that individual available for sale securities have been in a continuous unrealized loss position:

December 31, 2023	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
			(In Thousands)			
U.S. Treasury Securities	**$ 929**	**$ (11)**	**$ 29,519**	**$ (626)**	**$ 30,448**	**$ (637)**
U.S. Government Agency Securities	**-**	**-**	**14,847**	**(653)**	**14,847**	**(653)**
States and Political Subdivisions	**4,090**	**(15)**	**56,521**	**(3,731)**	**60,611**	**(3,746)**
U.S. Government-Sponsored Agency Mortgage-Backed	**-**	**-**	**63,035**	**(6,723)**	**63,035**	**(6,723)**
U.S. Government-Sponsored Collateralized Mortgage	**-**	**-**	**8,602**	**(1,433)**	**8,602**	**(1,433)**
Total Temporarily Impaired Securities	**$ 5,019**	**$ (26)**	**$ 172,524**	**$ (13,166)**	**$ 177,543**	**$ (13,192)**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4: SECURITIES (CONTINUED)

The following table shows securities gross unrealized losses and fair value, aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position for prior year:

December 31, 2022	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In Thousands)			
U.S. Treasury Securities	$ 52,402	$ (1,271)	$ 1,792	$ (189)	$ 54,194	$ (1,460)
U.S. Government Agency Securities	5,251	(248)	10,961	(928)	16,212	(1,176)
States and Political Subdivisions	59,487	(5,047)	4,733	(798)	64,220	(5,845)
U.S. Government-Sponsored Agency Mortgage-Backed	41,282	(4,038)	29,585	(4,617)	70,867	(8,655)
U.S. Government-Sponsored Collateralized Mortgage	6,041	(701)	3,578	(933)	9,619	(1,634)
Total Temporarily Impaired Securities	$ 164,463	$ (11,305)	$ 50,649	$ (7,465)	$ 215,112	$ (18,770)

The Bank reviews its position quarterly and has asserted at December 31, 2023 and 2022, the declines outlined in the previous tables represent temporary declines and the Bank does not intend to sell these securities nor is it more likely that the Bank will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 231 positions that were in an unrealized loss position. The gross unrealized loss positions were primarily related to securities issued by U.S. government agencies or U.S. government-sponsored enterprises. These securities carry the explicit and/or implicit guarantee of the U.S. Government, are widely recognized as “risk free,” and have a long history of zero credit loss. Total gross unrealized losses were primarily attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities. The Bank does not intend to sell the investment securities that were in an unrealized loss position and it is not more likely than not that the Bank will be required to sell the investment securities before recovery of their amortized cost basis, which may be at maturity. Therefore, as of December 31, 2023, no ACL was required for available for sale securities.

States and Political Subdivision Securities

As of December 31, 2023, all state and political subdivision securities were rated investment grade with a fair value of $60,611,000 which reflected unrealized losses of $3,746,000. Declines in the fair value of these securities are attributable to changes in interest rates, not credit quality.

U.S. Government-Sponsored Agency Mortgage-Backed Securities

U.S. government-sponsored agency mortgage-backed securities held by the Bank were issued by U.S. government sponsored entities and agencies. The unrealized losses of $6,723,000 is attributable to changes in interest rates and illiquidity.

Securities with a carrying value of $71,743,000 and $58,473,000 at December 31, 2023 and 2022, respectively, were pledged to secure deposits.

NOTE 5: EQUITY SECURITIES

The Company has separated the presentation of equity investments on the Consolidated Balance Sheet and reflected changes in fair value in net income.

Proceeds from the sale of equity securities were $829,000 during 2023, resulting in a realized gain of $395,000. During 2022, a $40,000 loss was recognized due to the change in the fair value of equity securities. The Company held equity securities at a fair value of $435,000 as of December 31, 2022. The Company did not sell any equity securities during 2022.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES

The composition of net loans receivable are as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Loans Receivable		
Commercial		
Commercial and Industrial	**$ 95,430**	$ 89,882
Commercial Real Estate	**364,011**	322,530
Commercial Real Estate Construction	**16,719**	24,380
Total Commercial	**476,160**	436,792
Retail		
Home Equity Lines of Credit	**56,548**	51,108
Residential Real Estate	**111,736**	110,136
Residential Real Estate Construction	**19,436**	14,241
Consumer	**32,455**	24,237
Total Retail	**220,175**	199,722
Total Loans	**696,335**	636,514
Deduct:		
Allowance for Loan Losses	**11,453**	11,166
Deferred Loan Fees, Net	**998**	-
Loans Receivable, Net	**$ 683,884**	$ 625,348

The loan composition presents loan categories as utilized by the Bank according to the allowance for credit losses (ACL) methodology utilized in 2023 and according to the allowance for loan losses (ALL) methodology utilized in 2022. Some loans may be reported under different loan categories as the criteria was redefined with the implementation of the ACL, however, the impact is insignificant.

At December 31, 2022, the amounts in the table above included net deferred loan origination fees of $911,000.

In 2020, the Bank participated in the Paycheck Protection Program (PPP), administered by the U.S. Small Business Administration (SBA). PPP provides loans to small businesses that were financially impacted by economic conditions resulting from COVID-19. The proceeds provided cash flow assistance to small businesses that maintain their payroll (excluding healthcare and certain related expenses), mortgage interest, rent, leases, utilities and interest on existing debt during the COVID-19 pandemic. PPP loans are fully guaranteed by the SBA and may be eligible for forgiveness by the SBA to the extent that proceeds were used to cover eligible expenses including: payroll expenses, interest expense, rent, and utility expenses over a period of up to 24 weeks after the loan is funded as long as SBA guidelines are met, including employee retention and compensation levels. PPP loans that are awarded forgiveness by the SBA will be repaid by the SBA to the Bank. In 2021, the Bank participated in a second round of PPP loan issuance. PPP loans are included in the commercial and industrial loan category and the Bank had outstanding balances of $130,000 and $208,000 as of December 31, 2023 and 2022, respectively.

In accordance with the SBA terms and conditions on these PPP loans, the Bank received approximately $1,000 during 2023 and $517,000 during 2022 in fees associated with the processing of these loans. Upon funding of the loan, these fees were deferred and amortized over the life of the loan which is five years as an adjustment to yield in accordance with FASB ASC 310-20-25-2 and is recognized in interest income.

