

**FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, DC 20429**

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2023

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

FDIC Certificate Number: 19101

HARFORD BANK

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
organization)

52-0799113
(IRS Employer incorporation or
Identification No.)

8 West Bel Air Avenue, Aberdeen, Maryland 21001
(Address of principal executive offices)

(410) 272-5000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☐ No ☐ (Not Applicable)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

Smaller reporting company ☒

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.
1,477,105 shares of common stock as of October 31, 2023.

This Quarterly Report of Harford Bank (the “Bank”) on Form 10-Q may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of “forward-looking statements”. Statements that are not historical in nature, including those that include the words “anticipate”, “estimate”, “should”, “expect”, “believe”, “intend”, and similar expressions, are forward-looking statements and are based on current expectations, estimates and projections about, among other things, the industry and the markets in which the Bank operates, and they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this report; general economic, market, or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in the Bank’s competitive position or competitive actions by other companies; changes in the quality or composition of loan and investment portfolios; the ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond the Bank’s control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on the Bank’s business or operations. These and other risks are discussed in detail in the periodic reports that the Bank files with the Federal Deposit Insurance Corporation (“FDIC”) (see Item 1A of Part II of this report for further information). Except as required by applicable laws, the Bank does not intend to publish updates or revisions of forward-looking statements it makes to reflect new information, future events or otherwise.

PART I

Item 1. Financial Statements

The information required by this item can be found beginning on page F-1 immediately following the signatures to this report and is incorporated herein by reference.

AVAILABLE INFORMATION

The Bank maintains an internet website at www.HarfordBank.com on which it makes available its most recent periodic report filed with the FDIC pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All of the periodic and other reports filed by the Bank with the FDIC pursuant to the Exchange Act are available through the FDIC’s website at: <https://efr.fdic.gov/fcxweb/efr/index.html>, and are also available for public inspection at: Federal Deposit Insurance Corporation, Accounting and Securities Disclosure Section, Division of Supervision and Consumer Protection, 550 17th Street, NW, Washington, DC 20429.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read and reviewed in conjunction with the interim consolidated financial statements and the notes thereto included elsewhere in this report, and with Management’s Discussion and Analysis of Financial Condition and Results of Operations, the audited consolidated financial statements and notes thereto, and the other statistical information contained in the Bank’s Annual Report on Form 10-K for the year ended December 31, 2022.

The Bank is a Maryland-chartered bank with its principal office in Aberdeen, Harford County, Maryland. Through its 9 branches, seven of which are located throughout Harford County and two of which are located in Cecil County, the Bank offers a full range of deposit services that are typically offered by most banks, savings and loan associations, and credit unions, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. In addition, the Bank offers Individual Retirement Accounts. The Bank offers a full range of consumer and commercial loans, including fixed-rate consumer mortgage loans, variable rate home equity lines of credit, fixed rate home equity loans, and other consumer loans as well as commercial lines of credit, commercial mortgage loans, and real estate construction loans. Other banking services include safe deposit boxes, direct deposit of payroll and social security checks, Internet banking with bill pay service, mobile banking, ATM services, Visa debit cards, Visa gift cards, and Visa credit cards issued through a third-party provider.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Bank’s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industry in which the Bank operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline

in the value of an asset not carried on the consolidated financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by other third-party sources, whenever available.

The most significant accounting policies followed by the Bank are presented in Note 1 to the consolidated financial statements appearing elsewhere in this report. These policies, along with the disclosures presented in the other notes to the consolidated financial statements and in this financial review, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for credit losses as the accounting area that requires the most subjective or complex judgments, and as such may be most subject to revision as new information becomes available.

The allowance for credit losses on loans represents management's estimate of probable expected loan losses inherent in the loan portfolio. Determining the amount of the allowance for credit losses on loans is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on individually evaluated loans, estimated losses on pools of homogeneous loans based on historical loss experience, consideration of current economic trends and conditions and reasonable and supportable forecasts, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheets. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for credit losses on loans.

RESULTS OF OPERATIONS

Summary

For the three-month period ended September 30, 2023, the Bank reported net income of \$1,475,600, compared to \$1,431,327 for the same period of 2022, an increase of \$44,273, or 3.1%. The increase in net income was due primarily to an increase in net interest income of \$156,496, an increase in non-interest revenue of \$25,649 and a decrease in non-interest expense of \$6,899, partially offset by a decrease in the recovery of credit loss expense of \$103,350 and an increase in income tax expense of \$41,421. Basic net income per share of common stock for the three-month period ended September 30, 2023 was \$1.00, compared to \$0.98 for the same period in 2022. Diluted net income per share of common stock for the three-month period ended September 30, 2023 was \$0.99, compared to \$0.97 for the same period in 2022.

For the nine-month period ended September 30, 2023, the Bank reported net income of \$4,343,208, compared to \$3,433,215 for the same period of 2022, an increase of \$909,993, or 26.5%. The increase in net income was due primarily to an increase in net interest income of \$2,480,468 and an increase in noninterest revenue of \$88,441, partially offset by an increase in credit loss expense of \$803,045, an increase in noninterest expense of \$496,842 and an increase in income tax expense of \$359,029. The increase in noninterest expense for the nine-month period ended September 30, 2023 was due primarily to an increase in employee compensation and benefits incurred to attract and retain quality employees when compared to the same period of 2022. Basic net income per share of common stock for the nine-month period ended September 30, 2023 was \$2.95, compared to \$2.35 for the same period in 2022. Diluted net income per share of common stock for the nine-month period ended September 30, 2023 was \$2.92, compared to \$2.34 for the same period in 2022.

Annualized return on average assets was 0.94% for the nine-month period ended September 30, 2023, compared to 0.77% for the same period in 2022. Annualized return on average stockholders' equity was 10.38% for the nine-month period ended September 30, 2023, compared to 9.01% for the same period in 2022.

Details of the changes in the various components of net income are discussed below.

Net Interest Income and Net Interest Margin

The primary source of income for the Bank is net interest income, which is the difference between interest earned on interest-earning assets, such as investment securities and loans, and interest paid on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balance of interest-earning assets and funding sources and the various rate spreads between the interest-earning assets and the Bank's funding sources. Changes in net interest income from period-to-period result from increases or decreases in the volumes of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volumes of interest-earning assets and interest-bearing liabilities are affected by management's ability to effectively and efficiently manage the earning-asset portfolio (which includes loans), and the availability of particular sources of funds, such as noninterest-bearing deposits. The table below entitled "Average Balances,

Interest, and Yields” shows the Bank’s average volume of interest-earning assets and interest-bearing liabilities for the three- and nine-month periods ended September 30, 2023 and 2022 and related interest income, interest expense, and yields.

Average Balances, Interest, and Yields

	For the Three Months Ended September 30, 2023			For the Three Months Ended September 30, 2022			For the Nine Months Ended September 30, 2023			For the Nine Months Ended September 30, 2022		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets												
FRB interest-bearing deposits	\$ 17,921,674	\$ 166,915	3.70%	\$ 88,929,233	\$ 453,489	2.02%	\$ 17,475,302	\$ 504,556	3.86%	\$ 89,576,601	\$ 693,353	1.03%
FHLBA interest-bearing deposits	274,417	3,882	5.61%	20,092	115	2.27%	136,599	5,629	5.51%	18,356	148	1.08%
Federal funds sold	-	-	0.00%	-	-	0.00%	-	-	0.00%	-	-	0.00%
Time deposits in other banks	2,385,532	2,629	0.44%	2,811,031	2,809	0.40%	2,486,598	8,367	0.45%	2,820,151	10,358	0.49%
Other	2,152,357	38,439	7.09%	330,100	3,873	4.65%	1,184,162	61,057	6.89%	317,684	9,994	4.21%
Investment securities:												
U.S. Treasury securities	20,365,501	58,825	1.15%	21,246,137	62,475	1.17%	20,433,901	175,870	1.15%	19,947,246	160,954	1.08%
U. S. government agency securities	35,437,264	126,712	1.42%	38,375,052	132,821	1.37%	36,065,111	384,429	1.43%	37,167,659	356,322	1.28%
Mortgage-backed and CMO securities	43,102,145	249,252	2.29%	42,578,367	198,820	1.85%	44,670,670	781,866	2.34%	38,829,137	466,423	1.61%
SBA asset-backed securities	10,716,126	50,639	1.87%	12,916,699	43,814	1.35%	11,161,251	153,762	1.84%	13,075,932	116,506	1.19%
State and municipal securities	3,561,802	16,514	1.84%	3,576,691	16,793	1.86%	3,565,504	49,909	1.87%	3,580,338	50,432	1.88%
Total investment securities	113,182,838	501,942	1.76%	118,692,946	454,723	1.52%	115,896,437	1,545,836	1.78%	112,600,312	1,150,637	1.37%
Loans:												
Overdrafts	48,982	-	0.00%	50,823	-	0.00%	50,021	-	0.00%	49,562	-	0.00%
Consumer	31,379,282	413,338	5.23%	8,423,070	106,916	5.04%	24,376,739	936,992	5.14%	7,041,562	268,073	5.09%
Credit lines	12,806,822	261,344	8.10%	13,130,426	166,122	5.02%	13,910,047	804,875	7.74%	12,520,087	364,741	3.89%
Commercial	63,352,160	1,182,539	7.41%	44,625,360	743,738	6.61%	55,491,530	2,960,992	7.13%	45,365,873	2,205,683	6.50%
Real estate	381,681,591	4,563,559	4.74%	321,817,297	3,423,893	4.22%	366,774,720	12,638,832	4.61%	308,778,815	9,707,657	4.20%
Other loan fees	-	52,522		-	45,457		-	200,738		-	217,989	
Total loans *	489,268,837	6,473,302	5.25%	388,046,976	4,486,126	4.59%	460,603,057	17,542,429	5.09%	373,755,899	12,764,143	4.57%
Allowance for credit losses on loans	(5,524,429)			(5,014,568)			(5,124,519)			(5,054,523)		
Total loans, net of allowance for credit losses on loans *	483,744,408	6,473,302	5.31%	383,032,408	4,486,126	4.65%	455,478,538	17,542,429	5.15%	368,701,376	12,764,143	4.63%
Total interest-earning assets	619,661,226	7,187,109	4.60%	593,815,810	5,401,135	3.61%	592,657,636	19,667,874	4.44%	574,034,480	14,628,633	3.41%
Noninterest-bearing cash	3,969,323			4,038,755			3,595,534			4,551,526		
Net bank premises and equipment	9,593,174			10,004,749			9,690,554			10,074,326		
Other assets	10,938,436			10,507,797			10,699,398			10,627,686		
Total assets	<u>\$ 644,162,159</u>			<u>\$618,367,111</u>			<u>\$616,643,122</u>			<u>\$599,288,018</u>		
Liabilities and Stockholders' Equity												
Interest-bearing deposits												
Checking	\$ 130,874,051	27,753	0.08%	\$144,450,041	22,601	0.06%	\$134,709,814	74,795	0.07%	\$133,882,194	61,685	0.06%
Savings	61,822,281	33,423	0.21%	69,180,788	23,444	0.13%	65,303,898	106,121	0.22%	67,539,037	67,715	0.13%
Money market	87,472,620	428,883	1.95%	103,656,980	40,647	0.16%	90,412,252	742,482	1.10%	92,808,020	106,854	0.15%
Certificates of deposit	109,156,712	834,277	3.03%	83,470,136	155,217	0.74%	94,239,526	1,650,543	2.34%	91,434,592	572,351	0.84%
Total interest-bearing deposits	389,325,664	1,324,336	1.35%	400,757,945	241,909	0.24%	384,665,490	2,573,941	0.89%	385,663,843	808,605	0.28%
Borrowed overnight funds	40,184,902	566,368	5.59%	-	-	0.00%	18,417,623	757,233	5.50%	-	-	0.00%
FHLBA term borrowings	-	-	0.00%	-	-	0.00%	1,172,161	46,933	5.35%	-	-	0.00%
Total borrowed funds	40,184,902	566,368	5.59%	-	-	0.00%	19,589,784	804,166	5.49%	-	-	0.00%
Total interest-bearing deposits and borrowed funds	429,510,566	1,890,704	1.75%	400,757,945	241,909	0.24%	404,255,274	3,378,107	1.12%	385,663,843	808,605	0.28%
Noninterest-bearing deposits	154,751,181			163,321,438			153,644,760			160,302,750		
Other liabilities	3,045,893			2,280,475			2,811,805			2,356,403		
Stockholders' equity	56,854,519			52,007,253			55,931,283			50,965,022		
Total liabilities and stockholders' equity	<u>\$ 644,162,159</u>			<u>\$618,367,111</u>			<u>\$616,643,122</u>			<u>\$599,288,018</u>		
Net interest spread			2.85%			3.37%			3.32%			3.13%
Net interest income		<u>\$ 5,296,405</u>			<u>\$ 5,159,226</u>			<u>\$16,289,767</u>			<u>\$13,820,028</u>	
Net margin on interest-earning assets			3.39%			3.45%			3.67%			3.22%

Interest on tax-exempt securities, loans and dividends are reported on a fully taxable equivalent basis.

* Includes non accrual loans.

Interest income on loans, on a fully taxable equivalent basis, for the three-month period ended September 30, 2023 was \$6,473,302, compared to \$4,486,126 for the same period in 2022, representing an increase of \$1,987,176, or 44.3%. The increase was due primarily to the \$100,712,000, or 26.3%, increase in average balances of loans for the three-month period ended September 30, 2023 when compared to the same period in 2022, coupled with the increase in the weighted average rate earned on loans, on a fully taxable equivalent basis, of 66 basis points to 5.31% for the three-month period ended September 30, 2023 when compared to the same period in 2022. Interest income on loans, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2023 was \$17,542,429, compared to \$12,764,143 for the same period in 2022, representing an increase of \$4,778,286, or 37.4%. The increase was due primarily to the \$86,777,162, or 23.5%, increase in average balances of loans for the nine-month period ended September 30, 2023, coupled with an increase in the weighted average rate earned on loans, on a fully taxable equivalent basis, of 52 basis points to 5.15% for the nine-month period ended September 30, 2023 when compared to the same period in 2022.

Interest income for interest-bearing deposits in the Federal Reserve Bank (“FRB”) and the Federal Home Loan Bank of Atlanta (“FHLBA”), federal funds sold, and time deposits in other banks, on a fully taxable equivalent basis, for the three-month period ended

September 30, 2023 was \$173,426, compared to \$456,413 for the same period in 2022, representing a decrease of \$282,987, or 62.0%. The decrease was due primarily to a decrease of \$71,178,733, or 77.6%, in average balances for these instruments for the three-month period ended September 30, 2023 when compared to the same period in 2022, partially offset by an increase in the weighted average rate earned on these holdings, on a fully taxable equivalent basis, of 137 basis points to 3.34% for the three-month period ended September 30, 2023 when compared to the same period in 2022. Interest income for interest-bearing deposits in the FRB and the FHLBA, federal funds sold, and time deposits in other banks, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2023 was \$518,552, compared to \$703,859 for the same period in 2022, representing a decrease of \$185,307, or 26.3%. The decrease was due primarily to a decrease of \$72,316,609, or 78.3%, in average balances for these instruments for the nine-month period ended September 30, 2023 when compared to the same period in 2022, partially offset by an increase in the weighted average rate earned on these holdings, on a fully taxable equivalent basis, of 243 basis points to 3.45% for the nine-month period ended September 30, 2023 when compared to the same period in 2022.

Interest income on investment securities, on a fully taxable equivalent basis, for the three-month period ended September 30, 2023 was \$501,942, compared to \$454,723 for the same period in 2022, representing an increase of \$47,219 or 10.4%. The increase was due primarily to an increase in the weighted average rate earned on investment securities, on a fully taxable equivalent basis, of 24 basis points to 1.76% for the three-month period ended September 30, 2023 when compared to the same period in 2022, partially offset by a decrease of \$5,510,108, or 4.6%, in average balances for investment securities for the three-month period ended September 30, 2023 when compared to the same period in 2022. Interest income on investment securities, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2023 was \$1,545,836, compared to \$1,150,637 for the same period in 2022, representing an increase of \$395,199, or 34.3%. The increase was due primarily to an increase in the weighted average rate earned on investment securities, on a fully taxable equivalent basis, of 41 basis points to 1.78% for the nine-month period ended September 30, 2023 when compared to the same period in 2022, coupled with an increase of \$3,296,125, or 2.9%, in average balances for investment securities for the nine-month period ended September 30, 2023 when compared to the same period in 2022.

The Bank is a member of the FHLBA and is required to purchase capital stock of the FHLBA as a condition to obtaining a line of credit. Dividends on FHLBA capital stock may be paid to member banks subject to the discretion of the Board of Directors of the FHLBA. Dividends received or accrued on stock issued by the FHLBA, on a fully taxable equivalent basis, for the three-month period ended September 30, 2023, were \$38,439, compared to \$3,873 for the same period in 2022, representing an increase of \$34,566, or 892.5%. The increase was due primarily to an increase of \$1,822,257, or 552.0%, in the average balance of FHLBA capital stock for the three-month period ended September 30, 2023 when compared to the same period in 2022, coupled with an increase in the weighted average rate earned on FHLBA capital stock, on a fully taxable equivalent basis, of 244 basis points to 7.09% for the three-month period ended September 30, 2023 when compared to the same period in 2022. Dividends received or accrued on stock issued by the FHLBA, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2023, were \$61,057 compared to \$9,994 for the same period in 2022, an increase of \$51,063, or 510.9%. The increase was due primarily to an increase of \$866,478, or 272.7%, in the average balance of FHLBA capital stock for the nine-month period ended September 30, 2023 when compared to the same period in 2022, coupled with an increase in the weighted average rate earned on FHLBA capital stock, on a fully taxable equivalent basis, of 268 basis points to 6.89% for the nine-month period ended September 30, 2023 when compared to the same period in 2022.

Interest expense on interest-bearing deposit liabilities for the three-month period ended September 30, 2023 was \$1,324,336, compared to \$241,909 for the same period in 2022, representing an increase of \$1,082,427, or 447.5%. The increase was due primarily to an increase in the weighted average rate paid on these deposits of 111 basis points to 1.35% for the three-month period ended September 30, 2023 when compared to the same period in 2022, partially offset by a decrease of \$11,432,281, or 2.9%, in the average balances of interest-bearing deposit liabilities for the three-month period ended September 30, 2023 when compared to the same period in 2022. Interest expense on interest-bearing deposit liabilities for the nine-month period ended September 30, 2023 was \$2,573,941, compared to \$808,605 for the same period in 2022, representing an increase of \$1,765,336, or 218.3%. The increase was due primarily to an increase in the weighted average rate paid on these deposits of 61 basis points to 0.89% for the nine-month period ended September 30, 2023 when compared to the same period in 2022, partially offset by a decrease of \$998,353, or 0.3%, in the average balances of interest-bearing deposit liabilities for the nine-month period ended September 30, 2023 when compared to the same period in 2022.

Interest expense on total borrowed funds was \$566,368 for the three-month period ended September 30, 2023. The average balance of total borrowed funds was \$40,184,902 for the three-month period ended September 30, 2023. The weighted-average rate paid on total borrowed funds was 5.59% for the three-month period ended September 30, 2023. The Bank had no borrowed funds during the three-month period ended September 30, 2022. Interest expense on total borrowed funds was \$804,166 for the nine-month period ended September 30, 2023. The average balance of total borrowed funds was \$19,589,784 for the nine-month period ended September 30, 2023. The weighted-average rate paid on total borrowed funds was 5.49% for the nine-month period ended September 30, 2023. The Bank had no borrowed funds during the nine-month period ended September 30, 2022.

Net interest income, on a fully taxable equivalent basis, for the three-month period ended September 30, 2023 was \$5,296,405, compared to \$5,159,226 for the same period in 2022, representing an increase of \$137,179, or 2.7%. Net interest income, on a fully taxable

equivalent basis, for the nine-month period ended September 30, 2023 was \$16,289,767, compared to \$13,820,028 for the same period in 2022, representing an increase of \$2,469,739, or 17.9%, when compared to the same period in 2022.

Net margin on interest-earning assets, on a fully taxable equivalent basis, for the three-month period September 30, 2023 was 3.39%, compared to 3.45% for the same period in 2022, representing a decrease of 6 basis points. Net interest margin on interest-earning assets, on a fully taxable equivalent basis, for the nine-month period September 30, 2023, was 3.67% compared to 3.22% for the same period in 2022, representing an increase of 45 basis points.

Provision for Credit Losses on Loans

The provision for, or recovery of, credit losses on loans is determined by management as the amount to be added to or subtracted from, respectively, the allowance for credit losses on loans after net charge-offs (charge-offs less recoveries) have been deducted to bring the allowance for credit losses on loans to a level which, in management's best estimation, is necessary to absorb probable expected credit losses inherent in the existing loan portfolio. The Bank recorded provision for credit losses on loans expense for the three-month period ended September 30, 2023 of \$180,000, compared to provision recovery of \$150,000 recorded for the same period of 2022. The Bank recorded provision for credit losses on loans expense for the nine-month period ended September 30, 2023 of \$678,461, compared to provision recovery of \$275,000 recorded for the same period of 2022. The difference in the amount of the provision for or recovery of credit losses on loans between the 2023 and 2022 periods resulted from the impact of the Bank's adoption of Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2016-13 that became effective on January 1, 2023, changes in loan volume and mix, and management's assessment of the current and a reasonable and supportable forecast of market conditions and inherent risk within the loan portfolio. The recovery of credit losses on loans for the three- and nine-month periods ended September 30, 2022 was determined based on incurred loss methodology, consistent with previously applied generally accepted accounting principles then in effect.

Provision for Credit Losses on Off-Balance Sheet Items

The provision for, or recovery of, credit losses on off-balance sheet items is determined by management as the amount to be added to or subtracted from, respectively, the allowance for credit losses on off-balance sheet items to bring the allowance for credit losses on off-balance sheet items to a level which, in management's best estimation, is necessary to absorb probable expected losses inherent in off-balance sheet items. The Bank recorded provision recovery for credit losses on off-balance sheet items expense for the three-month period ended September 30, 2023 of \$226,650, compared to provision expense of \$0 recorded for the same period of 2022. The Bank recorded provision recovery for credit losses on off-balance sheet items expense for the nine-month period ended September 30, 2023 of \$150,416, compared to provision expense of \$0 recorded for the same period of 2022. The provisions for credit losses on off-balance sheet items for the three- and nine-month periods ended September 30, 2022 were determined based on incurred loss methodology, consistent with previously applied generally accepted accounting principles then in effect.

Noninterest Revenue

Noninterest revenue for the three-month period ended September 30, 2023 was \$481,184, compared to \$455,535 for the same period in 2022, representing an increase of \$25,649, or 5.6%. Comparing the three-month period ended September 30, 2023 to the same period in 2022, the increase was primarily due to an increase of \$44,142 in service charges on deposit accounts, partially offset by a decrease of \$30,882 in other fees and commissions. Noninterest revenue for the nine-month period ended September 30, 2023 was \$1,464,800, compared to \$1,376,359 for the same period in 2022, representing an increase of \$88,441, or 6.4%. Comparing the nine-month period ended September 30, 2023 to the same period in 2022, the increase was primarily due to an increase of \$128,830 in service charges on deposit accounts, partially offset by decreases of \$4,356 on the recovery of previously written off restricted stock and \$68,427 in other fees and commissions.

Noninterest Expenses

Noninterest expenses for the three-month period ended September 30, 2023 were \$3,801,553, compared to \$3,808,452 for the same period in 2022, representing a decrease of \$6,899, or 0.2%. Comparing the three-month period ended September 30, 2023 to the same period in 2022, the decrease in noninterest expenses was primarily attributable to decreases in furniture and equipment expense of \$31,843, and internet banking fees of \$45,379, partially offset by increases in salaries and benefits expense of \$45,134, and professional fees of \$22,190. Noninterest expenses for the nine-month period ended September 30, 2023 were \$11,278,109, compared to \$10,781,267 for the same period in 2022, representing an increase of \$496,842, or 4.6%. Comparing the nine-month period ended September 30, 2023 to the same period in 2022, the increase in noninterest expenses was mainly attributable to increases in salaries and benefits expense of \$432,791, furniture and equipment expense of \$43,282, director and committee fees of \$11,282, FDIC and state assessments of \$34,965, advertising expense of \$3,227 and other operating expense of \$71,656, partially offset by decreases in data processing of \$47,654, professional fees of \$27,369 and stationery and supplies of \$20,137.

Income Tax Expense

Income tax expense for the three-month period ended September 30, 2023 was \$499,950, compared to \$458,529 for the same period of 2022, representing an increase of \$41,421, or 9.0%. The increase was due primarily to higher income before income taxes earned for the three-month period ended September 30, 2023 when compared to the same period of 2022. Income tax expense for the nine-month period ended September 30, 2023 was \$1,464,711, compared to \$1,105,682 for the same period of 2022, representing an increase of \$359,029, or 32.5%. The increase was due primarily to higher income before income taxes earned for the nine-month period ended September 30, 2023 when compared to the same period of 2022. The Bank's effective income tax rate was 25.22% for the nine-month period ended September 30, 2023, compared to 24.36% for the same period in 2022.

FINANCIAL CONDITION

Assets

Total assets at September 30, 2023 increased \$58,468,274, or 9.8%, to \$653,937,568, from \$595,469,294 at December 31, 2022.

The Bank invests excess cash balances in interest-bearing accounts at other banks and federal funds sold to correspondent banks. These balances decreased \$5,176,319, or 18.5%, to \$22,861,901 at September 30, 2023, from \$28,038,220 at December 31, 2022.

Investment securities decreased \$8,855,780, or 7.4%, to \$111,235,150 at September 30, 2023, from \$120,090,930 at December 31, 2022.

Loans

Loans, net of the allowance for credit losses on loans, increased \$69,683,878, or 16.4%, to \$493,604,437 at September 30, 2023, from \$423,920,559 at December 31, 2022. The average net loan portfolio represented 76.9% of average earning assets for the nine-month period ended September 30, 2023, compared to 64.2% for the same period in 2022.

The Bank has originated loans to qualified small businesses under the Paycheck Protection Program (the "PPP") administered by the Small Business Administration (the "SBA") under the provisions of the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"). In enacting the CARES Act in March 2020, Congress intended to prevent a severe economic downturn through various measures, including by providing funds for loans under the PPP. A second round of funding for PPP loans was implemented pursuant to the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, enacted in December 2020, and a third round of funding for PPP loans was implemented pursuant to the Consolidated Appropriations Act, enacted in December 2020. On March 30, 2021, the PPP Extension Act of 2021 was enacted, extending the expiration date of the PPP from March 31, 2021 to June 30, 2021. Loans made pursuant to the PPP bear interest at 1.0%, are 100% guaranteed by the SBA, and may be eligible for loan forgiveness for certain qualifying costs incurred by the borrower. The remaining loan balance after forgiveness of any amounts is still fully guaranteed by the SBA. Refer to the Bank's Annual Report on Form 10-K for the year ended December 31, 2022 for additional details. During the nine-month period ended September 30, 2023, the Bank recognized approximately \$5,000 in PPP loan-related deferred fees, net of deferred costs, as yield adjustments included in interest income on loans, compared to approximately \$750,000 in PPP loan-related deferred fees, net of deferred costs, as yield adjustments included in interest income on loans recognized in the same period of 2022, a decrease of \$595,000, or 99.2%.

The following table sets forth the major classifications of the Bank's loan portfolio.

	September 30, 2023		December 31, 2022	
	Amount	% of Total	Amount	% of Total
Real estate				
Construction, development and other land	\$ 31,364,629	6.28%	\$ 21,239,232	4.95%
Secured by farmland	9,186,455	1.84%	9,169,852	2.14%
Commercial	254,506,652	50.96%	226,820,382	52.87%
Residential	130,796,112	26.19%	126,777,277	29.55%
Commercial and Industrial	41,218,377	8.25%	28,964,832	6.75%
Other consumer	32,281,383	6.46%	15,975,357	3.72%
Overdrafts	47,989	0.02%	49,705	0.02%
Gross loans	499,401,597	100.00%	428,996,637	100.00%
Net deferred (fees) costs	(226,084)		(380,310)	
Allowance for credit losses on loans	(5,571,076)		(4,695,768)	
Net loans	<u>\$ 493,604,437</u>		<u>\$ 423,920,559</u>	
Allowance for credit losses on loans to gross loans	<u>1.12%</u>		<u>1.09%</u>	

Loan Credit Risk Management

The Bank's loan portfolio is subject to varying degrees of credit risk. The Bank seeks to mitigate credit risk through portfolio diversification, limiting exposure to any single industry or customer, collateral protection and strong underwriting criteria. The following discussion provides information and statistics on the overall quality of the Bank's loan portfolio. Notes 1 and 4 to the consolidated financial statements included elsewhere in this report describe the accounting policies related to nonperforming loans and charge-offs, and foreclosed and repossessed assets, and describes the methodologies used to develop the allowance for credit losses on loans. Management believes the policies governing nonperforming loans and charge-offs are consistent with industry and regulatory standards. The amount of the allowance for credit losses on loans and the resulting provision for or recovery of credit losses on loans expense are reviewed and approved quarterly by the Board of Directors.

The following table provides a comprehensive view of the allowance for credit losses on loans activity including the periodic activity of charge-offs and recoveries allocated by loan class for the three-month periods ended September 30, 2023 and 2022. No allowance for credit losses on loans has been recognized for loans made pursuant to the Paycheck Protection Program because such loans are fully guaranteed by the SBA.

For the Three Months Ended:		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Other Consumer & Overdrafts	Total
September 30, 2023	Unallocated						
Allowance for credit losses on loans:							
Beginning balance	\$ 12,022	\$ 383,462	\$ 2,555,017	\$ 1,212,050	\$ 413,206	\$ 813,632	\$ 5,389,389
Charge-offs	-	-	-	-	-	(4,483)	(4,483)
Recoveries	-	-	-	2,766	-	3,404	6,170
Provision for (recovery of) credit losses on loans	48,795	53,879	41,373	(42,249)	30,634	47,568	180,000
Ending balance	<u>\$ 60,817</u>	<u>\$ 437,341</u>	<u>\$ 2,596,390</u>	<u>\$ 1,172,567</u>	<u>\$ 443,840</u>	<u>\$ 860,121</u>	<u>\$ 5,571,076</u>
September 30, 2022							
Allowance for credit losses on loans:							
Beginning balance	\$ 5,740	\$ 430,587	\$ 3,079,907	\$ 939,974	\$ 373,211	\$ 161,820	\$ 4,991,239
Charge-offs	-	-	-	-	-	(34,859)	(34,859)
Recoveries	-	-	-	1,500	71,105	915	73,520
Provision for (recovery of) credit losses on loans	(205)	56,808	(262,642)	1,484	(13,098)	67,653	(150,000)
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 195,529</u>	<u>\$ 4,879,900</u>

The following table provides a comprehensive view of the allowance for credit losses on loans activity including the periodic activity of charge-offs and recoveries allocated by loan class for the nine-month periods ended September 30, 2023 and 2022. No allowance for credit losses on loans has been recognized for loans made pursuant to the Paycheck Protection Program because such loans are fully guaranteed by the SBA.

For the Nine Months Ended:	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Other Consumer & Overdrafts	Total
September 30, 2023							
Allowance for credit losses on loans:							
Beginning balance	\$ 13,670	\$ 446,024	\$ 2,550,667	\$ 986,573	\$ 452,861	\$ 245,973	\$ 4,695,768
Impact of ASC 326 adoption	(13,670)	(112,669)	97,825	219,576	(146,758)	162,017	206,321
Charge-offs	-	-	-	(766)	-	(20,353)	(21,119)
Recoveries	-	-	-	5,266	-	6,379	11,645
Provision for (recovery of) credit losses on loans	60,817	103,986	(52,102)	(38,082)	137,737	466,105	678,461
Ending balance	<u>\$ 60,817</u>	<u>\$ 437,341</u>	<u>\$ 2,596,390</u>	<u>\$ 1,172,567</u>	<u>\$ 443,840</u>	<u>\$ 860,121</u>	<u>\$ 5,571,076</u>
September 30, 2022							
Allowance for credit losses on loans:							
Beginning balance	\$ 46,680	\$ 292,339	\$ 3,355,417	\$ 883,184	\$ 334,073	\$ 168,450	\$ 5,080,143
Charge-offs	-	-	-	-	-	(54,269)	(54,269)
Recoveries	-	-	44,688	4,500	71,105	8,733	129,026
Provision for (recovery of) credit losses on loans	(41,145)	195,056	(582,840)	55,274	26,040	72,615	(275,000)
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 195,529</u>	<u>\$ 4,879,900</u>

The allowance for credit losses on loans is increased by provisions for credit losses on loans charged to expense and recoveries of credit losses on loans previously charged-off. The allowance for credit losses on loans is decreased by loan charge-offs and recovery of provision for credit losses on loans expense. Provision for or recovery of provision for credit losses on loans are made to bring the allowance for credit losses on loans within the range of balances that are considered appropriate based upon the allowance methodology and to reflect expected losses inherent in the loan portfolio as of the balance sheet date. For all periods in 2023, the allowance for credit losses on loans methodology includes allowance allocations calculated in accordance with FASB Accounting Standards Codification (“ASC”) Topic 326, “Financial Instruments – Credit Losses”. For all periods in 2022, the allowance for credit losses on loans methodology includes allowance allocations calculated in accordance with ASC Topic 310, “Receivables” and allowance allocations calculated in accordance with ASC Topic 450, “Contingencies,” which were the relevant accounting standards in effect during those periods. Accordingly, the current methodology is based on historical loss experience by loan classification and on specific loss allocations, with adjustments for current and reasonable and supportable forecast events and conditions, or the “expected loss” approach, whereas the prior methodology was based on the “incurred loss” approach. Management’s process for determining the appropriate level of the allowance for credit losses on loans is designed to account for credit losses over the expected life of loans. The provision for or recovery of provision for credit losses on loans reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, and net charge-offs or recoveries, among other factors, and adjustments for current and reasonable and supportable forecast events and conditions. The provision for or recovery of provision for credit losses on loans also reflect the totality of actions taken on all loans for a particular period. The amount of the provision for or recovery of provision for credit losses on loans reflects not only the necessary increases or decreases in the allowance for credit losses on loans related to newly identified rated loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The allowance for credit losses on loans was \$5,571,076 at September 30, 2023, compared to \$4,695,768 at December 31, 2022, an increase of \$875,308, or 18.6%. The increase in allowance for credit losses on loans was due to the impact of the adoption of ASC Topic 326 of \$206,321, recoveries of amounts previously charged-off of \$11,645 and provision for credit losses on loans of \$678,461, partially offset by amounts charged-off of \$21,119. The “Allowance for Credit Losses on Loans to Gross Loans” ratio at September 30, 2023 was 1.12% compared to 1.09% at December 31, 2022. The allowance level reflects the results of management’s assessment of current and forecasted market conditions and analysis of expected inherent risk within the loan portfolio performed during the quarter.