Allowance for Credit Losses and Loans Under ASC 326

The ACL breaks down the loan portfolio into three high-level segments: commercial and industrial, commercial real estate, and retail. These segments are analyzed in smaller cohort groupings based on similar risk characteristics. The commercial and industrial portfolio is further segmented by North American Industry Classification System (NAICS) and risk rating. Lifetime loss rates are determined using a data consortium containing historical loan and borrower information from contributing banks. By tracking the history of the individual loans in the data consortium, lifetime loss rates are calculated, and the model applies these realized lifetime loss rates to the commercial and industrial portfolio. The commercial real estate portfolio is further segmented based on loan-to-value (LTV) and property details. Lifetime loss rates are determined using peer data from twenty-one of the Bank's peers. This methodology was chosen since the Bank's geographic footprint typically lags national trends. Expected prepayments are figured in the calculations. Quantitative results are augmented with qualitative factor adjustments which are determined based on specific conditions present in the portfolio. The retail portfolio is further segmented by vintage (origination year), initial credit score, loan term, and geography (borrower's state). Lifetime loss rates are determined based on Equifax industry-level retail credit performance data and applied to the loans in the retail portfolio.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Allowance for Credit Losses and Loans Under ASC 326 (Continued)

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

December 31, 2023	Beginning Balance	Impact of Adopting ASC 326	Charge-Offs	Recoveries	Provisions (Reductions)	Ending Balance
			(In Thousands)			
Allowance for Credit Losses						
Commercial and Industrial	$ 1,208	$ (67)	$ (10)	$ 35	$ (342)	$ 824
Commercial Real Estate	6,553	364	-	14	721	7,652
Commercial Real Estate Construction	488	335	-	-	(272)	551
Home Equity Lines of Credit	809	(235)	-	-	125	699
Residential Real Estate	1,492	(648)	-	22	227	1,093
Residential Real Estate Construction	138	(37)	-	-	51	152
Consumer	478	(79)	(89)	32	171	513
Unallocated	-	-	-	-	(31)	(31)
Total	$ 11,166	$ (367)	$ (99)	$ 103	$ 650	$ 11,453

As of December 31, 2023, the Bank expects that the markets in which it operates will experience a decline in economic conditions based primarily on higher interest rates causing an increase in the level and trend of delinquencies over the next year. The historical loss experience is adjusted for these expectations.

Allowance for Loan Losses Under ASC 310

As of December 31, 2022, the Bank was responsible for ensuring that controls were in place to determine the appropriate level of the ALL, based on a comprehensive, well-documented, and consistently applied analysis of its loan portfolio. The Loan Review Officer performs the ALL analysis and presents it to the Board of Directors for approval on a quarterly basis, or more frequently if warranted. ALL estimates require analysis and reviews of individual loans and groups of loans.

For loans that are individually evaluated and found to be impaired, the associated allowance should be based upon one of the three impairment measurement methods as described in impaired loans. For all other loans the Bank will estimate loan losses for groups of loans with similar risk characteristics. These estimates will be based upon historical loss data to segmented portions of the loan portfolio, adjusted for environmental factors.

The ALL will be maintained at a level considered adequate to provide for reasonably anticipated losses.

The following table presents changes in the ALL:

December 31, 2022	Commercial and Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Total
			(In Thousands)		
Balance, Beginning of Year	$ 1,427	$ 6,384	$ 2,325	$ 481	$ 10,617
Provision for Loan Losses	(436)	614	113	9	300
Charge-Offs	-	(50)	(3)	(34)	(87)
Recoveries	216	93	4	23	336
Balance	$ 1,207	$ 7,041	$ 2,439	$ 479	$ 11,166

The changes in the ALL year over year are impacted by portfolio segment loan volume, trends in delinquency and charge-offs, and qualitative risk factors applied by management. The portfolio segments management uses in their analysis of the ALL are commercial and industrial, commercial real estate, residential real estate, and consumer.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Allowance for Loan Losses Under ASC 310 (Continued)

For the year ending December 31, 2022, the Bank experienced an increase in commercial real estate loans of $48,028,000 and an increase in consumer real estate loans of $22,559,000. The expanded commercial real estate and consumer real estate portfolios resulted in an increase in the reserve allocation for these loan categories. For the commercial and industrial reserve allocation, the factor for historical losses, which is derived from the last three years of loss history, decreased significantly as loss history improved which contributed to the reduction in the reserve allocation for this loan category. In evaluating the qualitative factors, overall, the Bank reduced the factors for changes in the loan review system and external factors across all loan categories to zero as no major changes have been implemented affecting the loan review system for many years and during 2022, there were minimal impacts from competition or regulatory changes that affected our loan portfolio.

Analyzing Individual Loans
Loans fitting the definition of impaired will be individually analyzed to determine an adequate allowance. The following methodology is utilized to determine an adequate allowance on a loan-by-loan basis:

1. Determine a fair value of the collateral utilizing appraisals, valuation assumptions and other calculations deemed appropriate for the collateral involved.
2. Make any adjustment to the appraised value to determine a reasonable sale price.
3. Deduct appropriate costs to sell, including applicable commissions or transfer tax, to determine a net proceeds amount.
4. Determine the final impairment by deducting the net proceeds from the recorded loan balance.
5. If a loan is determined to have no impairment, then no allocation amount is recorded in the ALL.

Once a loan is analyzed for impairment, whether or not it results in an impairment allocation, it is excluded from the homogenous pool of loans.

Analyzing Homogenous Pool of Loans
The loan portfolio is segmented into varying loan type categories (i.e., commercial real estate, consumer, etc.) allowing for a more in-depth analysis of higher-risk loan types. These segments may be adjusted based on changes in the portfolio or external factors affecting the overall risk of the loan portfolio.

The following methodology is utilized to determine an adequate allowance for each loan type segment:

1. Historical charge-offs are analyzed over a three-year period. A three-year weighted average charge-off percentage is calculated and then adjusted for current conditions and environmental factors as follows:
   a. Levels of and trends in delinquencies and nonaccruals;
   b. Trends in volume and terms of loans;
   c. Effects of any changes in lending policies;
   d. Experience, ability and depth of management;
   e. National and local economic trends and conditions;
   f. Concentrations of credit;
   g. Changes in the quality of the Bank's loan review system and the degree of oversight by the Bank's Board of Directors; and
   h. The effect of external factors, such as competition and legal and regulatory requirements, on the level of estimated credit losses in the Bank's current portfolio.
2. This Adjusted Loss Ratio is then applied to the outstanding loan balances in the various loan categories, with any impaired loans being excluded.
3. Problem loans are analyzed within the loan-type category in which they exist. Separate historical analyses and environmental adjustments are applied to problem loans.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Allowance for Loan Losses Under ASC 310 (Continued)

The Bank's recorded investment in loans related to each balance in the ALL by portfolio segment and disaggregated on the basis of the Bank's impairment methodology is as follows:

December 31, 2022	Commercial and Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Total
			(In Thousands)		
Loans Individually Evaluated for Impairment	$ 109	$ 1,659	$ 1,313	$ -	$ 3,081
Loans Collectively Evaluated for Impairment	89,773	345,251	174,172	24,237	633,433
Total	$ 89,882	$ 346,910	$ 175,485	$ 24,237	$ 636,514
Allowance for Loans Individually Evaluated for Impairment	$ -	$ 52	$ -	$ -	$ 52
Allowance for Loans Collectively Evaluated for Impairment	1,207	6,989	2,439	479	11,114
Total	$ 1,207	$ 7,041	$ 2,439	$ 479	$ 11,166

Age Analysis of Past Due Loans Receivable

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2023:

December 31, 2023	Current	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Total Loans
			(In Thousands)			
Commercial and Industrial	**$ 95,367**	**$ 18**	**$ 45**	**$ -**	**$ 63**	**$ 95,430**
Commercial Real Estate	**363,644**	**216**	**151**	**-**	**367**	**364,011**
Commercial Real Estate Construction	**16,719**	**-**	**-**	**-**	**-**	**16,719**
Home Equity Lines of Credit	**56,528**	**20**	**-**	**-**	**20**	**56,548**
Residential Real Estate	**110,956**	**199**	**83**	**498**	**780**	**111,736**
Residential Real Estate Construction	**19,436**	**-**	**-**	**-**	**-**	**19,436**
Consumer	**32,228**	**218**	**9**	**-**	**227**	**32,455**
Total	**$ 694,878**	**$ 671**	**$ 288**	**$ 498**	**$ 1,457**	**$ 696,335**

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Age Analysis of Past Due Loans Receivable (Continued)

The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2022:

December 31, 2022	Current	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Total Loans
	(In Thousands)					
Commercial and Industrial	$ 89,440	$ 442	$ -	$ -	$ 442	$ 89,882
Commercial Real Estate	345,615	1,077	182	36	1,295	346,910
Home Equity Lines of Credit	51,050	-	-	58	58	51,108
Residential Real Estate	123,078	287	-	1,012	1,299	124,377
Consumer	24,094	111	32	-	143	24,237
Total	$ 633,277	$ 1,917	$ 214	$ 1,106	$ 3,237	$ 636,514

Loan Origination/Risk Management

The basic objectives of the lending activities of the Bank are to profit from the investment of funds into good loans and to serve the credit needs of, and promote economic development within, the Bank's market areas. The Board of Directors recognizes that certain risks are inherent in lending money and commits the Bank to this activity with that in mind. The scope of the Bank's lending activities is influenced by the belief that a sound financial (asset/liability) management function forms the basis for successful lending activities. Management divides the loan portfolio into classes to monitor risk, which are the same as the portfolio segments.

Lending strategies and policies are influenced by competitive, economic, and regulatory factors. A reporting system supplements the review process by providing management with reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's business operation. Underwriting standards are designed to promote relationship banking rather than transactional banking. Current and projected cash flows are examined to determine the ability of borrowers to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral type and risk grade criteria.

Residential real estate loans, which include home equity term loans and lines of credit, are subject to underwriting standards that are influenced by regulatory requirements, loan-to-value percentages, debt-to-income ratios, and overall credit worthiness of the borrower.

The Bank utilizes an automated underwriting data system on direct and indirect consumer loans. In an effort to monitor and manage consumer loan risk, policies and procedures are developed and modified in accordance with changes in the portfolio and economic climate.

Concentrations of Credit

Diversification within the loan portfolio is important to minimize the risks involved in lending. Management will be alert to the development of such concentrations and report them to the Board of Directors for evaluation of the risk involved and for determination of a proper course of action. The Bank is aware of concentrations of credit in the real estate sector in rental of residential buildings which is 13.7% of total loans. Management has developed reports to monitor these and all components of the portfolio in an effort to minimize risk.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Loan Origination/Risk Management (Continued)

Nonaccrual and Past Due Loans
Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and maintained current for a period of at least six months.

Nonperforming Loans

The following tables present the amortized cost basis of loans on nonaccrual status and loans past due over 90 days still accruing interest:

December 31, 2023	**Nonaccrual with No ACL**	**Nonaccrual with ACL**	**Total Nonaccrual**	**Loans Past Due Over 90 Days Still Accruing**	**Total Nonperforming**
			(In Thousands)		
Residential Real Estate	**$ 598**	**$ -**	**$ 598**	**$ -**	**$ 598**
Commercial Real Estate	**552**	**-**	**552**	**-**	**552**
Balance	**$ 1,150**	**$ -**	**$ 1,150**	**$ -**	**$ 1,150**

December 31, 2022	**Nonaccrual with No ALL**	**Nonaccrual with ALL**	**Total Nonaccrual**	**Loans Past Due Over 90 Days Still Accruing**	**Total Nonperforming**
			(In Thousands)		
Residential Real Estate	$ 900	$ -	$ 900	$ 209	$ 1,109
Commercial Real Estate	805	-	805	-	805
Balance	$ 1,705	$ -	$ 1,705	$ 209	$ 1,914

Credit Quality Indicators

The Bank 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 Bank analyzes loans individually to classify the loans as to credit risk. This analysis includes all loans regardless of outstanding balance. This analysis is performed on an ongoing basis.