The adequacy of the allowance for credit losses on loans is determined based upon management’s estimate of the expected inherent risks associated with lending activities, estimated fair value of collateral, past experience and present indicators such as loan delinquency trends, nonaccrual loans and current and reasonable and supportable forecast market conditions. Management believes that the allowance for credit losses on loans is adequate as of September 30, 2023; however, future changes in the composition of the loan portfolio and financial condition of borrowers may result in additions to or subtractions from the allowance. Examination of the loan portfolio and the allowance for credit losses on loans by regulatory agencies, auditors and consultants engaged by the Bank may result

in the need for additional provision for or recovery of provision for credit losses on loans based upon information available at the time of examination.

Risk Elements of Loan Portfolio

The following table analyzes the payment status of loans by loan classification at the dates indicated.

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Over Past Due	Total Past Due	Current	Total Loans	Loans over 90 Days and Accruing
September 30, 2023							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 31,364,629	\$ 31,364,629	\$ -
Commercial real estate and farmland	264,478	-	-	264,478	263,428,629	263,693,107	-
Residential real estate	-	40,705	-	40,705	130,755,407	130,796,112	-
Commercial and Industrial	-	106,731	-	106,731	41,111,646	41,218,377	-
Other consumer and overdrafts	138,338	-	-	138,338	32,191,034	32,329,372	-
Total	<u>\$ 402,816</u>	<u>\$ 147,436</u>	<u>\$ -</u>	<u>\$ 550,252</u>	<u>\$ 498,851,345</u>	<u>\$ 499,401,597</u>	<u>\$ -</u>
December 31, 2022							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 21,239,232	\$ 21,239,232	\$ -
Commercial real estate and farmland	188,047	-	-	188,047	235,802,187	235,990,234	-
Residential real estate	-	-	766	766	126,776,511	126,777,277	-
Commercial and Industrial	-	-	-	-	28,964,832	28,964,832	-
Other consumer and overdrafts	12,191	-	101,520	113,711	15,911,351	16,025,062	101,520
Total	<u>\$ 200,238</u>	<u>\$ -</u>	<u>\$ 102,286</u>	<u>\$ 302,524</u>	<u>\$ 428,694,113</u>	<u>\$ 428,996,637</u>	<u>\$ 101,520</u>

The following table summarizes nonperforming loans and other non-performing assets for the dates indicated.

Non-performing Assets	September 30, 2023	December 31, 2022
Non-performing loans by class		
Commercial real estate and farmland	\$ 6,529,122	\$ 6,897,574
Residential real estate	62,125	82,273
Other consumer	7,428	118,240
Total non-performing loans	6,598,675	7,098,087
Foreclosed real estate	-	-
Reposessed assets	-	-
Total non-performing assets	<u>\$ 6,598,675</u>	<u>\$ 7,098,087</u>

The period-end balance of loan modifications to borrowers experiencing financial difficulty at the time of the modification during the three- and nine-month periods ending September 30, 2023 and 2022 are set forth in the table below:

For the Three Months Ended:	Term Extension	Payment Delay	Interest Rate Reduction	Principal Forgiveness	Combination Thereof	Total	% of Total Class of Loans
September 30, 2023							
Commercial real estate	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0.00%</u>
September 30, 2022							
Commercial real estate	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0.00%</u>
For the Nine Months Ended:							
September 30, 2023							
Commercial real estate	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,029,651</u>	<u>\$ 4,029,651</u>	<u>1.58%</u>
September 30, 2022							
Commercial real estate	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0.00%</u>

Further information about the loan portfolio is provided in Note 4 to the consolidated financial statements included elsewhere in this report.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, the amount undrawn on lines of credit, and standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Bank generally requires collateral or other security to support the financial instruments with credit risk. The amount of collateral or other security is determined based on management's credit evaluation of the counterparty. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

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. Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

Management does not believe that any of the foregoing arrangements are reasonably likely to have an impact on the Bank's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. As part of implementing ASU 2016-13 on January 1, 2023, the Bank created an allowance for credit losses on off-balance sheet items related to these financial instruments with off-balance sheet risk, which is reported as a liability on the consolidated statements of condition. The allowance for credit losses on off-balance sheet items was \$341,155 as of September 30, 2023.

Further information about these arrangements is provided in Note 5 to the consolidated financial statements included elsewhere in this report.

Deposit Liabilities

Total deposit liabilities at September 30, 2023 were \$550,563,372, an increase of \$12,042,197, or 2.2%, when compared to total deposit liabilities at December 31, 2022. Noninterest-bearing deposit liabilities at September 30, 2023 were \$155,441,621, an increase of \$3,893,454, or 2.6%, when compared to December 31, 2022. Interest-bearing deposit liabilities at September 30, 2023 were \$395,121,751, an increase of \$8,148,743, or 2.1%, when compared to December 31, 2022. The Bank utilizes core deposits primarily to fund its earning assets. During the nine-month period ended September 30, 2023, average deposit liabilities provided funding for approximately 90.8% of average earning assets, compared to 95.1% for the comparable period of 2022.

Certificates of deposit greater than the FDIC deposit insurance limit of \$250,000 at September 30, 2023 were \$36,452,685, compared to \$21,151,168 at December 31, 2022.

Capital

Total stockholders' equity was \$57,140,063 at September 30, 2023, an increase of \$3,093,375, or 5.7%, when compared to total stockholders' equity at December 31, 2022. The increase was due to earnings in the amount of \$4,343,208 and stock transactions netting \$246,717, partially offset by dividends declared and paid of \$973,131 and the impact of the adoption effective January 1, 2023 of ASU 2016-13 of \$523,419, net of tax.

The federal banking agencies have provided community banking organizations the option to phase in the regulatory capital impact of the adoption of ASU 2016-13, which was effective for the Bank on January 1, 2023. Under this option, the initial impact of adoption of ASU 2016-13 may be phased into the regulatory capital calculations evenly over a three year period, starting with the first required regulatory report as of March 31, 2023. The Bank has elected not to phase in the impact of ASU 2016-13 on regulatory capital.

In July 2013, the Board of Governors of the FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and fully phased-in as of January 1, 2019, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new minimum Common Equity Tier 1 capital ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which are now fully phased-in, effectively resulting in a minimum CET1 ratio of 7.0%. Basel III raised the minimum Tier 1 capital ratio from 4.0% to 6.0% which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%. Basel III maintained the minimum total capital ratio of 8.0%, which, with the capital

conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 10.5%. Basel III maintains the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

On September 17, 2019 the FDIC finalized a rule that introduced an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio framework, “CBLR framework”), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. To qualify for the CBLR framework, a community banking organization must have a Tier 1 leverage ratio of at least 9 percent, less than \$10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The Bank has elected not to opt into the CBLR framework at this time.

The Bank continues to maintain capital at levels in excess of the minimum risk-based capital requirements adopted by the federal banking agencies and was considered to be “well capitalized” as of September 30, 2023. One measure of capital adequacy is the risk-based capital ratio, or the ratio of total capital to risk adjusted assets. Total capital is composed of both core capital (Tier 1) and supplemental capital (Tier 2). Total assets are adjusted for off-balance sheet items, such as letters of credit, and the different degrees of risk among various assets. Regulators require a minimum risk-based capital ratio of 10.50% including the fully phased-in amount of the capital conservation buffer, with 10.00% being the regulatory minimum for well-capitalized banks. At September 30, 2023, the Bank’s risk-based capital ratio was 12.83%.

The CET1 capital ratio, which became effective for the Bank January 1, 2015, is the ratio of CET1 to risk adjusted assets. CET1 capital consists of common stock, surplus and undivided profits. Regulators require a minimum CET1 ratio of 7.00% including the fully phased-in amount of the capital conservation buffer, with 6.50% being the regulatory minimum for well-capitalized banks. At September 30, 2023, the Bank’s CET1 ratio was 11.62%.

Tier 1 capital consists of CET1 capital plus certain additional Tier 1 capital instruments. The Tier 1 capital ratio is the ratio of Tier 1 capital to risk adjusted assets. The Bank had no additional Tier 1 capital instruments. Regulators require a minimum Tier 1 capital ratio of 8.50% including the fully phased-in amount of the capital conservation buffer, with 8.00% being the regulatory minimum for well-capitalized banks. At September 30, 2023, the Bank’s Tier 1 capital ratio was 11.62%.

Another measure of capital adequacy is the leverage capital ratio, which is calculated by dividing average total assets for the most recent quarter into Tier 1 capital outstanding at the end of the quarter. The regulatory minimum for this ratio is 4.00%, with 5.00% being the regulatory minimum for well-capitalized banks. The Bank’s leverage capital ratio as of September 30, 2023, was 8.87%.

Management is not aware of any trends, favorable or unfavorable, that are likely to have a material effect on our financial condition or on our earnings. Further information about capital is provided in Note 14 to the consolidated financial statements included elsewhere in this report.

Liquidity

Liquidity describes the ability of the Bank to meet financial obligations that arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of customers and to fund current and planned expenditures. Liquidity is derived through increased customer deposits, maturities in the investment portfolio, loan repayments and income from earning assets. To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in short-term funds markets. The Bank has an arrangement with a correspondent bank whereby it has \$3,000,000 available in unsecured federal funds lines of credit, and \$5,000,000 available through a secured credit facility.

The Bank is also a member of the FHLBA, which provides another source of liquidity. The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the lender. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans. The Bank is required to purchase shares of capital stock in the FHLBA as a condition to obtaining the line of credit. As of September 30, 2023, the Bank had \$43.0 million in adjustable rate advances with no fixed maturity outstanding under the line of credit at an interest rate of 5.57%. Based on the value of available collateral as of September 30, 2023, the Bank could borrow an additional \$66,572,084 from the FHLBA.

The Bank is eligible to borrow from the FRB Discount Window. This credit line is secured by the Bank’s eligible consumer loan portfolio. Based on the value of available collateral as of September 30, 2023, the Bank could borrow \$12,216,166 from the FRB Discount Window.

In the first quarter of 2023, the Bank established a Bank Term Funding Program (“BTFP”) liquidity facility with the FRB. This facility allows the Bank to pledge eligible investment securities to the facility and receive funding equal to 100% of the par value of the investments pledged. The FRB BTFP offers a fixed rate for up to one year with borrowing rates set daily. The amount of funding available under the FRB BTFP is dependent upon the aggregate par value of the investments pledged. As of September 30, 2023, the Bank had no investments pledged, and no borrowings outstanding under the BTFP facility.

The Certificate of Deposit Account Registry Service (“CDARS”) network is a form of brokered deposit program in which the Bank has been a participant since June 2005. In addition to providing Bank clients enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through the One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes that this arrangement would be a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may borrow up to 10% of its reported total assets as of September 30, 2023, or \$65,393,757.

Further information about borrowings and available lines of credit is provided in Note 9 to the consolidated financial statements included elsewhere in this report.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Bank is a smaller reporting company and, as such, is not required to provide information called for by this item.

Item 4. Controls and Procedures.

The Bank maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Bank’s reports filed under the Securities Exchange Act of 1934 with the FDIC, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in those rules and forms, and that such information is accumulated and communicated to the Bank’s management, including its principal executive officer (“PEO”) and its principal financial officer (“PFO”), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

The Bank adopted ASU 2016-13, *“Financial Instruments- Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,”* and related updates, as described further in Note 1 to the consolidated interim financial statements, effective January 1, 2023. Related to the adoption of these new accounting standards, the Bank modified internal controls and designed and implemented certain new internal controls over the measurement of the allowance for credit losses on loans and the allowance for credit losses on off-balance sheet items and related disclosures. New internal controls related primarily to the modeling of expected credit losses on loans, including controls over critical data and other inputs and model results. There were no other changes in the Bank’s internal control over financial reporting during the nine months ended September 30, 2023 that have materially affected, or are reasonably likely to materially affect, the Bank’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Bank is party to various legal actions normally associated with a financial institution, none of which, in management's opinion, is likely to have a material effect on the Bank’s financial condition or future results of operations.

Item 1A. Risk Factors.

The risks and uncertainties to which the Bank’s financial condition and operations are subject are discussed in detail in Item 1A of Part I of the Bank’s Annual Report on Form 10-K for the year ended December 31, 2022. Management does not believe that any material changes in the Bank’s risk factors have occurred since these risks were last discussed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Section 3(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), exempts from the definition of “security” any securities issued by a bank, and the FDIC, as the Bank’s primary federal regulator, does not require the registration of the Bank’s securities prior to offer or sale. From time to time, the Bank sells shares of its common stock pursuant to its dividend reinvestment plan (“DRIP”) and upon exercise of options granted under its 2004 Director Non-Qualified Stock Option Plan (the “2004 Director Plan”), the 2008 Key Employee Stock Option Plan (the “2008 Key Employee Plan”), the 2015 Director Stock Option Plan (the “2015 Director Plan”) and the 2020 Employee Stock Purchase Plan (the “2020 ESPP”). The DRIP was adopted before the Bank converted from a national banking association into a state chartered bank, and the Office of the Comptroller of the Currency required that the shares issuable under such plans be registered under the Securities Act prior to their offer and sale. The 2004 Director Plan expired in April 2014, and no further grants may be made under the plan, but options granted under the 2004 Director Plan remain outstanding and subject to exercise until April 2024. On April 9, 2015, the Bank’s Board of Directors adopted the 2015 Director Plan so that the Bank may continue to incent non-employee directors through the grant of non-qualified stock options. The 2008 Key Employee Plan expired in April 2018 and no further grants may be made under the plan, but options granted under the 2008 Key Employee Plan remain outstanding and subject to exercise until April 2028. On May 20, 2020, the Bank’s stockholders approved the 2020 ESPP that allows eligible employees to acquire in total up to 100,000 shares of the Bank’s common stock at a discount through accumulated payroll deductions.

During the first quarter of 2023, a net total of 1,983 shares of common stock were sold pursuant to the DRIP at \$32.67 per share, a total of 1,744 shares of common stock issued pursuant to the exercise of options at an average exercise price of \$16.20 per share, and a total of 647 shares of common stock were sold pursuant to the 2020 ESPP at a weighted-average price of \$30.54 per share.

During the second quarter of 2023, a net total of 1,026 shares of common stock were sold pursuant to the DRIP at \$33.75 per share, no shares of common stock were issued pursuant to the exercise of options, and a total of 465 shares of common stock were sold pursuant to the 2020 ESPP at a weighted-average price of \$31.35 per share.