The Bank uses the following definitions for risk ratings:

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 institution'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 must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Credit Quality Indicators (Continued)

A meeting of the Asset Quality Committee is held quarterly to discuss any changes in ratings of loans and the appropriate administrative action to be taken for each account. If applicable, an estimate of loss to the Bank will be discussed, as recommended by loan review personnel. The Asset Quality Committee consists of loan officers, credit administration, collection personnel and others as necessary.

Loan review personnel report to the Board of Directors with results and recommendations concerning the review process on a quarterly basis. In addition, the Bank utilizes an outside consultant to perform an independent loan review from time to time as may be necessary in accordance with regulatory requirements.

Based on the most recent analysis performed, the following table presents the recorded investment in non-homogeneous loans by internal risk rating system in accordance with ASC 326 (in thousands):

December 31, 2023	Term Loans Amortized Cost Basis by Origination Year 2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Commercial and Industrial									
Risk Rating									
Pass	$15,277	$ 8,000	$ 8,044	$ 3,753	$ 4,805	$ 6,389	$42,061	$ 5,229	$ 93,558
Special Mention	90	-	-	58	-	-	1,445	-	1,593
Substandard	20	29	58	-	12	-	16	144	279
Total	15,387	8,029	8,102	3,811	4,817	6,389	43,522	5,373	95,430
Commercial and Industrial Current Period Gross Charge-Offs	-	5	-	-	-	-	-	5	10
Commercial Real Estate									
Risk Rating									
Pass	44,891	59,298	54,693	45,730	13,361	60,325	13,193	62,719	354,210
Special Mention	-	-	866	-	673	3,500	41	1,059	6,139
Substandard	460	154	244	151	68	2,331	254	-	3,662
Total	45,351	59,452	55,803	45,881	14,102	66,156	13,488	63,778	364,011
Commercial Real Estate Current Period Gross Charge-Offs	-	-	-	-	-	-	-	-	-
Commercial Real Estate Construction									
Risk Rating									
Pass	-	-	-	-	-	642	3,582	12,495	16,719
Special Mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Total	-	-	-	-	-	642	3,582	12,495	16,719
Commercial Real Estate Construction Current Period Gross Charge-Offs	-	-	-	-	-	-	-	-	-
Total									
Risk Rating									
Pass	60,168	67,299	62,738	49,482	18,166	67,356	58,836	80,443	464,488
Special Mention	90	-	866	58	673	3,500	1,486	1,059	7,732
Substandard	480	182	302	151	80	2,331	270	144	3,940
Total	$60,738	$67,481	$63,906	$49,691	$18,919	$73,187	$60,592	$81,646	$476,160

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Credit Quality Indicators (Continued)

The following table present the credit exposure risk grades and classified loans by class of loan in accordance with ASC 310:

December 31, 2022	Pass	Watchlist	OAEM	Substandard	Doubtful	Total
			(In Thousands)			
Commercial and Industrial	$ 88,918	$ 209	$ 224	$ 531	$ -	$ 89,882
Commercial Real Estate	328,326	5,361	7,347	5,876	-	346,910
Total	$ 417,244	$ 5,570	$ 7,571	$ 6,407	$ -	$ 436,792

The Bank monitors the credit risk profile by payment activity for the retail segment. Loans past due 90 days or more and loans on nonaccrual status are considered nonperforming. Nonperforming loans are reviewed monthly. The following table presents the amortized cost in residential and consumer loans based on payment activity in accordance with ASC 326 (in thousands):

December 31, 2023	Term Loans Amortized Cost Basis by Origination Year 2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Home Equity Lines of Credit									
Payment Performance									
Performing	$ -	$ -	$ -	$ -	$ -	$ 3	$ 56,545	$ -	$ 56,548
Nonperforming	-	-	-	-	-	-	-	-	-
Total	-	-	-	-	-	3	56,545	-	56,548
Home Equity Lines of Credit									
Current Period Gross Charge-Offs	-	-	-	-	-	-	-	-	-
Residential Real Estate									
Payment Performance									
Performing	18,258	21,793	15,593	7,776	6,864	38,667	-	2,187	111,138
Nonperforming	-	-	-	-	-	598	-	-	598
Total	18,258	21,793	15,593	7,776	6,864	39,265	-	2,187	111,736
Residential Real Estate									
Current Period Gross Charge-Offs	-	-	-	-	-	-	-	-	-
Residential Real Estate Construction									
Payment Performance									
Performing	879	5,047	2,737	660	955	8,688	-	470	19,436
Nonperforming	-	-	-	-	-	-	-	-	-
Total	879	5,047	2,737	660	955	8,688	-	470	19,436
Residential Real Estate Construction									
Current Period Gross Charge-Offs	-	-	-	-	-	-	-	-	-
Consumer									
Payment Performance									
Performing	12,105	11,571	3,904	1,859	719	1,757	540	-	32,455
Nonperforming	-	-	-	-	-	-	-	-	-
Total	12,105	11,571	3,904	1,859	719	1,757	540	-	32,455
Consumer									
Current Period Gross Charge-Offs	6	14	13	2	46	8	-	-	89
Total									
Payment Performance									
Performing	31,242	38,411	22,234	10,295	8,538	49,115	57,085	2,657	219,577
Nonperforming	-	-	-	-	-	598	-	-	598
Total	$31,242	$38,411	$22,234	$10,295	$8,538	$49,713	$ 57,085	$ 2,657	$ 220,175

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Credit Quality Indicators (Continued)

The following table presents performing and nonperforming loans based solely on payment activity that has not been assigned an internal risk grade in accordance with ASC 310:

December 31, 2022	Performing	Nonperforming (In Thousands)	Total
Consumer			
Home Equity Lines of Credit	$ 51,050	$ 58	$ 51,108
Residential Real Estate	123,326	1,051	124,377
Consumer	24,237	-	24,237
Total	$ 198,613	$ 1,109	$ 199,722

The consumer loans that are performing and nonperforming, presented in the prior tables, are not assigned a risk grade unless there is evidence of a problem. Payment activity is reviewed by management on a monthly basis to evaluate performance. Loans are considered to be nonperforming when they become 90 days past due or if management believes they may not collect all of the principal and interest.

Modifications to Borrowers Experiencing Financial Difficulty

Occasionally, the Bank modifies loans to borrowers in financial distress by providing principal forgiveness, an interest rate concession, a term extension, or a significant payment delay. When principal forgiveness is provided, the amount of forgiveness is charged-off against the allowance for credit losses.

In some cases, the Bank provides 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.

The following table shows the amortized cost basis at the end of the reporting period of the loans modified to borrowers experiencing financial difficulty, disaggregated by portfolio segment and type of concession granted in accordance with ASC 326:

Combination — Additional Advance, Term Extension, and Interest Only Payments

	Amortized Cost Basis at December 31, 2023 (In Thousands)	% of Total of Portfolio Segment
Commercial Real Estate	**$ 972**	**0.27%**
Total	**$ 972**	

The Bank has not committed to lend any additional proceeds beyond the initial advance granted at the time of the modification to the borrowers included in the previous table. The following table describes the financial effect of the modifications made to borrowers experiencing financial difficulty during the year ended December 31, 2023:

Combination — Additional Advance, Term Extension, and Interest Only Payments

Loan Type	Financial Effect
Commercial Real Estate	Consolidated existing debt, issued additional funds for working capital, and granted interest only payments for 12 months.

The Bank did not incur any payment default during the period from loans that were modified in the 12 months before default to borrowers experiencing financial difficulty.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Modifications to Borrowers Experiencing Financial Difficulty (Continued)

Upon the Bank's determination that a modified loan (or portion of a loan) has subsequently been deemed uncollectible, the loan (or a portion of the loan) is written off. Therefore, the amortized cost basis of the loan is reduced by the uncollectible amount and the allowance for credit losses is adjusted by the same amount.

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

December 31, 2023	Current	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days Past Due	Total Past Due
Commercial Real Estate	$ 972	$ -	$ -	$ -	$ -

Individually Evaluated Loans

The following table presents the amortized cost basis of individually evaluated loans of December 31, 2023 in accordance with ASC 326. Changes in fair value of the collateral for individually evaluated loans are reported as a provision for credit losses in the period of change.

December 31, 2023	Type of Collateral	
	Business	Real Estate
	(In Thousands)	
Commercial Real Estate	$ -	$ 552
Residential Real Estate	-	598
Total	**$ -**	**$ 1,150**

Impaired Loans Under ASC 310

In 2022, on a quarterly basis, the Bank maintained a list of loans identified as impaired loans. A commercial loan is considered impaired when, based on current information and events, it is probable the creditor will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Loans modified and considered a troubled debt restructuring are also impaired loans regardless of loan type. Impaired loans do not apply to homogeneous pools of loans evaluated collectively, loans accounted for at fair value or lower of cost or fair value, leases, and debt securities. Management strives to identify borrowers in financial difficulty early and works with them to modify to more affordable terms before their loan reaches nonaccrual status. Concessions may include modified terms such as: rate reductions, principal forgiveness, payment forbearance, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. Loans granted such concessions are considered impaired through a troubled debt restructuring. Individually reviewed loans that are determined impaired loans will have a specific reserve analysis on a case-by-case basis.

The methodology for determining and measuring impairment will be documented as follows: (1) if impairment is based on present value of expected cash flows, the amount and timing of cash flows, the effective interest rate used in discounting, and the basis for the determination of cash flows must be properly analyzed; (2) if based on the fair value of collateral, how fair value was determined, including valuation assumptions, costs to sell, appraisal quality, and experience and independence of the appraiser, must be clearly analyzed; (3) if based on observable market price, document amount, source, and date of the price. A valuation allowance is to be established at the time that a loan becomes impaired. The determined amount of impairment will be considered as a specific reserve in the ALL for each loan.

NOTE 6: LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Impaired Loans Under ASC 310 (Continued):

Year-end impaired loans are set forth in the following table:

December 31, 2022	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
				(In Thousands)			
Impaired Loans							
Commercial and Industrial	$ 109	$ 109	$ -	$ 109	$ -	$ 301	$ 7
Commercial Real Estate	1,740	1,410	249	1,659	52	2,282	64
Consumer Real Estate							
Home Equity Lines of Credit	58	58	-	58	-	29	1
Residential Real Estate	1,303	1,255	-	1,255	-	1,296	21
Total Impaired Loans	$ 3,210	$ 2,832	$ 249	$ 3,081	$ 52	$ 3,908	$ 93

As of December 31, 2022, the Bank recognized five additional loans as impaired. Four of these impaired loans are secured by commercial real estate and were designated as impaired as the borrower experienced difficulty in making payments. As of December 31, 2023, three of the four loans were current and one of the loans paid off in February 2023. The additional loan recognized as impaired in 2022, was secured by a one-to-four family residential property and was paid off in January 2023.

Troubled Debt Restructuring (TDR)

There were no loan modifications in 2022 that were considered a TDR.

NOTE 7: LEASE COMMITMENT

The Bank analyzes all property and financing lease contracts. Several assumptions are made when evaluating leases, including the allocation of consideration in the contracts between lease and non-lease components, the lease term, and the discount rate to calculate the present value of the lease payments. As of December 31, 2023, the Bank is not contracted under any financing leases. The Bank currently has five office locations operating under leases.

The Bank elects to account for non-lease components such as: common area maintenance charges, utilities, real estate taxes, and insurance, separate from the lease component. These variable non-lease components are reported under occupancy expense on the Consolidated Statements of Income as incurred. These variable non-lease components are not included in the present value calculation of the remaining lease payments and are not reflected in the right-of-use assets and lease liabilities reported on the Consolidated Balance Sheet. Total lease expense recorded was $143,000 and $131,000 during 2023 and 2022, respectively.

The Bank's leases contain an option to renew the lease after the initial term. The renewal option is evaluated by the Bank for reasonability given historical elections and the Bank's overall strategic plan to determine its inclusion in the present value calculation. The discount rate utilized in calculating the present value of the lease payments for each lease with the Federal Home Loan Bank of Pittsburgh advance rate corresponding to the remaining maturity of the lease at the time the lease commitment was recognized as an asset.

The following table reflects the weighted average remaining lease term and discount rate for the leases outstanding:

	December 31, 2023
Weighted Average Remaining Term (Years)	**14**
Weighted Average Discount Rate	**3.84%**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7: LEASE COMMITMENT (CONTINUED)

The following table presents the undiscounted cash flows due related to operating leases as of December 31, 2023, along with a reconciliation to the discounted amount recorded on the Consolidated Balance Sheet.