During the third quarter of 2023, a net total of 230 shares of common stock were sold pursuant to the DRIP at \$32.86 per share, no shares of common stock were issued pursuant to the exercise of options, and a total of 564 shares of common stock were sold pursuant to the 2020 ESPP at a weighted-average price of \$31.26 per share.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits filed or furnished herewith are listed in the following Exhibit Index:

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 31.2	Certifications of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 32.1	Certification of the Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

SIGNATURES

Pursuant to the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HARFORD BANK

Date: November 8, 2023

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: November 8, 2023

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer & Principal Accounting Officer)

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CONDITION

At:	September 30, 2023 (Unaudited)	December 31, 2022
ASSETS		
Cash and due from banks	\$ 3,149,705	\$ 2,951,800
Federal Reserve Bank deposit	20,331,439	25,466,624
Federal funds sold and Federal Home Loan Bank deposit	<u>262,471</u>	<u>25,972</u>
Cash and cash equivalents	23,743,615	28,444,396
Time deposits in other banks	2,267,991	2,545,624
Investment securities held to maturity (fair value of \$98,560,582 in 2023 and \$108,252,713 in 2022)	111,235,150	120,090,930
Federal Home Loan Bank stock, at cost	2,554,400	330,100
Total loans, including deferred fees net of costs	499,175,513	428,616,327
Less: Allowance for credit losses on loans	<u>(5,571,076)</u>	<u>(4,695,768)</u>
Net loans	493,604,437	423,920,559
Bank premises and equipment, net	9,514,579	9,817,299
Income taxes refundable	-	146,070
Accrued interest receivable	1,668,352	1,418,195
Deferred income taxes	1,154,504	980,031
Bank owned life insurance	6,508,158	6,406,523
Other assets	<u>1,686,382</u>	<u>1,369,567</u>
Total assets	<u>\$ 653,937,568</u>	<u>\$ 595,469,294</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 155,441,621	\$ 151,548,167
Interest-bearing	<u>395,121,751</u>	<u>386,973,008</u>
Total deposits	550,563,372	538,521,175
Federal Home Loan Bank overnight borrowings	43,000,000	-
Accrued interest payable	574,810	88,851
Income taxes payable	78,103	-
Allowance for credit losses on off-balance sheet items	341,155	-
SERP liability	1,144,004	1,174,379
Other liabilities	<u>1,096,061</u>	<u>1,638,201</u>
Total liabilities	<u>596,797,505</u>	<u>541,422,606</u>
Stockholders' equity		
Common stock, par value \$10 per share; authorized 5,000,000 shares; issued and outstanding 1,477,105 shares in 2023, and 1,470,446 shares in 2022	14,771,050	14,704,460
Surplus	17,854,285	17,674,158
Undivided profits	<u>24,514,728</u>	<u>21,668,070</u>
Total stockholders' equity	<u>57,140,063</u>	<u>54,046,688</u>
Total liabilities and stockholders' equity	<u>\$ 653,937,568</u>	<u>\$ 595,469,294</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2023	2022	2023	2022
Interest revenue				
Loans, including fees	\$ 6,457,153	\$ 4,467,261	\$ 17,491,878	\$ 12,706,642
Investment securities held to maturity	484,591	436,951	1,493,122	1,102,766
Federal funds sold and Federal Home Loan Bank deposit	3,629	106	5,262	137
Federal Reserve Bank deposit	156,037	423,933	471,672	648,164
Time deposits in other banks	2,629	2,809	8,367	10,358
Other	35,934	3,622	57,079	9,343
Total interest revenue	<u>7,139,973</u>	<u>5,334,682</u>	<u>19,527,380</u>	<u>14,477,410</u>
Interest expense				
Deposits	1,324,336	241,909	2,573,941	808,605
Borrowed funds	566,368	-	804,166	-
Total interest expense	<u>1,890,704</u>	<u>241,909</u>	<u>3,378,107</u>	<u>808,605</u>
Net interest income	5,249,269	5,092,773	16,149,273	13,668,805
Credit loss expense				
Provision for (recovery of) credit losses on loans	180,000	(150,000)	678,461	(275,000)
Provision for (recovery of) credit losses on off-balance sheet items	(226,650)	-	(150,416)	-
Total credit loss expense (recovery of expense)	<u>(46,650)</u>	<u>(150,000)</u>	<u>528,045</u>	<u>(275,000)</u>
Net interest income after provision for (recovery of) credit loss expense	<u>5,295,919</u>	<u>5,242,773</u>	<u>15,621,228</u>	<u>13,943,805</u>
Noninterest revenue				
Service charges on deposit accounts	207,523	163,381	613,817	484,987
Debit card income	142,635	131,667	411,864	381,741
Earnings on bank owned life insurance	35,148	33,727	101,635	99,364
Recovery on restricted stock previously written off	-	-	-	4,356
Other fees and commissions	95,878	126,760	337,484	405,911
Total noninterest revenue	<u>481,184</u>	<u>455,535</u>	<u>1,464,800</u>	<u>1,376,359</u>
Noninterest expense				
Salaries and benefits	2,354,212	2,309,078	6,936,098	6,503,307
Occupancy	284,091	276,493	858,575	849,814
Furniture and equipment	219,528	251,371	675,682	632,400
Data processing expense	216,773	232,345	686,058	733,712
Internet banking fees	4,221	49,600	150,991	148,141
Professional fees	108,219	86,029	333,116	360,485
Director and committee fees	135,707	160,392	304,274	292,992
Stationery and supplies	16,019	14,265	49,880	70,017
FDIC and state assessments	106,398	92,941	301,194	266,229
Advertising	59,976	64,883	178,481	175,254
Loss on disposal of fixed assets	2,025	1,949	2,025	18,837
Other operating	294,384	269,106	801,735	730,079
Total noninterest expense	<u>3,801,553</u>	<u>3,808,452</u>	<u>11,278,109</u>	<u>10,781,267</u>
Income before income taxes	1,975,550	1,889,856	5,807,919	4,538,897
Income taxes	499,950	458,529	1,464,711	1,105,682
Net income	<u>\$ 1,475,600</u>	<u>\$ 1,431,327</u>	<u>\$ 4,343,208</u>	<u>\$ 3,433,215</u>
Basic net income per share	\$ 1.00	\$ 0.98	\$ 2.95	\$ 2.35
Diluted net income per share	\$ 0.99	\$ 0.97	\$ 2.92	\$ 2.34

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

	Common stock			Undivided	Total
	<u>Shares</u>	<u>Par value</u>	<u>Surplus</u>	<u>profits</u>	<u>Stockholders'</u> <u>Equity</u>
Three Months Ended:					
September 30, 2023					
Balance at beginning of period	1,476,311	\$ 14,763,110	\$ 17,777,493	\$ 23,363,918	\$ 55,904,521
Net income				1,475,600	1,475,600
Cash dividends, \$0.22 per share				(324,790)	(324,790)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	564	5,640	11,991	-	17,631
Stock sold and dividend reinvestment plan (DRIP)	2,456	24,560	56,130	-	80,690
Stock-based compensation expense			59,557	-	59,557
Stock acquired for DRIP administration	(2,226)	(22,260)	(50,886)	-	(73,146)
Balance at end of period	<u>1,477,105</u>	<u>\$ 14,771,050</u>	<u>\$ 17,854,285</u>	<u>\$ 24,514,728</u>	<u>\$ 57,140,063</u>
September 30, 2022					
Balance at beginning of period	1,460,538	\$ 14,605,380	\$ 17,494,615	\$ 19,115,683	\$ 51,215,678
Net income				1,431,327	1,431,327
Cash dividends, \$0.19 per share				(277,812)	(277,812)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	7,408	74,080	67,890	-	141,970
Stock sold and dividend reinvestment plan (DRIP)	2,313	23,130	50,886	-	74,016
Stock-based compensation expense			55,659	-	55,659
Stock acquired for DRIP administration	(2,302)	(23,020)	(50,646)	-	(73,666)
Balance at end of period	<u>1,467,957</u>	<u>\$ 14,679,570</u>	<u>\$ 17,618,404</u>	<u>\$ 20,269,198</u>	<u>\$ 52,567,172</u>
Nine Months Ended:					
September 30, 2023					
Balance at beginning of period	1,470,446	\$ 14,704,460	\$ 17,674,158	\$ 21,668,070	\$ 54,046,688
Transition adjustment pursuant to adoption of ASU 2016-13				(523,419)	(523,419)
Net income				4,343,208	4,343,208
Cash dividends, \$0.66 per share				(973,131)	(973,131)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	3,420	34,200	46,022	-	80,222
Stock sold and dividend reinvestment plan (DRIP)	7,502	75,020	173,181	-	248,201
Stock-based compensation expense			59,557	-	59,557
Stock acquired for DRIP administration	(4,263)	(42,630)	(98,633)	-	(141,263)
Balance at end of period	<u>1,477,105</u>	<u>\$ 14,771,050</u>	<u>\$ 17,854,285</u>	<u>\$ 24,514,728</u>	<u>\$ 57,140,063</u>
September 30, 2022					
Balance at beginning of period	1,451,175	\$ 14,511,750	\$ 17,367,493	\$ 17,667,292	\$ 49,546,535
Net income				3,433,215	3,433,215
Cash dividends, \$0.57 per share				(831,309)	(831,309)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	12,433	124,330	102,898	-	227,228
Stock sold and dividend reinvestment plan (DRIP)	7,371	73,710	157,804	-	231,514
Stock-based compensation expense			55,659	-	55,659
Stock acquired for DRIP administration	(3,022)	(30,220)	(65,450)	-	(95,670)
Balance at end of period	<u>1,467,957</u>	<u>\$ 14,679,570</u>	<u>\$ 17,618,404</u>	<u>\$ 20,269,198</u>	<u>\$ 52,567,172</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For the nine months ended September 30,	2023	2022
Cash flows provided by (used in) operating activities		
Interest received	\$ 19,083,774	\$ 13,859,283
Fees and commissions received	1,925,149	2,003,203
Interest paid	(2,892,148)	(860,816)
Cash paid to suppliers and employees	(11,801,387)	(10,946,940)
Income taxes paid	(1,240,538)	(1,211,117)
Net cash provided by (used in) operating activities	<u>5,074,850</u>	<u>2,843,613</u>
Cash flows provided by (used in) investing activities		
Proceeds from maturities of time deposits in other banks	250,000	-
Proceeds from calls and maturities of investment securities	8,534,694	10,686,174
Purchases of investment securities	-	(23,111,133)
Redemption (purchase) of FHLB stock	(2,224,300)	(44,600)
Loans originated, net of principal repayments	(70,414,434)	(33,277,121)
Net (decrease) increase in deferred loan fees and costs	(72,407)	17,035
Purchases of bank premises and equipment	(105,410)	(215,674)
Net cash provided by (used in) investing activities	<u>(64,031,857)</u>	<u>(45,945,319)</u>
Cash flows provided by (used in) financing activities		
Net (decrease) increase in time deposits	38,720,070	(25,197,229)
Net (decrease) increase in other deposits	(26,677,873)	83,460,944
Proceeds from borrowed funds	55,000,000	-
Repayments of borrowed funds	(12,000,000)	-
Dividends paid	(973,131)	(831,309)
Dividends reinvested	248,201	231,514
Shares issued under stock-based compensation plans and related tax effects	80,222	227,228
Stock acquired for DRIP administration	(141,263)	(95,670)
Net cash provided by (used in) financing activities	<u>54,256,226</u>	<u>57,795,478</u>
Net increase (decrease) in cash and cash equivalents	(4,700,781)	14,693,772
Cash and cash equivalents at beginning of period	<u>28,444,396</u>	<u>82,430,959</u>
Cash and cash equivalents at end of period	<u>\$ 23,743,615</u>	<u>\$ 97,124,731</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited - continued)

For the nine months ended September 30,	2023	2022
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 4,343,208	\$ 3,433,215
Adjustments to reconcile net income to net cash provided by operating activities		
Net amortization and accretion on loan fees and costs	(81,819)	(683,006)
Net amortization and accretion on time deposits in other banks	27,633	27,515
Net amortization and accretion on investment securities	321,086	556,289
Depreciation and amortization on fixed assets and software	409,882	409,413
Earnings on bank owned life insurance	(101,635)	(99,364)
Provision for (recovery of) credit losses on loans	678,461	(275,000)
Provision for (recovery of) credit losses on off-balance sheet items	(150,416)	-
Loss (gain) on disposition of bank premises and equipment	2,025	18,837
Stock-based compensation expense	59,557	55,659
Decrease (increase) in		
Accrued interest receivable	(250,157)	107,919
Income taxes refundable	146,070	(105,435)
Other assets	(320,592)	345,130
Increase (decrease) in		
Accrued interest payable	485,959	(52,211)
Income taxes payable	78,103	-
SERP liability	(30,375)	17,575
Other liabilities	(542,140)	(912,923)
	<u>\$ 5,074,850</u>	<u>\$ 2,843,613</u>
Non-Cash Transactions:		
Transition adjustment pursuant to adoption of ASU 2016-13	<u>\$ 697,892</u>	<u>\$ -</u>

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Nature of operations

Harford Bank (the “Bank”) provides a full range of banking services to customers located in Harford and Cecil Counties and areas surrounding northeastern Maryland.

Basis of presentation

The accounting and reporting policies reflected in the consolidated financial statements conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry, and, in the opinion of management, the consolidated financial statements reflect all adjustments necessary for a fair presentation of the Bank's financial position and results of operations. Management has evaluated subsequent events for potential recognition and/or disclosure through the date of issuance of the consolidated financial statements.

Principles of consolidation

The consolidated financial statements include the accounts of Harford Bank and its subsidiary, HB Trust, a Maryland Statutory Trust. Intercompany accounts and entries have been eliminated in the consolidated financial statements.

Use of estimates

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 financial statements. These estimates and assumptions may affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Current expected credit losses – Adoption of ASU 2016-13

Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments” affects financial assets with the contractual right to receive cash, including loans held for investment, held to maturity debt securities, and off-balance sheet credit exposures, unless specifically excluded from scope. Financial assets measured at an amortized cost basis are presented at the net amount expected to be collected. The allowance for credit losses (“ACL”) is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value and the amount expected to be collected on the financial asset. The Bank has made the accounting policy election to exclude accrued interest receivable on financial assets from the estimate of credit losses.

The Bank adopted the Current Expected Credit Loss (“CECL”) Standard using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures on January 1, 2023. Upon adoption, the Bank recognized an after-tax cumulative effect reduction to undivided profits totaling \$523,419, as detailed in the table below. Results for reporting periods beginning on January 1, 2023 are presented under the CECL standard while prior period amounts continue to be reported in accordance with previously applicable accounting guidance.

The adoption of the CECL standard resulted in the following adjustments to the Bank’s financial statements as of January 1, 2023.

	Changes in Consolidated Statements of Condition	Income Tax Effect	Changes to Undivided Profits
<u>At January 1, 2023</u>			
Allowance for credit losses on loans	\$ 206,321	\$ 51,580	\$ 154,741
Allowance for credit losses on off-balance sheet items	491,571	122,893	368,678
	<u>\$ 697,892</u>	<u>\$ 174,473</u>	<u>\$ 523,419</u>

Reclassifications

Certain reclassifications have been made to the 2022 consolidated financial statement presentation to conform to the current year’s format. Total stockholders’ equity and net income are unchanged due to these reclassifications.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, deposits with other financial institutions that have an initial maturity of less than 90 days when acquired, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Time deposits in other banks

Negotiable time deposits in other banks are carried at cost and are generally placed in amounts of \$250,000 or less to qualify for Federal Deposit Insurance Corporation ("FDIC") deposit insurance coverage. Non-negotiable time deposits placed with correspondent banks may exceed the \$250,000 limit.

Investment securities

Management has classified all investment securities as held to maturity. Management has the intent and ability to hold all investment securities to maturity. These investment securities are recorded at amortized cost which is cost adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are recognized in interest revenue using the interest method over the term of the securities, except that premiums on callable securities are amortized to the call price at the first call date. An allowance for credit losses on held to maturity investments is recognized when lifetime credit losses are expected, for an amount that reflects the expected lifetime credit losses.

Restricted equity securities

As a member of the Federal Home Loan Bank of Atlanta ("FHLBA"), the Bank is required to hold FHLBA stock as a condition of membership as well as in relation to the Bank's use of products and services. FHLBA stock is not publicly-traded and is sold and redeemed by the FHLBA at par. The Bank views its investment in FHLBA stock as a long-term investment and as a restricted equity security, which is carried at cost and periodically evaluated for impairment based on the ultimate recoverability of the par value. The Bank does not consider this investment to be impaired as of September 30, 2023, and no impairment has been recognized.

Loans and allowance for credit losses on loans

Loans are stated at unpaid principal balance adjusted for any interest amounts applied to principal on nonaccrual loans, any amounts partially charged-off, the allowance for credit losses on loans, and deferred origination fees and costs.