	December 31, 2023 (In Thousands)
Undiscounted Cash Flows Due	
2024	$ **126**
2025	**107**
2026	**109**
2027	**105**
2028	**89**
2029 and Thereafter	**902**
Total	**1,438**
Impact of Present Value Discount	**(342)**
Total	$ **1,096**

NOTE 8: PREMISES AND EQUIPMENT

The components of premises and equipment are as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Premises and Equipment		
Land	**$ 2,249**	$ 2,249
Buildings and Building Improvements	**9,559**	9,503
Furniture and Equipment	**2,890**	2,676
Total	**14,698**	14,428
Accumulated Depreciation	**(7,755)**	(7,497)
Total	**$ 6,943**	$ 6,931

Depreciation expense was $441,000 and $423,000 for the years ended December 31, 2023 and 2022, respectively.

NOTE 9: DEPOSITS

The components of deposits are as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Total Deposits		
Demand, Non-Interest-Bearing	**$ 257,351**	$ 288,743
Demand, Interest-Bearing	**172,414**	175,320
Savings	**127,972**	162,305
Time, $250,000 and Over	**71,199**	34,639
Time, Other	**193,611**	119,028
Total	**$ 822,547**	$ 780,035

NOTE 9: DEPOSITS (CONTINUED)

At December 31, 2023 the scheduled maturities of time deposits are as follows (in thousands):

2024	$	**207,252**
2025		**51,972**
2026		**3,692**
2027		**1,265**
2028		**629**
Thereafter		**-**
Total	**$**	**264,810**

NOTE 10: BORROWINGS

The Bank had a maximum borrowing capacity with the Federal Home Loan Bank of Pittsburgh (FHLB) of $269,500,000 at December 31, 2023. FHLB borrowings and the letters of credit are collateralized by FHLB stock and qualifying pledged loans. There were no outstanding letters of credit with FHLB used for pledging to secure public fund deposits at December 31, 2023 or December 31, 2022. The Bank had no long-term debt outstanding as of December 31, 2023 or December 31, 2022.

Short-Term Borrowings

The Bank has a $121,456,000 cash management advance line of credit with FHLB. The outstanding balance and related information for this short-term borrowing is summarized as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Balance	**$ -**	$ 16,000
Average Balance Outstanding During Period	**1,447**	1,259
Maximum Amount Outstanding at Any Month	**11,738**	16,000
Weighted Average Interest Rate at Period End	**5.02%**	4.34%
Average Interest Rate During Period	**4.98%**	4.28%

The Company also has a short-term outstanding line of credit with ACBB of $500,000. The line of credit for $500,000 has a floating interest rate equivalent to the Wall Street Journal Prime Rate which was 8.50% as of December 31, 2023. The Company had no outstanding balances on the line of credit as of December 31, 2023 or December 31, 2022.

NOTE 11: EMPLOYEE BENEFITS

The Bank has an Employee Stock Ownership Plan with 401(k) provisions (Plan). The Plan is for the benefit of all employees who meet the eligibility requirements set forth in the Plan. The amount of employer contributions to the Plan, including 401(k) matching contributions, is at the discretion of the Board of Directors. Bank contributions charged to expense for the years ended December 31, 2023 and 2022, were $1,275,000 and $1,320,000, respectively.

At December 31, 2023 and 2022, 144,462 and 152,526 shares, respectively, of the Bank's common stock were held in the Plan. In the event a terminated Plan participant desires to sell his or her shares of the Bank's stock, or for certain employees who elect to diversify their account balances, the Bank may be required to purchase the shares from the participant at their fair market value.

The Bank has adopted various deferred compensation plans for certain directors and officers of the Bank. Under the deferred compensation plan's provisions, benefits will be payable upon retirement, death, or permanent disability of the participant. As of December 31, 2023 and 2022, $5,166,000 and $5,192,000, respectively, of deferred compensation expense has been accrued. The deferred compensation plan is funded by life insurance carried on the lives of the participants. The Bank recognized deferred compensation expense of $369,000 and $349,000 as of December 31, 2023 and 2022, respectively. Benefits of $395,000 and $272,000 were disbursed in 2023 and 2022, respectively.

NOTE 12: INCOME TAXES

The components of income tax expense are as follows:

	December 31, 2023 (In Thousands)	December 31, 2022 (In Thousands)
Income Tax Expense		
Current	$ **2,664**	$ 3,263
Deferred	**47**	(533)
Total	$ **2,711**	$ 2,730

A reconciliation of the statutory income tax expense to the income tax expense included on the Consolidated Statements of Income computed at a tax rate of 21% is as follows:

	December 31, 2023 (In Thousands)		December 31, 2022 (In Thousands)	
	Amount	% of Pretax	Amount	% of Pretax
Federal Income Tax at Statutory Rate	$ **3,271**	**21%**	$ 3,334	21%
Tax-Exempt Income	**(432)**	**(3)**	(386)	(2)
Interest Disallowance	**92**	**1**	13	-
Bank-Owned Life Insurance Income	**(88)**	**(1)**	(85)	(1)
Low-Income Housing Credit	**(153)**	**(1)**	(156)	(1)
Other, Net	**21**	**-**	10	-
Total	$ **2,711**	**17%**	$ 2,730	17%

The components of income tax expense are as follows:

	December 31, 2023 (In Thousands)	December 31, 2022 (In Thousands)
Deferred Tax Assets		
Allowance for Credit Losses	$ **2,401**	$ 2,398
Deferred Compensation	**1,085**	1,092
Investment in Low-Income Housing Partnerships	**574**	541
Nonaccrual Interest	**20**	17
Accrued Expense	**126**	116
Unrealized Loss on Available for Sale Securities	**2,743**	3,930
Operating Lease Liability	**230**	128
Impairment Allowance	**137**	216
	7,316	8,438
Valuation Allowance	**(80)**	(80)
Total Deferred Tax Assets	**7,236**	8,358
Deferred Tax Liabilities		
Bank Premises and Equipment	**(141)**	(172)
Mortgage Servicing Rights	**(243)**	(282)
Unrealized Gain on Equity Securities	**-**	(39)
Operating Lease	**(228)**	(126)
Prepaid Expenses and Loan Origination Costs	**(597)**	(478)
Total Deferred Tax Liabilities	**(1,209)**	(1,097)
Net Deferred Tax Assets	$ **6,027**	$ 7,261

NOTE 12: INCOME TAXES (CONTINUED)

The ability to realize the benefits of deferred tax assets is dependent on a number of factors, including the generation of future taxable income, the ability to carryback to taxable income in previous years, the ability to offset capital losses with capital gains, the reversal of deferred tax liabilities, and certain tax planning strategies. A valuation allowance has been established to offset deferred tax assets that could result in future capital losses which management believed may not be realizable. The valuation allowance is $80,000 as of December 31, 2023 and 2022.