Interest on loans is accrued based on the principal amounts outstanding. Origination fees and costs are recognized as an adjustment to the related loan yield using an approximate interest method. The accrual of interest is discontinued when any portion of the principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full. Non-accrual loans may be considered for return to accrual status after a minimum six-month period of on-time payment performance provided that no amount of the loan has been charged-off. Past due status is based on the contractual terms of the loan. If collection of principal is evaluated as doubtful, all payments are applied to principal.

Loans are individually evaluated when they do not share similar risk characteristics with other loans collectively evaluated (generally collateral dependent), and when, based on current information, management considers it unlikely that the collection of principal and interest payments on these loans will be made according to contractual terms. Generally, loans are reviewed for individual evaluation when rated 4, Special Mention, or 5, Substandard, when 60 or more days past due, when the accrual of interest has been discontinued, and when the loan has been modified due to a borrower experiencing financial difficulty.

The allowance for credit losses on loans is a valuation account that is deducted from the amortized cost basis of loans to present the net amount expected to be collected on the loans. Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate. Credit losses on loans are charged against the allowance for credit losses on loans when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for credit losses on loans.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies – continued

Management estimates the required allowance for credit losses on loans using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience (past events) provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current conditions such as differences relating to underwriting standards, nature and volume of the loan portfolio, delinquency level and overall loan portfolio quality, or term as well as for changes in environmental conditions, such as changes in economic conditions that may affect the borrower's ability to pay, unemployment rates, property values, or other relevant factors. If the current economy or real estate market were to suffer a severe downturn, the provision for credit losses on loans would need to be increased.

The allowance for credit losses on loans is measured on a collective (pool) basis when similar risk characteristics exist. The Bank has identified portfolio segments based on collateral type and measures the allowance for credit losses on loans using Call Report-derived data. The Bank utilizes the discounted cash flow approach to calculate the expected loss for each loan within the pool. The Bank also considers qualitative adjustments to the historical loss rate for each loan portfolio segment, which are a combination of specific risk characteristics or current conditions at the reporting date that may differ from those in effect during the historical loss calculation period as well as forward looking projections for each pool based on a reasonable and supportable forecast based on objective economic data (primarily Federal Reserve Economic Data). The Bank uses a one-year forecast period, after which the loss factors revert immediately to historical loss rates. The total loss rate is the lifetime historical loss rate plus the total qualitative factor adjustments.

Some loans are not sufficiently similar in risk characteristics to other loans. These loans are evaluated on an individual basis. Loans evaluated individually are not included in the collective evaluation. Loans that are individually evaluated for which impairment is determined to exist will have a specific reserve allocated to them and included in the expected allowance for credit losses on loans.

An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable expected losses. The unallocated component of the allowance for credit losses on loans reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general expected losses in the loan portfolio. Allocation of a portion of the allowance for credit losses on loans to one category of loans does not preclude its availability to absorb expected losses in other categories.

Allowance for credit losses on off-balance sheet items

The Bank estimates expected credit losses on off-balance sheet items, which consist of contractual obligations to extend credit, loans which the Bank has approved but have not been funded, and letters of credit, over the contractual period during which the Bank is exposed to credit risk, unless that obligation is unconditionally cancellable by the Bank. The allowance for credit losses on off-balance sheet items is recorded as a liability and is adjusted each reporting period through credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on off-balance sheet items expected to be funded over its estimated life. The loss rates used to determine the required allowance for credit losses on off-balance sheet items are essentially the same as those used on originated loans.

Bank premises and equipment

Land is carried at cost. Buildings and improvements, and furniture and equipment are recorded at cost, less accumulated depreciation computed principally by the straight-line method over the estimated useful lives of the assets. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements. Software is recorded in other assets at cost and amortized using the straight-line method over three years.

Other real estate owned and other repossessed assets

Real estate acquired through foreclosure or by deed in lieu of foreclosure is recorded on the date acquired at the fair value less estimated costs to sell. Loan collateral, other than real estate, acquired through or in lieu of foreclosure is recorded in other assets on the date acquired at the fair value less estimated costs to sell. Losses incurred at the time of acquisition of the real estate property or other collateral are charged to the allowance for credit losses on loans. Subsequent reductions in the estimated value of the real estate property or other collateral are included in noninterest expense.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies – continued

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Interest and penalties incurred related to income taxes are included in income tax expense.

Management considers the likelihood of changes by taxing authorities in its filed income tax returns and recognizes a liability for or discloses potential changes that management believes are more likely than not to occur upon examination by tax authorities. Management has not identified any uncertain tax positions in filed income tax returns that require recognition or disclosure in the accompanying financial statements. The Bank's income tax returns for the past three years are subject to examination by tax authorities and may change upon examination.

Advertising costs

Advertising costs are expensed as incurred.

Earnings per common share

Basic earnings per common share is determined by dividing net income by the weighted-average number of shares of common stock outstanding after giving retroactive effect to stock dividends for all periods presented. Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

Stock-based compensation

The Bank accounts for employee and director stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock-based compensation at the date of grant. The Bank accounts for stock-based compensation in accordance with FASB Accounting Standards Codification ("ASC") Topic 718, *Stock Compensation*. This standard requires public companies to recognize compensation expense related to stock-based compensation awards in their income statements over the period during which an individual is required to provide service in exchange for such award.

Segment reporting

ASC Topic 280, *Segment Reporting*, requires reporting of selected information about operating segments in its financial reports issued to stockholders. Management has performed an analysis and determined that the Bank has only one operating segment, which is commercial banking. The Bank's chief operating decision makers use combined results to make operating and strategic decisions and therefore the Bank is not required to disclose any additional segment information.

2. Cash and Cash Equivalents

The Bank normally carries balances with other banks that exceed the federally insured limit.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

3. Investment Securities Held to Maturity

The amortized cost and estimated fair value of the investment securities portfolio for the respective periods are shown below. The Bank owns residential mortgage-backed (“RMBS”), commercial mortgage-backed (“CMBS”) and collateralized mortgage obligation (“CMO”) investment securities which are issued and guaranteed by the Government National Mortgage Association (“GNMA”), the Federal National Mortgage Association (“FNMA”), and the Federal Home Loan Mortgage Corporation (“FHLMC”). The asset-backed investment security holdings are issued and guaranteed by the Small Business Administration (“SBA”).

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2023				
U.S. Treasury securities	\$ 20,356,715	\$ -	\$ 1,078,482	\$ 19,278,233
U.S. government agency securities	34,663,482	-	3,520,890	31,142,592
Agency RMBS	36,768,029	-	5,297,857	31,470,172
Agency CMBS	4,212,990	-	305,553	3,907,437
Agency CMO securities	1,196,294	-	258,087	938,207
SBA asset-backed securities	10,478,301	-	1,426,818	9,051,483
State and municipal securities	3,559,339	-	786,881	2,772,458
	<u>\$ 111,235,150</u>	<u>\$ -</u>	<u>\$ 12,674,568</u>	<u>\$ 98,560,582</u>
December 31, 2022				
U.S. Treasury securities	\$ 20,897,234	\$ -	\$ 1,356,764	\$ 19,540,470
U.S. government agency securities	36,774,973	-	3,567,219	33,207,754
Agency RMBS	41,318,236	14,808	4,470,323	36,862,721
Agency CMBS	4,243,971	-	212,585	4,031,386
Agency CMO securities	1,294,386	-	254,809	1,039,577
SBA asset-backed securities	11,991,588	-	1,297,078	10,694,510
State and municipal securities	3,570,542	-	694,247	2,876,295
	<u>\$ 120,090,930</u>	<u>\$ 14,808</u>	<u>\$ 11,853,025</u>	<u>\$ 108,252,713</u>

Contractual maturities and the amount of pledged investment securities for the respective periods are shown below. Actual maturities might differ from contractual maturities because the issuers of the securities might have the right to call or prepay obligations with or without call or prepayment penalties. Investment securities are pledged to secure deposits of federal and local governments.

	September 30, 2023		December 31, 2022	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing				
In one year or less	\$ 17,791,925	\$ 17,279,590	\$ 5,519,031	\$ 5,369,120
Over one to five years	27,085,599	24,824,863	41,604,207	38,361,992
Over five to ten years	8,743,471	7,064,096	9,162,464	7,660,678
Greater than ten years	4,958,541	4,024,734	4,957,047	4,232,729
Mortgage-backed, CMO and asset-backed securities	<u>52,655,614</u>	<u>45,367,299</u>	<u>58,848,181</u>	<u>52,628,194</u>
	<u>\$ 111,235,150</u>	<u>\$ 98,560,582</u>	<u>\$ 120,090,930</u>	<u>\$ 108,252,713</u>
 Pledged securities	 <u>\$ 81,000,147</u>	 <u>\$ 70,215,867</u>	 <u>\$ 85,650,747</u>	 <u>\$ 75,899,055</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

3. Investment Securities Held to Maturity - continued

Investment securities with unrealized losses as of the respective periods are shown below.

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2023						
U.S. Treasury securities	\$ -	\$ -	\$ 19,278,233	\$ 1,078,482	\$ 19,278,233	\$ 1,078,482
U.S. government agency securities	-	-	31,142,592	3,520,890	31,142,592	3,520,890
Agency RMBS	3,058,811	102,980	28,411,361	5,194,877	31,470,172	5,297,857
Agency CMBS	-	-	3,907,437	305,553	3,907,437	305,553
Agency CMO securities	-	-	938,207	258,087	938,207	258,087
Asset-backed securities	-	-	9,051,483	1,426,818	9,051,483	1,426,818
State and municipal securities	-	-	2,772,458	786,881	2,772,458	786,881
	<u>\$ 3,058,811</u>	<u>\$ 102,980</u>	<u>\$ 95,501,771</u>	<u>\$ 12,571,588</u>	<u>\$ 98,560,582</u>	<u>\$ 12,674,568</u>
December 31, 2022						
U.S. Treasury securities	\$ 6,272,900	\$ 192,235	\$ 13,267,570	\$ 1,164,529	\$ 19,540,470	\$ 1,356,764
U.S. government agency securities	4,953,686	471,728	28,254,068	3,095,491	33,207,754	3,567,219
Agency RMBS	10,899,697	542,897	22,403,666	3,927,426	33,303,363	4,470,323
Agency CMBS	4,031,386	212,585	-	-	4,031,386	212,585
Agency CMO securities	-	-	1,039,577	254,809	1,039,577	254,809
SBA asset-backed securities	3,591,560	255,008	7,102,950	1,042,070	10,694,510	1,297,078
State and municipal securities	303,789	5,638	2,572,506	688,609	2,876,295	694,247
	<u>\$ 30,053,018</u>	<u>\$ 1,680,091</u>	<u>\$ 74,640,337</u>	<u>\$ 10,172,934</u>	<u>\$ 104,693,355</u>	<u>\$ 11,853,025</u>

Based on its review of investment securities experiencing unrealized losses as of September 30, 2023 and December 31, 2022, the Bank concluded that it expected to recover the amortized cost basis of its investment. The Bank has the intent and ability to hold and does not believe it will be required to sell these investment securities until maturity. Unrealized losses are primarily due to increases in market interest rates over the yields available at the time the underlying investments were purchased, and the Bank does not believe that any of the securities are experiencing unrealized losses due to reasons of credit quality. The fair value is expected to recover as the securities approach their maturity date or if market interest rates for such securities decline. The U.S. Treasury securities the Bank owns are backed by the full faith and credit of the U.S. government. The U.S. government agency securities the Bank owns are issued by FNMA and FHLMC, which the U.S. government has affirmed its commitment to support, and by the FHLB and the Federal Farm Credit system ("FFCB"), which are government-sponsored enterprises. The RMBS, CMBS and CMO securities owned by the Bank are issued by GNMA, which carry U.S. government guarantees, and FNMA and FHLMC, which the U.S. government has affirmed its commitment to support. The asset-backed securities owned by the Bank are issued by the SBA and carry U.S. government guarantees. The state and municipal securities owned by the Bank are all general obligation bonds, with unlimited and limited taxing authority.

As part of implementing ASU 2016-13 on January 1, 2023, the Bank determined that no allowance for credit losses was required on the Bank's investment portfolio. The securities owned by the Bank that are issued by the U.S. Treasury, the SBA, and U.S. government agencies, including agency MBS and CMO securities, are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies and have a long history of no credit losses. The state and municipal securities owned by the Bank are general obligation bonds, highly rated by major rating agencies and have a long history of no credit losses. Based on management's assessment of the investment portfolio at September 30, 2023, no allowance for credit losses was required on the Bank's investment portfolio.

The following table displays the amortized cost of held to maturity state and municipal securities by credit rating provided by Moody's at September 30, 2023 and December 31, 2022.

September 30, 2023	AAA	AA2	AA3	Below AA3	Total
State and municipal securities	<u>\$ 1,463,476</u>	<u>\$ 748,081</u>	<u>\$ 1,347,782</u>	<u>\$ -</u>	<u>\$ 3,559,339</u>
December 31, 2022	AAA	AA2	AA3	Below AA3	Total
State and municipal securities	<u>\$ 1,471,675</u>	<u>\$ 749,440</u>	<u>\$ 1,349,427</u>	<u>\$ -</u>	<u>\$ 3,570,542</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans

The Bank makes loans to customers located primarily in Harford and Cecil Counties and surrounding areas. The performance of the loan portfolio will be influenced by the regional real estate market and economy.

Major classifications of loans are as follows for the periods indicated:

At:	September 30, 2023	December 31, 2022
Real estate		
Construction, development & other land	\$ 31,364,629	\$ 21,239,232
Secured by farmland	9,186,455	9,169,852
Commercial	254,506,652	226,820,382
Residential	130,796,112	126,777,277
Commercial & industrial	41,218,377	28,964,832
Other consumer	32,281,383	15,975,357
Overdrafts	47,989	49,705
Gross loans	499,401,597	428,996,637
Net deferred (fees) costs	(226,084)	(380,310)
Allowance for credit losses on loans	(5,571,076)	(4,695,768)
Net loans	<u>\$ 493,604,437</u>	<u>\$ 423,920,559</u>
Principal balance of pledged loans	<u>\$ 237,094,674</u>	<u>\$ 186,022,819</u>

Substantial portions of the Bank's loans are secured by residential and commercial real estate. Loans secured by commercial real estate and farmland generally involve larger principal amounts and a higher degree of risk than loans secured by residential one- to four-family mortgages. Repayment of loans secured by commercial real estate and farmland is often dependent on the successful operation or management of the properties, making collectability of such loans subject to adverse economic or real estate market conditions. The Bank seeks to mitigate these risks through its underwriting standards which require that loans be qualified on the basis of the property's value and debt service coverage ratios, and additional collateral may be required under certain circumstances. The Bank will generally obtain personal guarantees.

Construction lending is generally considered to present a higher degree of credit risk than other types of real estate lending. Risks of loss include the accuracy of the borrower's estimate of construction costs, timing, and ultimate completion value, and the borrower's ability to complete the project in a workmanlike manner. These risks may result in a project whose value is insufficient to ensure full repayment.

The Bank originates one- to four-family residential mortgage loans in amounts typically up to 80% of the lower of the appraised value or purchase price of the property securing the loan. The predominance of the Bank's residential mortgage portfolio consists of fixed-rate mortgages with original maturities ranging from 10 to 30 years. Fixed-rate lending can expose the Bank to interest rate risk in a rising rate environment.

Commercial loans are generally secured by inventories, equipment and other assets of the business. Personal guarantees of the borrowers are generally required.

The Bank makes consumer installment loans secured by vehicles, boats, mobile homes and other collateral as well as unsecured loans with personal guarantees.

Eligible consumer installment loans are pledged to secure borrowing facilities at the Federal Reserve Discount Window. The Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans are pledged to secure borrowing facilities at the FHLBA.

Loan balances in the following tables are presented at recorded investment, which is unpaid principal balance adjusted for any interest amounts applied to principal on nonaccrual loans, and any amounts partially charged-off.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The maturity distribution of the loan portfolio is as follows for the periods indicated:

At:	September 30, 2023	December 31, 2022
<i>Maturing</i>		
In one year or less	\$ 36,436,779	\$ 26,700,208
Over one to five years	53,235,918	28,852,310
Over five to fifteen years	122,148,815	122,114,156
Over fifteen years	287,580,085	251,329,963
Gross loans	<u>\$ 499,401,597</u>	<u>\$ 428,996,637</u>
Variable rate loans included above	<u>\$ 336,983,046</u>	<u>\$ 304,529,517</u>

The following table analyzes the payment status of loans for the periods indicated:

	30-59 Days	60-89 Days	90 Days and Over	Total		Total	Loans over
	Past Due	Past Due	Past Due	Past Due	Current	Loans	90 Days and Accruing
September 30, 2023							
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ 31,364,629	\$ 31,364,629	\$ -
Commercial real estate & farmland	264,478	-	-	264,478	263,428,629	263,693,107	-
Residential real estate	-	40,705	-	40,705	130,755,407	130,796,112	-
Commercial & industrial	-	106,731	-	106,731	41,111,646	41,218,377	-
Other consumer & overdrafts	138,338	-	-	138,338	32,191,034	32,329,372	-
Total	<u>\$ 402,816</u>	<u>\$ 147,436</u>	<u>\$ -</u>	<u>\$ 550,252</u>	<u>\$ 498,851,345</u>	<u>\$ 499,401,597</u>	<u>\$ -</u>
December 31, 2022							
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ 21,239,232	\$ 21,239,232	\$ -
Commercial real estate & farmland	188,047	-	-	188,047	235,802,187	235,990,234	-
Residential real estate	-	-	766	766	126,776,511	126,777,277	-
Commercial & industrial	-	-	-	-	28,964,832	28,964,832	-
Other consumer & overdrafts	12,191	-	101,520	113,711	15,911,351	16,025,062	101,520
Total	<u>\$ 200,238</u>	<u>\$ -</u>	<u>\$ 102,286</u>	<u>\$ 302,524</u>	<u>\$ 428,694,113</u>	<u>\$ 428,996,637</u>	<u>\$ 101,520</u>

Credit Quality Indicators. As part of the on-going monitoring of the quality of the Bank's loan portfolio management tracks certain credit quality indicators.

The Bank does not credit score new loans but does utilize a risk grading system for non-consumer loans. Loans are risk rated on the scale listed below:

Grade 1, 2 and 3A – These grades include “pass grade” loans to borrowers of acceptable credit quality and risk.

Grade 3W – This grade includes loans that are on management's “watch list” and are classified as “Pass Watch”. It is management's intent to utilize this rating on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near future.

Grade 4 – This grade is for “Other Assets Especially Mentioned” or “Special Mention” in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation. This grade may include loans not fully secured where a specific valuation allowance may be warranted.

Grade 5 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which accrual of interest may have stopped. This grade includes loans that are past due or not fully secured where a specific valuation allowance may be warranted.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Consumer loans will be assigned a loan grade of 5, substandard, when placed on non-accrual or when experiencing significant, protracted delinquency.

The following table presents loan grades applied at September 30, 2023 to the various loan classes by year of origination.

	Term Loans by Origination Year						Revolving	
	2023	2022	2021	2020	2019	Prior	Loans	Total
Construction, development & other land:								
Loan grades:								
Pass	\$ 2,982,903	\$ 9,823,540	\$ 1,834,652	\$ 2,439,715	\$ 2,633,496	\$ 1,205,002	\$ 7,364,459	\$ 28,283,767
Pass watch	-	-	-	-	145,883	-	2,934,979	3,080,862
Special mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
	<u>\$ 2,982,903</u>	<u>\$ 9,823,540</u>	<u>\$ 1,834,652</u>	<u>\$ 2,439,715</u>	<u>\$ 2,779,379</u>	<u>\$ 1,205,002</u>	<u>\$ 10,299,438</u>	<u>\$ 31,364,629</u>
Commercial real estate & farmland:								
Loan grades:								
Pass	\$ 27,188,748	\$ 45,921,414	\$ 30,308,655	\$ 25,502,426	\$ 8,984,107	\$ 76,886,034	\$ 5,483,142	\$ 220,274,526
Pass watch	5,656,049	4,812,224	52,350	-	6,847,903	10,744,262	866,785	28,979,573
Special mention	349,859	4,496,657	-	1,060,038	365,324	176,183	-	6,448,061
Substandard	-	378,997	-	-	-	7,611,950	-	7,990,947
	<u>\$ 33,194,656</u>	<u>\$ 55,609,292</u>	<u>\$ 30,361,005</u>	<u>\$ 26,562,464</u>	<u>\$ 16,197,334</u>	<u>\$ 95,418,429</u>	<u>\$ 6,349,927</u>	<u>\$ 263,693,107</u>
Residential real estate:								
Loan grades:								
Pass	\$ 10,507,226	\$ 33,226,247	\$ 22,101,378	\$ 16,537,631	\$ 8,127,689	\$ 21,102,904	\$ 17,305,289	\$ 128,908,364
Pass watch	-	234,251	-	-	-	847,859	361,531	1,443,641
Special mention	-	-	-	-	-	-	-	-
Substandard	-	97,378	-	-	-	346,729	-	444,107
	<u>\$ 10,507,226</u>	<u>\$ 33,557,876</u>	<u>\$ 22,101,378</u>	<u>\$ 16,537,631</u>	<u>\$ 8,127,689</u>	<u>\$ 22,297,492</u>	<u>\$ 17,666,820</u>	<u>\$ 130,796,112</u>
Commercial & industrial:								
Loan grades:								
Pass	\$ 13,227,940	\$ 7,527,145	\$ 4,307,398	\$ 1,984,691	\$ 600,839	\$ 533,662	\$ 9,772,983	\$ 37,954,658
Pass watch	646,843	636,502	245,589	127,187	10,237	89,141	1,269,454	3,024,953
Special mention	-	-	-	-	-	-	-	-
Substandard	-	-	106,731	-	48,541	83,494	-	238,766
	<u>\$ 13,874,783</u>	<u>\$ 8,163,647</u>	<u>\$ 4,659,718</u>	<u>\$ 2,111,878</u>	<u>\$ 659,617</u>	<u>\$ 706,297</u>	<u>\$ 11,042,437</u>	<u>\$ 41,218,377</u>
Other consumer & overdrafts:								
Loan grades:								
Pass	\$ 18,141,520	\$ 10,356,829	\$ 1,050,259	\$ 442,958	\$ 340,874	\$ 1,933,376	\$ 29,030	\$ 32,294,846
Pass watch	-	-	27,098	-	-	-	-	27,098
Special mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	7,428	-	7,428
	<u>\$ 18,141,520</u>	<u>\$ 10,356,829</u>	<u>\$ 1,077,357</u>	<u>\$ 442,958</u>	<u>\$ 340,874</u>	<u>\$ 1,940,804</u>	<u>\$ 29,030</u>	<u>\$ 32,329,372</u>
Total loans:								
Loan grades:								
Pass	\$ 72,048,337	\$ 106,855,175	\$ 59,602,342	\$ 46,907,421	\$ 20,687,005	\$ 101,660,978	\$ 39,954,903	\$ 447,716,161
Pass watch	6,302,892	5,682,977	325,037	127,187	7,004,023	11,681,262	5,432,749	36,556,127
Special mention	349,859	4,496,657	-	1,060,038	365,324	176,183	-	6,448,061
Substandard	-	476,375	106,731	-	48,541	8,049,601	-	8,681,248
	<u>\$ 78,701,088</u>	<u>\$ 117,511,184</u>	<u>\$ 60,034,110</u>	<u>\$ 48,094,646</u>	<u>\$ 28,104,893</u>	<u>\$ 121,568,024</u>	<u>\$ 45,387,652</u>	<u>\$ 499,401,597</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans – continued

The following table presents risk-rated loan grades applied at December 31, 2022 to the various loan classes.

December 31, 2022	Pass Watch Grade 3W	Special Mention Grade 4	Substandard Grade 5	Total
Construction, development & other land	\$ 1,176,418	\$ 148,625	\$ -	\$ 1,325,043
Commercial real estate & farmland	21,882,024	10,569,562	8,936,604	41,388,190
Residential real estate	4,643,145	-	493,517	5,136,662
Commercial & industrial	1,075,032	25	133,191	1,208,248
Mobile home	-	-	143,375	143,375
Other consumer	71,863	-	-	71,863
	<u>\$ 28,848,482</u>	<u>\$ 10,718,212</u>	<u>\$ 9,706,687</u>	<u>\$ 49,273,381</u>

The following table presents gross charge-offs allocated by loan class by year of origination for the three-month periods ended September 30, 2023 and 2022. All charge-offs reported in overdrafts for the three-month periods ended September 30, 2023 and 2022 were related to deposit overdrafts.

Three Months Ended September 30, 2023 by Year of Origination							
	2023	2022	2021	2020	2019	Prior	Total
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	-	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-	-
Commercial & industrial	-	-	-	-	-	-	-
Other consumer	-	-	-	-	-	-	-
Overdrafts	<u>4,483</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,483</u>
	<u>\$ 4,483</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,483</u>

Three Months Ended September 30, 2022 by Year of Origination							
	2022	2021	2020	2019	2018	Prior	Total
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	-	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-	-
Commercial & industrial	-	-	-	-	-	-	-
Other consumer	-	-	-	-	-	23,543	23,543
Overdrafts	<u>11,316</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>11,316</u>
	<u>\$ 11,316</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,543</u>	<u>\$ 34,859</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans – continued

The following table presents gross charge-offs allocated by loan class by year of origination for the nine-month periods ended September 30, 2023 and 2022. All charge-offs reported in overdrafts for the nine-month periods ended September 30, 2023 and 2022 were related to deposit overdrafts.

	2023	2022	2021	2020	2019	Prior	Total
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	-	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	766	766
Commercial & industrial	-	-	-	-	-	-	-
Other consumer	-	-	-	-	-	-	-
Overdrafts	<u>20,353</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,353</u>
	<u>\$ 20,353</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 766</u>	<u>\$ 21,119</u>

Nine Months Ended September 30, 2022 by Year of Origination							
	2022	2021	2020	2019	2018	Prior	Total
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	-	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-	-
Commercial & industrial	-	-	-	-	-	-	-
Other consumer	-	-	-	-	-	23,543	23,543
Overdrafts	<u>30,726</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>30,726</u>
	<u>\$ 30,726</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,543</u>	<u>\$ 54,269</u>

The following table provides a comprehensive view of the allowance for credit losses on loans activity including the periodic activity of charge-offs and recoveries allocated by loan class for the three-month periods ended September 30, 2023 and 2022.

Three Months Ended:	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Other Consumer & Overdrafts	Total
September 30, 2023							
Allowance for credit losses on loans:							
Beginning balance	\$ 12,022	\$ 383,462	\$ 2,555,017	\$ 1,212,050	\$ 413,206	\$ 813,632	\$ 5,389,389
Charge-offs	-	-	-	-	-	(4,483)	(4,483)
Recoveries	-	-	-	2,766	-	3,404	6,170
Provision for (recovery of) credit losses on loans	<u>48,795</u>	<u>53,879</u>	<u>41,373</u>	<u>(42,249)</u>	<u>30,634</u>	<u>47,568</u>	<u>180,000</u>
Ending balance	<u>\$ 60,817</u>	<u>\$ 437,341</u>	<u>\$ 2,596,390</u>	<u>\$ 1,172,567</u>	<u>\$ 443,840</u>	<u>\$ 860,121</u>	<u>\$ 5,571,076</u>

September 30, 2022							
Allowance for credit losses on loans:							
Beginning balance	\$ 5,740	\$ 430,587	\$ 3,079,907	\$ 939,974	\$ 373,211	\$ 161,820	\$ 4,991,239
Charge-offs	-	-	-	-	-	(34,859)	(34,859)
Recoveries	-	-	-	1,500	71,105	915	73,520
Provision for (recovery of) credit losses on loans	<u>(205)</u>	<u>56,808</u>	<u>(262,642)</u>	<u>1,484</u>	<u>(13,098)</u>	<u>67,653</u>	<u>(150,000)</u>
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 195,529</u>	<u>\$ 4,879,900</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans – continued

The following table provides a comprehensive view of the allowance for credit losses on loans activity including the periodic activity of charge-offs and recoveries allocated by loan class for the nine-month periods ended September 30, 2023 and 2022.

Nine Months Ended:	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Other Consumer & Overdrafts	Total
September 30, 2023							
Allowance for credit losses on loans:							
Beginning balance	\$ 13,670	\$ 446,024	\$ 2,550,667	\$ 986,573	\$ 452,861	\$ 245,973	\$ 4,695,768
Impact of ASC 326 adoption	(13,670)	(112,669)	97,825	219,576	(146,758)	162,017	206,321
Charge-offs	-	-	-	(766)	-	(20,353)	(21,119)
Recoveries	-	-	-	5,266	-	6,379	11,645
Provision for (recovery of) credit losses on loans	60,817	103,986	(52,102)	(38,082)	137,737	466,105	678,461
Ending balance	<u>\$ 60,817</u>	<u>\$ 437,341</u>	<u>\$ 2,596,390</u>	<u>\$ 1,172,567</u>	<u>\$ 443,840</u>	<u>\$ 860,121</u>	<u>\$ 5,571,076</u>
September 30, 2022							
Allowance for credit losses on loans:							
Beginning balance	\$ 46,680	\$ 292,339	\$ 3,355,417	\$ 883,184	\$ 334,073	\$ 168,450	\$ 5,080,143
Charge-offs	-	-	-	-	-	(54,269)	(54,269)
Recoveries	-	-	44,688	4,500	71,105	8,733	129,026
Provision for (recovery of) credit losses on loans	(41,145)	195,056	(582,840)	55,274	26,040	72,615	(275,000)
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 195,529</u>	<u>\$ 4,879,900</u>

The following table presents the allocation of allowance for credit losses on loans and the balances of loans by loan class for loans that were individually and collectively evaluated for impairment at September 30, 2023 and December 31, 2022.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Other Consumer & Overdrafts	Total
September 30, 2023							
Allowance balance allocated to loans:							
Individually evaluated	\$ -	\$ -	\$ 82,000	\$ -	\$ 1,430	\$ -	\$ 83,430
Collectively evaluated	60,817	437,341	2,514,390	1,172,567	442,410	860,121	5,487,646
	<u>\$ 60,817</u>	<u>\$ 437,341</u>	<u>\$ 2,596,390</u>	<u>\$ 1,172,567</u>	<u>\$ 443,840</u>	<u>\$ 860,121</u>	<u>\$ 5,571,076</u>
Loan balances:							
Individually evaluated	\$ -	\$ -	\$ 7,142,385	\$ 306,606	\$ 132,035	\$ 7,428	\$ 7,588,454
Collectively evaluated	31,364,629	31,364,629	256,550,722	130,489,506	41,086,342	32,321,944	491,813,143
	<u>\$ 31,364,629</u>	<u>\$ 31,364,629</u>	<u>\$ 263,693,107</u>	<u>\$ 130,796,112</u>	<u>\$ 41,218,377</u>	<u>\$ 32,329,372</u>	<u>\$ 499,401,597</u>
December 31, 2022							
Allowance balance allocated to loans:							
Individually evaluated	\$ -	\$ -	\$ 325,000	\$ -	\$ 2,131	\$ -	\$ 327,131
Collectively evaluated	13,670	446,024	2,225,667	986,573	450,730	245,973	4,368,637
	<u>\$ 13,670</u>	<u>\$ 446,024</u>	<u>\$ 2,550,667</u>	<u>\$ 986,573</u>	<u>\$ 452,861</u>	<u>\$ 245,973</u>	<u>\$ 4,695,768</u>
Loan balances:							
Individually evaluated	\$ -	\$ -	\$ 8,052,262	\$ 338,543	\$ 133,191	\$ 143,375	\$ 8,667,371
Collectively evaluated	21,239,232	21,239,232	227,937,972	126,438,734	28,831,641	15,881,687	420,329,266
	<u>\$ 21,239,232</u>	<u>\$ 21,239,232</u>	<u>\$ 235,990,234</u>	<u>\$ 126,777,277</u>	<u>\$ 28,964,832</u>	<u>\$ 16,025,062</u>	<u>\$ 428,996,637</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents the recorded investment and the unpaid principal balance of individually evaluated loans segmented by those with and without a related allowance recorded at September 30, 2023 and December 31, 2022. The average recorded investment and interest income recognized is presented for the time during which the loans were impaired within the nine- and 12-month periods then ended.