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

The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes on the Consolidated Statements of Income. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expense. The Company's federal and Pennsylvania income tax returns for taxable years prior to 2020 have been closed for purposes of examination by the Internal Revenue Service and the Pennsylvania Department of Revenue. The Company's New Jersey income tax returns for taxable years prior to 2019 have been closed for purposes of examination.

NOTE 13: TRANSACTIONS WITH EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL STOCKHOLDERS

The Company has had, and may be expected to have in the future, transactions in the ordinary course of business with its executive officers, directors, principal stockholders, and their related interests on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. The Company added one executive officer during the period and two executive officers were removed from inclusion.

An analysis of the activity for loans to related parties is as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Balance, Beginning	**$ 29,224**	$ 24,411
New Loans and Additions	**37,265**	25,940
Repayments and Removals	**(38,271)**	(21,127)
Balance, Ending	**$ 28,218**	$ 29,224

NOTE 14: FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to 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 and letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company held $128,000 in reserves for off-balance sheet instruments as of December 31, 2023.

A summary of the Company's financial instrument commitments is as follows:

	December 31, 2023	December 31, 2022
	(In Thousands)	
Loan Commitments		
Commitments to Grant Loans	**$ 38,483**	$ 52,470
Unfunded Commitments Under Lines of Credit	**159,389**	157,618
Outstanding Letters of Credit	**5,441**	4,655

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include: personal or commercial real estate, accounts receivable, inventory, and equipment.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These standby letters of credit expire within the next 12 months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit, as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2023 and 2022, was $5,441,000 and $4,655,000, respectively.

NOTE 15: FAIR VALUE MEASUREMENTS AND DISCLOSURES

Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Bank's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Bank could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end. The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

NOTE 15: FAIR VALUE MEASUREMENTS AND DISCLOSURES (CONTINUED)

Fair Value Measurements (Continued)

In accordance with this guidance, the Bank groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded, and the reliability of the assumptions used to determine fair value.

Level I
Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level I assets and liabilities generally include debt and equity securities that are traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level II
Valuation is based on inputs other than quoted prices included within Level I that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted policies 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 for substantially the full term of the asset or liability.

Level III
Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level III assets and liabilities include financial instruments, the value of which is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

The hierarchy requires the use of observable market data when available. The fair value of investment securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

December 31, 2023	Total	Level I	Level II	Level III
		(In Thousands)		
Investment Securities Available for Sale				
U.S. Treasury Securities	**$ 30,448**	**$ -**	**$ 30,448**	**$ -**
U.S. Government Agency Securities	**14,847**	**-**	**14,847**	**-**
States and Political Subdivisions	**72,938**	**-**	**72,938**	**-**
Other Debt Securities				
U.S. Government-Sponsored Mortgage-Backed Securities	**63,035**	**-**	**63,035**	**-**
U.S. Government-Sponsored Collateralized Mortgage Obligations	**8,602**	**-**	**8,602**	**-**

December 31, 2022	Total	Level I	Level II	Level III
		(In Thousands)		
Investment Securities Available for Sale				
U.S. Treasury Securities	$ 54,194	$ -	$ 54,194	$ -
U.S. Government Agency Securities	16,212	-	16,212	-
States and Political Subdivisions	73,268	-	73,268	-
Other Debt Securities				
U.S. Government-Sponsored Mortgage-Backed Securities	70,867	-	70,867	-
U.S. Government-Sponsored Collateralized Mortgage Obligations	9,619	-	9,619	-
Equity Securities − Financial Institutions	435	435	-	-

NOTE 15: FAIR VALUE MEASUREMENTS AND DISCLOSURES (CONTINUED)

Fair Value Measurements (Continued)

Collateral Dependent Loans
The Bank has measured impairment on collateral dependent loans generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. Additionally, management makes estimates about expected costs to sell the property which are also included in the net realizable value. If the fair value of the collateral-dependent loan is less than the carrying amount of the loan, a specific reserve for the loan is made in the allowance for credit losses (ACL) or a charge-off is taken to reduce the loan to the fair value of the collateral (less estimated selling costs) and the loan is included in the following tables as a Level III measurement. If the fair value of the collateral exceeds the carrying amount of the loan, then the loan is not included in the following tables as it is not currently being carried at its fair value.

Other Real Estate Owned (OREO)
OREO is carried at the lower of cost or fair value, which is measured at the date of foreclosure. If the fair value of the collateral exceeds the carrying amount of the loan, no charge-off or adjustment is necessary, the loan is not considered to be carried at fair value and is therefore not included in the following tables. If the fair value of the collateral is less than the carrying amount of the loan, management will charge the loan down to its estimated realizable value.

The fair value of OREO is based on the appraised value of the property, which is generally unadjusted by management and is based on comparable sales for similar properties in the same geographic region as the subject property and is included in the following tables as a Level II measurement. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. In these cases, the loans are categorized in the following tables as a Level III measurement since these adjustments are considered to be unobservable inputs. Income and expenses from operations and further declines in the fair value of the collateral subsequent to foreclosure are included in net expenses from OREO.

Mortgage Servicing Rights
The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation incorporates assumptions that market participants would use in estimating future net servicing income. The Bank is able to compare the valuation model inputs and results with widely available published industry data for reasonableness.

There were no financial assets measured at fair value on a nonrecurring basis as of December 31, 2023.