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2023					
With no related allowance recorded:					
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	3,751,802	3,228,098	-	3,323,355	44,118
Residential real estate	522,587	306,606	-	321,343	11,066
Commercial & industrial	-	-	-	-	-
Other consumer	46,538	7,428	-	11,519	-
With an allowance recorded:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	4,381,519	3,914,287	82,000	3,881,459	-
Residential real estate	-	-	-	-	-
Commercial & industrial	132,035	132,035	1,430	132,476	8,991
Other consumer	-	-	-	-	-
Total:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	8,133,321	7,142,385	82,000	7,204,814	44,118
Residential real estate	522,587	306,606	-	321,343	11,066
Commercial & industrial	132,035	132,035	1,430	132,476	8,991
Other consumer	46,538	7,428	-	11,519	-
	<u>\$ 8,834,481</u>	<u>\$ 7,588,454</u>	<u>\$ 83,430</u>	<u>\$ 7,670,152</u>	<u>\$ 64,175</u>
December 31, 2022					
With no related allowance recorded:					
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	4,770,052	4,372,212	-	5,151,701	66,883
Residential real estate	553,709	338,543	-	365,548	9,237
Commercial & industrial	-	-	-	-	-
Other consumer	179,687	143,375	-	151,322	2,672
With an allowance recorded:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	4,081,519	3,680,050	325,000	3,717,082	-
Residential real estate	-	-	-	-	-
Commercial & industrial	133,191	133,191	2,131	140,483	9,445
Other consumer	-	-	-	-	-
Total:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	8,851,571	8,052,262	325,000	8,868,783	66,883
Residential real estate	553,709	338,543	-	365,548	9,237
Commercial & industrial	133,191	133,191	2,131	140,483	9,445
Other consumer	179,687	143,375	-	151,322	2,672
	<u>\$ 9,718,158</u>	<u>\$ 8,667,371</u>	<u>\$ 327,131</u>	<u>\$ 9,526,136</u>	<u>\$ 88,237</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

From time to time, the Bank may modify certain loans to borrowers who are experiencing financial difficulty. In some cases, these modifications may result in new loans. Loan modifications to borrowers experiencing financial difficulty may be in the form of a principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay, or a term extension or a combination thereof, among other things.

During the three-month period ended September 30, 2023, there were no modifications of loans to borrowers who were experiencing financial difficulty. During the three-month period ended September 30, 2022, there were no modifications of loans to borrowers who were experiencing financial difficulty.

During the nine-month period ended September 30, 2023, the terms of one commercial real estate relationship with an initial balance of \$4,078,793 was modified to provide an extension of term and a blended weighted-average interest rate over the loan relationship to a borrower that was experiencing financial difficulty. During the nine-month period ended September 30, 2022, there were no modifications of loans to borrowers who were experiencing financial difficulty.

The period-end balance of loan modifications to borrowers experiencing financial difficulty at the time of the modification during the three- and nine-month periods ending September 30, 2023 and 2022 are set forth in the table below.

Three Months Ended:	Term	Payment	Interest Rate	Principal	Combination		% of Total
September 30, 2023	Extension	Delay	Reduction	Forgiveness	Thereof	Total	Class of Loans
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	0.00%

	Term	Payment	Interest Rate	Principal	Combination		% of Total
September 30, 2022	Extension	Delay	Reduction	Forgiveness	Thereof	Total	Class of Loans
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	0.00%

Nine Months Ended:	Term	Payment	Interest Rate	Principal	Combination		% of Total
September 30, 2023	Extension	Delay	Reduction	Forgiveness	Thereof	Total	Class of Loans
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ 4,029,651	\$ 4,029,651	1.58%

	Term	Payment	Interest Rate	Principal	Combination		% of Total
September 30, 2022	Extension	Delay	Reduction	Forgiveness	Thereof	Total	Class of Loans
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	0.00%

There were no loans that the Bank modified in the 12 months preceding the three-month period ended September 30, 2023 for which there was a payment default during the 12-month period ended September 30, 2023. There were no loans that the Bank modified in the 12 months preceding the three-month period ended September 30, 2022 for which there was a payment default during the 12-month period ended September 30, 2022. Payment default is defined as any time the loan was more than 60 days past due.

There were no loans that the Bank modified in the 12 months preceding the nine-month period ended September 30, 2023 for which there was a payment default during the 12-month period ended September 30, 2023. There were no loans that the Bank modified in the 12 months preceding the nine-month period ended September 30, 2022 for which there was a payment default during the 12-month period ended September 30, 2022. Payment default is defined as any time the loan was more than 60 days past due.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table summarizes non-accrual loans at September 30, 2023 and December 31, 2022 and the amount of gross interest income that would have been recorded during the three- and nine-month periods ended September 30, 2023 and 2022 had the non-accrual loans been current and performing according to terms.

	Non-accrual With No ACL Allocated	Non-accrual With ACL Allocated	Total Non-accrual	Loans Past Due Over 90 Days And Accruing	Total Non-performing Loans	ACL on Non-accrual Loans
September 30, 2023						
Commercial real estate	\$ 2,614,835	\$ 3,914,287	\$ 6,529,122	\$ -	\$ 6,529,122	\$ 82,000
Residential real estate	62,125	-	62,125	-	62,125	-
Other consumer	7,428	-	7,428	-	7,428	-
Commercial real estate	<u>\$ 2,684,388</u>	<u>\$ 3,914,287</u>	<u>\$ 6,598,675</u>	<u>\$ -</u>	<u>\$ 6,598,675</u>	<u>\$ 82,000</u>
	Non-accrual With No ACL Allocated	Non-accrual With ACL Allocated	Total Non-accrual	Loans Past Due Over 90 Days And Accruing	Total Non-performing Loans	ACL on Non-accrual Loans
December 31, 2022						
Commercial real estate	\$ 3,217,524	\$ 3,680,050	\$ 6,897,574	\$ -	\$ 6,897,574	\$ 325,000
Residential real estate	82,273	-	82,273	-	82,273	-
Other consumer	16,720	-	16,720	101,520	118,240	-
Commercial real estate	<u>\$ 3,316,517</u>	<u>\$ 3,680,050</u>	<u>\$ 6,996,567</u>	<u>\$ 101,520</u>	<u>\$ 7,098,087</u>	<u>\$ 325,000</u>
				For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023	
Interest not accrued on non-accrual loans			<u>\$ 144,166</u>	<u>\$ 141,259</u>	<u>\$ 217,882</u>	<u>\$ 329,604</u>

There were no consumer mortgage loans secured by residential real estate that were in the process of foreclosure as of September 30, 2023.

5. Credit Commitments

The table below shows outstanding loan commitments, unused lines of credit, and letters of credit.

At:	September 30, 2023	December 31, 2022
Commitments to extend credit		
Loan origination commitments	\$ 11,192,785	\$ 16,492,548
Unused consumer real estate construction	1,498,867	2,722,091
Unused home equity lines of credit	18,430,145	18,354,652
Unused overdraft lines of credit	7,156,538	6,873,321
Unused commercial lines of credit	<u>53,161,465</u>	<u>56,546,751</u>
	<u>\$ 91,439,800</u>	<u>\$ 100,989,363</u>
Letters of credit	<u>\$ 3,676,102</u>	<u>\$ 4,349,155</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have variable interest rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

5. Credit Commitments - continued

The Bank's exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans.

As part of implementing ASU 2016-13 on January 1, 2023, the Bank created an allowance for credit losses on off-balance sheet items related to these financial instruments with off-balance sheet risk, which is reported as a liability on the consolidated statements of condition. The liability excludes commitments for which the Bank can, at any time and for any reason cancel its commitment to lend as unconditionally cancellable commitments do not require an allowance. The allowance for credit losses on off-balance sheet items was \$341,155 as of September 30, 2023.

The following table presents activity in the allowance for credit losses on off-balance sheet items for the three- and nine-month periods ended September 30, 2023.

	For the Three Months Ended September 30, 2023	For the Nine Months Ended September 30, 2023
Beginning balance	\$ 567,805	\$ -
Impact of ASC 326 adoption	-	491,571
Provision for (recovery of) allowance for credit losses on off-balance sheet items	<u>(226,650)</u>	<u>(150,416)</u>
Ending balance	<u>\$ 341,155</u>	<u>\$ 341,155</u>

6. Related Party Transactions

In the normal course of business, the Bank's executive officers and directors and their related parties enter into loan transactions with the Bank. A summary of related party loan activity follows:

Year to Date Through:	September 30, 2023	December 31, 2022
Beginning balance	\$ 17,275,810	\$ 17,710,130
Advances	1,013,411	2,263,410
Change in related party	-	(289,558)
Payments	<u>(913,934)</u>	<u>(2,408,172)</u>
Ending balance	<u>\$ 17,375,287</u>	<u>\$ 17,275,810</u>

The change in related party was due to the resignation of a related party that occurred in June 2022.

In addition to the outstanding balances listed above, the Bank's executive officers and directors and their related parties had \$3,122,468 in unused loans committed but not funded as of September 30, 2023. As of December 31, 2022, the Bank's executive officers and directors and their related parties had \$3,498,889 in unused loans committed but not funded.

The Bank obtains goods and services from firms of which owners are also members of the Bank's Board of Directors. Amounts paid to these related parties totaled \$11,599 during the nine months ended September 30, 2023. Amounts paid to these related parties totaled \$10,534 during the nine months ended September 30, 2022.

The Bank has a wealth management referral relationship with the firm of a director. The Bank recognized \$9,460 of income from the referral relationship in the nine months ended September 30, 2023. The Bank recognized \$8,931 of income from the referral relationship in the nine months ended September 30, 2022.

Deposits of the Bank's executive officers and directors and their related parties totaled \$9,091,787 at September 30, 2023. Deposits of the Bank's executive officers and directors and their related parties totaled \$8,073,801 at December 31, 2022.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

7. Bank Premises and Equipment

Bank premises and equipment and the related depreciation are as follows:

	Useful Lives	September 30, 2023	December 31, 2022
Land		\$ 3,632,621	\$ 3,632,621
Building and improvements	15 - 39 years	8,721,830	8,714,774
Leasehold improvements	10 - 19 years	588,014	588,014
Furniture, fixtures, and equipment	3 - 10 years	2,723,599	2,675,554
		<u>15,666,064</u>	<u>15,610,963</u>
Accumulated depreciation		<u>6,151,485</u>	<u>5,793,664</u>
Net bank premises and equipment		<u>\$ 9,514,579</u>	<u>\$ 9,817,299</u>

	For the Three Months Ended September 30, 2023	2022	For the Nine Months Ended September 30, 2023	2022
Depreciation expense	<u>\$ 135,107</u>	<u>\$ 134,546</u>	<u>\$ 406,105</u>	<u>\$ 405,161</u>

Computer software included in other assets and the related amortization expense are as follows:

	Useful Life	September 30, 2023	December 31, 2022
Computer software	3 years	\$ 65,493	\$ 66,393
Accumulated amortization		<u>61,157</u>	<u>58,280</u>
Net computer software		<u>\$ 4,336</u>	<u>\$ 8,113</u>

	For the Three Months Ended September 30, 2023	2022	For the Nine Months Ended September 30, 2023	2022
Software amortization expense	<u>\$ 994</u>	<u>\$ 1,641</u>	<u>\$ 3,777</u>	<u>\$ 4,252</u>

8. Lease Commitments

The Bank leases certain banking facilities under operating leases expiring on various dates through 2026. At September 30, 2023, the Bank had lease liabilities totaling \$240,865 included in other liabilities and right-of-use lease assets totaling \$240,865 included in other assets related to these leases. At December 31, 2022, the Bank had lease liabilities totaling \$362,646 included in other liabilities and right-of-use lease assets totaling \$362,646 included in other assets related to these leases.

The weighted-average discount rate on operating lease balances outstanding at September 30, 2023 was 2.29%. The weighted-average remaining lease term of operating leases outstanding at September 30, 2023 was 1.9 years. The weighted-average discount rate on operating lease balances outstanding at December 31, 2022 was 2.13%. The weighted-average remaining lease term of operating leases outstanding at December 31, 2022 was 2.5 years.

Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for the three months ended September 30, 2023 was \$57,676. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for the three months ended September 30, 2022 was \$57,565. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for the nine months ended September 30, 2023 was \$166,695. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for the nine months ended September 30, 2022 was \$168,069.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

8. Lease Commitments - continued

As of September 30, 2023, future minimum payments, by year and in the aggregate, of operating leases are as follows:

Year	Amount
Remainder of 2023	\$ 43,240
2024	153,451
2025	47,339
2026	<u>27,614</u>
Total undiscounted lease payments	271,644
Discount on cash flows	<u>(30,779)</u>
Total lease liability	<u>\$ 240,865</u>

9. Borrowings and Available Lines of Credit

The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the lender. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans. The Bank is required to purchase shares of capital stock in the FHLBA as a condition to obtaining the line of credit. As of September 30, 2023, the Bank had \$43.0 million in adjustable rate advances with no fixed maturity outstanding under the line of credit at an interest rate of 5.57%. Based on the value of available collateral as of September 30, 2023, the Bank could borrow an additional \$66,572,084 from the FHLBA.

The Bank is eligible to borrow from the Federal Reserve Discount Window. This credit line is secured by the Bank's eligible consumer loan portfolio. Based on the value of available collateral as of September 30, 2023, the Bank could borrow \$12,216,166 from the Federal Reserve Discount Window.

In the first quarter of 2023, the Bank established a Bank Term Funding Program ("BTFP") liquidity facility with the Federal Reserve Bank of Richmond. This facility allows the Bank to pledge eligible investment securities to the facility and receive funding equal to 100% of the par value of the investments pledged. The BTFP offers a fixed rate for up to one year with borrowing rates set daily. The amount of funding available under the BTFP is dependent upon the aggregate par value of the investments pledged. As of September 30, 2023, the Bank had no investments pledged, and no borrowings outstanding under the BTFP facility.

The Certificate of Deposit Account Registry Service ("CDARS") is a form of brokered deposit program in which the Bank has been a participant since June 2005. In addition to offering depositors enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through their One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes this arrangement would be a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may obtain funds through the One-Way Buy program up to 10% of reported total assets as of September 30, 2023, or \$65,393,757.

The Bank has secured and unsecured credit lines with a correspondent bank, which are subject to periodic review. Based on the last review performed in the third quarter of 2022, the amount available under the secured line is \$5,000,000 and the amount available under the unsecured line is \$3,000,000.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

10. Retirement Plan

The Bank has a tax-qualified 401(k) and Profit Sharing Plan (the “401(k) Plan”) which is available to all employees who have reached the age of 20 and have completed at least three months of service as defined by the Plan. The Bank makes matching contributions of 100% on the first 3% of compensation deferred, plus 50% on the next 2% of compensation deferred. Participants are immediately vested in the matching contributions made by the Bank, and discretionary profit sharing contributions, if any, will vest ratably over a six-year period beginning in year two.

For the three months ended September 30, 2023, the Bank recognized \$64,910 of expense associated with the 401(k) Plan. For the three months ended September 30, 2022, the Bank recognized \$60,132 of expense associated with the 401(k) Plan. For the nine months ended September 30, 2023, the Bank recognized \$197,237 of expense associated with the 401(k) Plan. For the nine months ended September 30, 2022, the Bank recognized \$185,349 of expense associated with the 401(k) Plan.

In 2006 and in 2017, the Bank entered into agreements under its Supplemental Executive Retirement Plans (“SERP”) with certain executive officers to provide for retirement income benefits. The Bank accrues the present value of these benefits over the remaining number of years to the executives' retirement dates. The Bank has recorded a liability of \$1,144,004 and \$1,174,379 related to these benefits at September 30, 2023 and December 31, 2022, respectively. SERP expense for the three months ended September 30, 2023 was \$10,221. SERP expense for the three months ended September 30, 2022 was \$25,704. SERP expense for the nine months ended September 30, 2023 was \$30,663. SERP expense for the nine months ended September 30, 2022 was \$77,112.

11. Interest-Bearing Deposits

Major classifications of interest-bearing deposits at:	September 30, 2023	December 31, 2022
Interest-bearing checking and Money Market	\$ 219,803,129	\$ 238,897,337
Savings	57,154,844	68,631,963
Certificates of deposit	118,163,778	79,443,708
	<u>\$ 395,121,751</u>	<u>\$ 386,973,008</u>

Maturities of certificates of deposit at:	September 30, 2023	December 31, 2022
Maturing within twelve months	\$ 93,367,996	\$ 48,010,291
Maturing over one to three years	20,912,224	26,309,100
Maturing over three to five years	3,883,558	5,124,317
	<u>\$ 118,163,778</u>	<u>\$ 79,443,708</u>

Certificates of deposit over \$250,000 included above:	<u>\$ 36,452,685</u>	<u>\$ 21,151,168</u>
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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Interest expense:	2023	2022	2023	2022
Interest-bearing checking and Money Market	\$ 456,636	\$ 63,248	\$ 817,277	\$ 168,539
Savings	33,423	23,444	106,121	67,715
Certificates of deposit	834,277	155,217	1,650,543	572,351
	<u>\$ 1,324,336</u>	<u>\$ 241,909</u>	<u>\$ 2,573,941</u>	<u>\$ 808,605</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

12. Income Taxes

The components of income tax expense are as follows:

Income tax expense:	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2023	2022	2023	2022
Federal	\$ 376,895	\$ 362,637	\$ 1,102,963	\$ 854,638
State	<u>123,055</u>	<u>95,892</u>	<u>361,748</u>	<u>251,044</u>
	<u>\$ 499,950</u>	<u>\$ 458,529</u>	<u>\$ 1,464,711</u>	<u>\$ 1,105,682</u>

The differences between the statutory federal income tax rate in effect during the periods indicated and the effective tax rate for the Bank are reconciled as follows:

Year to date through:	September 30, 2023	September 30, 2022
Statutory federal income tax rate	21.00 %	21.00 %
Increase (decrease) resulting from		
State income taxes, net of federal income tax benefit	4.92	4.37
Tax-exempt income	(0.91)	(1.24)
Nondeductible expenses	<u>0.21</u>	<u>0.23</u>
	<u>25.22 %</u>	<u>24.36 %</u>

13. Stock Option and Stock Purchase Plans

The Bank has adopted stock option plans for directors and officers. Option exercise prices are equal to the fair market value of the stock on the date of grant. Options granted under the director plan fully vest at the time of grant. Options granted under the officer plan vest three years after their grant dates. On April 23, 2018, the officer plan expired, eliminating the Bank's ability to make future grants, although options granted remain outstanding and subject to exercise through April 2028.

The total number of shares originally authorized for active stock option plans and plans with outstanding options was 249,890. At September 30, 2023, a total of 18,702 shares remain available for grant under the director plan.

A summary of activity for stock option activity for the nine months ended September 30, 2023 is as follows:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2023	60,449	\$ 26.06		
Options granted	9,300	\$ 32.90		
Options exercised	(1,744)	\$ 16.20		
Options forfeited or expired	<u>(586)</u>	<u>\$ 14.45</u>		
Outstanding at September 30, 2023	<u>67,419</u>	<u>\$ 27.36</u>	<u>5.83</u>	<u>\$ 373,501</u>
Exercisable at September 30, 2023	<u>67,419</u>	<u>\$ 27.36</u>	<u>5.83</u>	<u>\$ 373,501</u>

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The service period generally matches the vesting period.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

13. Stock Option and Stock Purchase Plans - continued

For the three months ended September 30, 2023, the Bank recorded stock-based compensation expense of \$59,557. For the three months ended September 30, 2022, the Bank recorded stock-based compensation expense of \$55,659. For the nine months ended September 30, 2023, the Bank recorded stock-based compensation expense of \$59,557. For the nine months ended September 30, 2022, the Bank recorded stock-based compensation expense of \$55,659.

The intrinsic value of options exercised during the nine months ended September 30, 2023 was \$27,502. The intrinsic value of options exercised during the nine months ended September 30, 2022 was \$159,804.

At the annual meeting of stockholders held on May 20, 2020, the Bank's stockholders approved the Harford Bank 2020 Employee Stock Purchase Plan (the "2020 ESPP") that allows eligible employees to acquire up to 100,000 shares of the Bank's common stock at a discount through accumulated payroll deductions.

Based on employee withholdings during the nine months ended September 30, 2023, a total of 1,676 shares were granted under the 2020 ESPP at a weighted-average purchase price of \$31.01. At September 30, 2023, a total of 92,903 shares remain available for grant under the 2020 ESPP.

14. Capital Standards

The Board of Governors of the Federal Reserve System (the "FRB") and the FDIC have adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions.

In July 2013, the FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and fully phased-in as of January 1, 2019, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new minimum Common Equity Tier 1 capital ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which are now fully phased-in, effectively resulting in a minimum CET1 ratio of 7.0%. Basel III raised the minimum Tier 1 capital ratio from 4.0% to 6.0% which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%. Basel III maintained the minimum Total capital ratio of 8.0%, which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Total capital ratio of 10.5%. Basel III maintains the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall and the institution's "eligible retained income" (that is, four quarter trailing net income, net of distributions and tax effects not reflected in net income).

Under Basel III, Total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of Common equity Tier 1 capital and additional Tier 1 capital. For the Bank, Common equity Tier 1 capital consists of common stock, surplus and undivided profits. The Bank has no additional Tier 1 capital items. The Bank's Tier 2 capital consists of a limited amount of the allowance for credit losses on loans and the allowance for credit losses on off-balance sheet items. The Bank's Total capital is the sum of Tier 1 capital plus Tier 2 capital.

The Total capital ratio, the Tier 1 capital ratio and the Common equity Tier 1 capital ratio are calculated using end of period risk-weighted assets. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items based on regulatory requirements. The Tier 1 leverage capital ratio is calculated using quarterly average assets.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

14. Capital Standards - continued

On September 17, 2019 the FDIC finalized a rule that introduced an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio framework, “CBLR framework”), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. To qualify for the CBLR framework, a community banking organization must have a Tier 1 leverage ratio of at least 9 percent, less than \$10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The Bank has elected not to opt into the CBLR framework at this time.

The federal banking agencies have provided community banking organizations the option to phase in the impact on regulatory capital of the adoption of ASU 2016-13, which was effective for the Bank on January 1, 2023. The Bank did not select the option to phase in the impact of ASU 2016-13 on regulatory capital.

The Bank’s actual capital ratios, the required regulatory capital ratios to be considered well capitalized, the regulatory minimum capital ratios, and the regulatory minimum capital ratios with the 2.5% capital conservation buffer added based on the Basel III Capital Rules are as follows for the periods indicated:

(\$ in thousands)	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
September 30, 2023	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 63,052	12.83%	\$ 49,158	10.00%	\$ 39,326	8.00%	\$ 51,616	10.50%
Tier 1 capital	57,140	11.62%	39,326	8.00%	29,495	6.00%	41,784	8.50%
Common equity Tier 1 capital	57,140	11.62%	31,953	6.50%	22,121	4.50%	34,411	7.00%
Tier 1 leverage capital	57,140	8.87%	32,208	5.00%	25,766	4.00%	25,766	4.00%

December 31, 2022	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 58,743	13.79%	\$ 42,612	10.000%	\$ 34,089	8.00%	\$ 44,742	10.50%
Tier 1 capital	54,047	12.68%	34,089	8.000%	25,567	6.00%	36,220	8.50%
Common equity Tier 1 capital	54,047	12.68%	27,697	6.500%	19,175	4.50%	29,828	7.00%
Tier 1 leverage capital	54,047	8.78%	30,762	5.000%	24,610	4.00%	24,610	4.00%

As of September 30, 2023, capital levels at the Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Based on the ratios presented above, capital levels of the Bank exceed the minimum levels necessary to be considered well capitalized.

Failure to meet the capital requirements could affect the Bank’s ability to pay dividends and accept deposits and may significantly affect the operations of the Bank.

In its most recent regulatory report, the Bank was categorized as well capitalized under the prompt corrective action regulations. Management knows of no events or conditions that should change this classification.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

15. Net Income per Common Share

The calculations of basic and diluted net income per common share are presented in the following table.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2023	2022	2023	2022
Basic:				
Net income	\$1,475,600	\$1,431,327	\$4,343,208	\$3,433,215
Weighted-average common shares outstanding	<u>1,476,346</u>	<u>1,463,277</u>	<u>1,474,291</u>	<u>1,458,405</u>
Basic net income per common share	<u>\$ 1.00</u>	<u>\$ 0.98</u>	<u>\$ 2.95</u>	<u>\$ 2.35</u>
Diluted:				
Net income	\$1,475,600	\$1,431,327	\$4,343,208	\$3,433,215
Weighted-average common shares outstanding	1,476,346	1,463,277	1,474,291	1,458,405
Dilutive common stock equivalents	<u>13,933</u>	<u>10,197</u>	<u>13,554</u>	<u>9,198</u>
Dilutive shares	<u>1,490,279</u>	<u>1,473,474</u>	<u>1,487,845</u>	<u>1,467,603</u>
Diluted net income per common share	<u>\$ 0.99</u>	<u>\$ 0.97</u>	<u>\$ 2.92</u>	<u>\$ 2.34</u>
Anti-dilutive shares	<u>-</u>	<u>-</u>	<u>9,300</u>	<u>8,360</u>

16. Fair Value Measurements

ASC Topic 820 defines fair value as the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date under current market conditions (an exit price) and establishes a framework for measuring fair value and expands disclosures about fair value. ASC Topic 820 also establishes a hierarchy for determining fair value measurement. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities.

The fair value hierarchy is as follows:

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

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

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements – continued

During the nine- and 12-month periods ended September 30, 2023 and December 31, 2022, respectively, the Bank did not measure any assets or liabilities at fair value on a recurring basis. The following table presents individually evaluated loans measured at fair value on a nonrecurring basis where the outstanding investment in the loan exceeded fair value resulting in an allowance being allocated to the loan.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
September 30, 2023				
Individually evaluated loans (net of impairment)	\$ -	\$ -	\$ 3,947,651	\$ 3,947,651
December 31, 2022				
Individually evaluated loans (net of impairment)	\$ -	\$ -	\$ 3,944,669	\$ 3,944,669

The Bank does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is individually evaluated and a specific allowance for credit loss on loans is established. The Bank measures impairment either based on the fair value of the collateral if the loan is collateral dependent or uses the present value of expected future cash flows discounted at the loan's effective interest rate, which is not a fair value measurement. The Bank maintains a valuation allowance to the extent that this measure of the individually evaluated loan is less than the recorded investment in the loan. When an individually evaluated loan is measured at fair value based solely on observable market prices or a current appraisal without further adjustment for unobservable inputs, the Bank records the individually evaluated loan as a nonrecurring fair value measurement classified as Level 2. However, if based on management's review, additional discounts to observed market prices or appraisals are required or if observable inputs are not available, the Bank records the individually evaluated loan as a nonrecurring fair value measurement classified as Level 3. Individually evaluated loans that are measured based on expected future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, are not recorded at fair value and are therefore excluded from fair value disclosure requirements.

The following table present qualitative information about Level 3 fair value measurements for individually evaluated loans at September 30, 2023 and December 31, 2022:

	Fair Value Estimate	Valuation Techniques	Unobservable Inputs	Discount
September 30, 2023				
Individually evaluated loans (net of impairment)	<u>\$ 3,947,651</u>	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	2%
December 31, 2022				
Individually evaluated loans (net of impairment)	<u>\$ 3,944,669</u>	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	10%

(1) Fair value is generally determined through independent appraisal of the underlying collateral, which generally includes various level 3 inputs which are not observable.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

In estimating fair values, the Bank utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. Also, the calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2023					
Financial assets:					
Cash and cash equivalents	\$ 23,743,615	\$ 23,743,615	\$ 23,743,615	\$ -	\$ -
Time deposits in other banks	2,267,991	2,196,250	-	2,196,250	-
Investment securities held to maturity					
U.S. Treasury securities	20,356,715	19,278,233	19,278,233	-	-
U.S. government agencies	34,663,482	31,142,592	-	31,142,592	-
Agency RMBS	36,768,029	31,470,172	-	31,470,172	-
Agency CMBS	4,212,990	3,907,437	-	3,907,437	-
Agency CMO securities	1,196,294	938,207	-	938,207	-
SBA asset-backed securities	10,478,301	9,051,483	-	9,051,483	-
State and municipal securities	3,559,339	2,772,458	-	2,772,458	-
Loans, net	493,604,437	456,841,339	-	-	456,841,339
Accrued interest receivable	1,668,352	1,668,352	-	1,668,352	-
Bank owned life insurance	6,508,158	6,508,158	-	6,508,158	-
Financial liabilities:					
Noninterest-bearing deposits	155,441,621	155,441,621	-	155,441,621	-
Interest-bearing deposits	395,121,751	393,286,411	-	-	393,286,411
FHLB overnight borrowings	43,000,000	43,000,000	-	43,000,000	-
Accrued interest payable	574,810	574,810	-	574,810	-
December 31, 2022					
Financial assets:					
Cash and cash equivalents	\$ 28,444,396	\$ 28,444,396	\$ 28,444,396	\$ -	\$ -
Time deposits in other banks	2,545,624	2,413,203	-	2,413,203	-
Investment securities held to maturity					
U.S. Treasury securities	20,897,234	19,540,470	19,540,470	-	-
U.S. government agencies	36,774,973	33,207,754	-	33,207,754	-
Agency RMBS	41,318,236	36,862,721	-	36,862,721	-
Agency CMBS	4,243,971	4,031,386	-	4,031,386	-
Agency CMO securities	1,294,386	1,039,577	-	1,039,577	-
SBA asset-backed securities	11,991,588	10,694,510	-	10,694,510	-
State and municipal securities	3,570,542	2,876,295	-	2,876,295	-
Loans, net	423,920,559	411,318,395	-	-	411,318,395
Accrued interest receivable	1,418,195	1,418,195	-	1,418,195	-
Bank owned life insurance	6,406,523	6,406,523	-	6,406,523	-
Financial liabilities:					
Noninterest-bearing deposits	151,548,167	151,548,167	-	151,548,167	-
Interest-bearing deposits	386,973,008	384,426,824	-	-	384,426,824
Accrued interest payable	88,851	88,851	-	88,851	-

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

17. Legal Proceedings

The Bank is at times, in the ordinary course of business, subject to other legal actions that are normally associated with a financial institution. In management's opinion, the effect of these other actions will not be material to the financial condition or results of operations of the Bank.

18. Accounting Standard Updates

ASU 2016-13, *"Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments."* ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The standard became effective for the Bank on January 1, 2023. Upon adoption, transition adjustments were made to record an increase in the reported amount of the allowance for credit losses on loans, recognize a liability for credit losses on off-balance sheet items, and reduce total stockholders' equity of the Bank. Subsequent to adoption, the Bank will record adjustments to its allowance(s) for credit losses on loans and allowance for credit losses on off-balance sheet items through the provisions for credit losses in the consolidated statements of income. The Bank is utilizing a third-party model to tabulate its estimate of current expected credit losses, using a discounted cashflow methodology. In accordance with ASC 326, the Bank has segmented its loan portfolio based on similar risk characteristics which included collateral type. The Bank primarily utilizes national and local economic and unemployment data for its reasonable and supportable forecasting of current expected credit losses. To further adjust the allowance for credit losses for expected losses not already included within the quantitative component of the calculation, the Bank may consider qualitative adjustment factors, the most significant of which include: changes in regional and local conditions; changes in the value of underlying collateral for collateral dependent loans; changes in the volume and severity of past due loans; and the effect of other external factors. The Bank's CECL implementation process was overseen by the President, Chief Financial Officer, Controller, Senior Credit Officer, Chief Administrative Officer, Enterprise Risk Management Officer, Asset Liability Committee and Audit Committee, and included an assessment of data availability and gap analysis, data collection, consideration and analysis of multiple loss estimation methodologies, an assessment of relevant qualitative factors and correlation analysis of multiple potential loss drivers and their impact on the Bank's historical loss experience. The cumulative effect of the transition adjustments made on loans and off-balance sheet items reduced undivided profits by \$523,419 net of tax. Pre-tax impact consisted of an increase of \$206,321 to the allowance for credit losses on loans and an increase of \$491,571 on the allowance for credit losses on off-balance sheet items before deferred income tax effects of \$174,473. No adjustment was required for the held-to-maturity investment portfolio.

ASU 2022-02, *"Financial Instruments-Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures."* ASU 2022-02 addresses areas identified by the FASB as part of its post-implementation review of the credit losses standard (ASU 2016-13) that introduced the CECL model. The amendments eliminate the accounting guidance for troubled debt restructurings by creditors that have adopted the CECL model and enhance the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. In addition, the amendments require a public business entity to disclose current-period gross write-offs for financing receivables and net investment in leases by year of origination in the vintage disclosures. The amendments in this ASU should be applied prospectively, except for the transition method related to the recognition and measurement of TDRs, an entity has the option to apply a modified retrospective transition method, resulting in a cumulative-effect adjustment to retained earnings in the period of adoption. For entities that have adopted ASU 2016-13, ASU 2022-02 is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For entities that have not yet adopted ASU 2016-13, the effective dates for ASU 2022-02 are the same as the effective dates in ASU 2016-13. Early adoption is permitted if an entity has adopted ASU 2016-13. An entity may elect to early adopt the amendments about TDRs and related disclosure enhancements separately from the amendments related to vintage disclosures. The adoption of ASU 2022-02 on January 1, 2023 did not have a material impact on the Bank's financial statements.

CERTIFICATIONS OF THE PRINCIPAL EXECUTIVE OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Michael F. Allen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harford Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2023

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

CERTIFICATIONS OF THE PRINCIPAL FINANCIAL OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Neil L. Christ, CPA, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harford Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2023

/s/ Neil L. Christ, CPA

Neil L. Christ, CPA

Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION OF THE PERIODIC REPORT
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, each of the undersigned hereby certifies that (i) the Quarterly Report of Harford Bank on Form 10-Q for the quarter ended September 30, 2023, filed with the Federal Deposit Insurance Corporation (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Harford Bank.

Date: November 8, 2023

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: November 8, 2023

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)