NOTE 15: FAIR VALUE MEASUREMENTS AND DISCLOSURES (CONTINUED)

Fair Value Measurements (Continued)

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy are as follows:

December 31, 2022	Total	Level I	Level II	Level III
		(In Thousands)		
Financial Assets				
Impaired Loans	$ 185	$ -	$ -	$ 185

The following table presents quantitative information about the Level III significant unobservable inputs for assets and liabilities measured at fair value on a nonrecurring basis:

December 31, 2022	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average
			(In Thousands)		
Impaired Loans	$ 186	Appraisal of Collateral	Appraisal Adjustments	30%	30%

For certain financial instruments, the carrying amount is a reasonable estimate of the fair value. For short-term financial assets such as cash and cash equivalents, the relatively short duration between origination and the anticipated maturity indicates that the carrying amount is a reasonable estimate of fair value. Certificates of deposits purchased have maturity dates less than two years and the carrying amount is a reasonable estimate of fair value. For investments in restricted stock, stock can only be redeemed at par value and therefore, the carrying amount is a reasonable estimate of fair value. For deposits including demand deposits and savings deposits in which no maturity is stated, the Company assumes the carrying value is a reasonable estimate of fair value.

The following tables present the fair value of the Bank's financial instruments not carried at fair value:

December 31, 2023	Carrying Amount	Fair Value	Level I	Level II	Level III
			(In Thousands)		
Financial Assets					
Mortgage Loans Held for Sale	**$ 1,337**	**$ 1,362**	**$ 1,362**	**$ -**	**$ -**
Loans Receivable, Net	**683,884**	**668,699**	**-**	**-**	**668,699**
Mortgage Service Rights	**1,158**	**1,812**	**-**	**-**	**1,812**
Financial Liabilities					
Time Deposits	**264,810**	**262,587**	**-**	**-**	**262,587**

December 31, 2022	Carrying Amount	Fair Value	Level I	Level II	Level III
			(In Thousands)		
Financial Assets					
Mortgage Loans Held for Sale	$ 114	$ 118	$ 118	$ -	$ -
Loans Receivable, Net	625,348	599,542	-	-	599,542
Mortgage Servicing Rights	1,343	1,849	-	-	1,849
Financial Liabilities					
Time Deposits	153,667	149,068	-	-	149,068

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16: REGULATORY MATTERS

The Bank is required under certain circumstances to maintain cash reserve balances in vault cash or with the Federal Reserve Bank (FRB). The Bank is required to hold reserves to enable same day settlement with Visa®. The total of those reserve balances was approximately $103,000 at December 31, 2023 and $78,000 at December 31, 2022.

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

In November 2019, federal bank regulatory agencies finalized a rule that simplifies capital requirements for community banks by allowing them to optionally adopt a simple leverage ratio to measure capital adequacy, which removes requirements for calculating and reporting risk-based capital ratios for a qualifying community Bank that has less than $10 billion in total consolidation assets, limited amounts of off-balance sheet exposures and trading assets and liabilities, and a leverage ratio greater than 9 percent. The Community Bank Leverage Ratio (CBLR) framework was effective on January 1, 2020. The Bank has elected to adopt the optional CBLR framework in the first quarter of 2020.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total, Tier 1 capital (as defined in the regulations), common equity Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2023 and December 31, 2022, that the Bank meets all capital adequacy requirements to which it is subject.

A summary of the Bank's capital ratios is as follows:

As of December 31, 2023	Actual		For Capital Adequacy Purposes (In Thousands)		To Be Capitalized Under Prompt Corrective Action Provisions	
Capital Ratios	**Actual**	**Ratio**	**Actual**	**Ratio**	**Actual**	**Ratio**
Tier 1 Capital (to Average Assets)	**$133,769**	**13.56%**	**$39,462**	**4.0%**	**$49,327**	**5.0%**

As of December 31, 2022	Actual		For Capital Adequacy Purposes (In Thousands)		To Be Capitalized Under Prompt Corrective Action Provisions	
Capital Ratios	**Actual**	**Ratio**	**Actual**	**Ratio**	**Actual**	**Ratio**
Tier 1 Capital (to Average Assets)	$126,352	13.42%	$37,672	4.0%	$47,090	5.0%

Banking regulations place certain restrictions on dividends paid by the Bank to the Company. A national Bank is required to obtain the approval of the Office of the Comptroller of the Currency (OCC) if the total of all dividends declared in any calendar year exceeds the Bank's net profits (as defined) for that year combined with its retained net profits for the preceding two calendars years. Under this formula, the Bank can declare dividends in 2024 of approximately $15,126,000 plus an additional amount equal to the Bank's net profits for 2023, up to the date of such dividend declaration. In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

NOTE 17: ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The activity in accumulated other comprehensive (loss) income is as follows:

	Unrealized Losses on Securities Available for Sale [1] December 31, 2023	2022
	(In Thousands)	
Beginning Balance	**$ (14,784)**	$ 1,212
Other Comprehensive Income (Loss) Before Reclassifications	**4,466**	(16,440)
Amounts Reclassified from Accumulated Other Comprehensive Loss	**-**	444
Period Change	**4,466**	(15,996)
Ending Balance	**$ (10,318)**	$ (14,784)

[1] *All amounts are net of tax. Related income tax expense or benefit is calculated using an income tax rate approximating 21%.*

Details about Accumulated Other Comprehensive (Loss) Income Components	Amount Reclassified from Accumulated Other Comprehensive (Loss) Income for the Year Ended December 31, [2] 2023	2022	Affected Line Item in the Consolidated Statements of Income
	(In Thousands)		
Securities Available for Sale [1]:			
Net Securities Loss Reclassified into Earnings	**$ -**	$ (562)	Loss on Sale of Available for Sale Securities
Related Income Tax Expense	**-**	118	Federal Income Tax Expense
Total Reclassifications for the Period	**$ -**	$ (444)	

[1] *For additional details related to unrealized losses on securities and related amounts reclassified from accumulated other comprehensive (loss) income, see Note 4: Securities.*
[2] *Amounts in parenthesis indicate debits.*

NOTE 18: SUBSEQUENT EVENTS

Management has reviewed events occurring through March 1, 2024, the date the financial statements were issued, and no additional subsequent events occurred requiring accrual or disclosure.

HNB

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Michelle Kowalewski
Commercial Loan Officer II

Sarah O'Hora
Commercial Loan Officer II

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