

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

FORM 10-K

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

For the fiscal year ended December 31, 2022

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

For the transition period from _____ to _____.

FDIC file number 19101

HARFORD BANK
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

52-0799113
(I.R.S. Employer Identification No.)

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

21001
(Zip Code)

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

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$10.00 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

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 period 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 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 ☐

Non-accelerated filer ☒

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 has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to § 240.10D-1(b). ☐

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$41,624,419.

The number of shares outstanding of the registrant's common stock as of February 28, 2023 was 1,472,190.

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2023 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

HARFORD BANK

**FORM 10-K
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SIGNATURES

As used in this Annual Report of Harford Bank on Form 10-K for the year ended December 31, 2022, the terms “the Bank”, “we”, “us” and “our” refer to Harford Bank and, unless the context clearly requires otherwise, its consolidated subsidiary, HB Trust.

This annual report contains 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 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, including those impacted and/or driven by current and/or future pandemics; 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. Forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, the Bank undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, the Bank cannot assess the impact of each factor on the Bank’s business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

You should also consider carefully the Risk Factors contained in Item 1A of Part I of this annual report, which address additional factors that could cause the Bank’s actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect the Bank’s business, operating results and financial condition. The risks discussed in this annual report are factors that, individually or in the aggregate, management believes could cause the Bank’s actual results to differ materially from expected and historical results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider such disclosures to be a complete discussion of all potential risks or uncertainties.

PART I

Item 1. BUSINESS.

General

The Bank was chartered as a national banking association on April 27, 1964 under the name of Aberdeen National Bank. On December 8, 1980, desiring to expand into other municipalities in Harford County, Maryland, Aberdeen National Bank legally changed its name to Harford National Bank. On July 2, 2001, Harford National Bank converted to a Maryland-chartered bank and changed its name to Harford Bank. The Bank operates eight banking offices in Harford County, Maryland, and two banking offices in Cecil County, Maryland, with the Bank’s main office located in Aberdeen, Maryland. The Bank opened the Southfield banking office in Cecil County in the first quarter of 2020. The Bank opened a non-banking office in the second quarter of 2021, and a banking office in Jarrettsville, Harford County in the fourth quarter of 2021. The Bank is engaged in a general commercial and retail banking business serving individuals, businesses, and governmental units in Harford County, Maryland and neighboring counties. The Bank has one subsidiary, HB Trust, which is a Maryland statutory trust formed for the purposes of servicing and disposing of the real estate that the Bank acquires through foreclosure or by deed in lieu of foreclosure.

Information about the Bank’s revenues, net income and assets derived from its operations for the years ended December 31, 2022 and 2021 may be found in the audited consolidated financial statements and notes thereto, which are contained in Item 8 of Part II of this annual report.

Location and Market Area

The Bank conducts general commercial banking in its primary service areas, emphasizing the banking needs of individuals and small to medium sized businesses and professional concerns. The Bank operates from eight branches located throughout Harford County, Maryland and two branch offices in Cecil County, Maryland. The Bank draws most of its customer deposits and conducts most of its lending transactions from within its primary service area.

Harford County, Maryland has experienced moderate growth during the last several years and is located in northeastern Maryland between Baltimore and Delaware just off the I-95 corridor. Harford County is noted for its inland waterways that allow access to the Chesapeake Bay. Aberdeen Proving Ground, Higher Education and Technology Center, Ripken Stadium, and the Havre de Grace Decoy Museum are all located in Harford County.

The primary growth corridor of Harford County is located in and around Bel Air, Maryland, where the Bank has three branches.

Deposit and Related Services

The Bank offers deposit services to consumers and commercial entities customary for a state-chartered community bank, including checking accounts, savings accounts, money market accounts, and time deposits consisting of certificates of deposit of various types. The transaction accounts and certificates of deposit are tailored to the Bank's principal market areas at rates competitive to those offered in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts ("IRAs"). All deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") up to the maximum allowed by law. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities.

Other banking services include, but are not limited to, mobile banking, drive-through banking services, automated teller machine ("ATM") services, on-line banking with bill payment, cash management services, commercial account remote deposit capture, safe deposit boxes, direct deposit of payroll and social security checks, and ACH origination. The Bank is associated with the STAR and Money Pass networks of ATMs that may be used by Bank customers throughout Maryland and other regions. The Bank also offers a Visa check (debit) card, Visa gift cards, and Visa credit cards issued through a third-party provider.

Lending Activities

The Bank also offers a full range of commercial and consumer loans. Commercial loans include secured and unsecured loans for working capital, business expansion (including acquisition and real estate improvements), purchase of equipment and machinery, as well as commercial mortgages secured by real estate, real estate construction loans and real estate acquisition loans. It is typical for commercial loans to be secured by real estate, accounts receivable, inventory, equipment or other assets of the business. Commercial loans generally involve a greater degree of credit risk than one-to-four family residential consumer mortgage loans. Repayment is often dependent on the successful operation of the business and may be affected by adverse conditions in the local economy or real estate market. The financial condition and cash flow of commercial borrowers is therefore carefully analyzed during the loan approval process, and continues to be monitored by obtaining business financial statements, personal financial statements and income tax returns. Personal guarantees of the borrowers are generally required. The frequency of this ongoing analysis depends upon the size and complexity of the credit and collateral that secures the loan.

Consumer loans include secured and unsecured loans for financing automobiles, boats, mobile homes, education, bill consolidation and home improvements. The Bank also originates secured fixed-rate consumer mortgage loans, variable rate home equity lines of credit and fixed rate home equity loans, as well as real estate construction loans and real estate acquisition loans. These lending activities are subject to a variety of lending limits imposed on state-chartered banks. Careful analysis of an applicant's creditworthiness is performed before granting credit, and on-going monitoring of loans outstanding is performed in an effort to minimize risk of loss by identifying problem loans early. The risk of loss associated with real estate construction lending is controlled through conservative underwriting policies and procedures such as loan-to-value ratios of 80% or less, obtaining additional collateral when prudent, and closely monitoring construction projects to control disbursement of funds on loans. The Bank's underwriting standards for residential mortgage loans recommend loan to value ratios not to exceed 80%, without private mortgage insurance, based on appraisals performed by approved independent appraisers of the Bank. Title insurance protecting the Bank's lien priority, as well as fire and casualty insurance, for all mortgage loans is generally required. Repayment of these loans is dependent on the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy.

Seasonality

Management does not believe that the business activities of the Bank are seasonal in nature.

Employees

At December 31, 2022, the Bank had 89 full- and part-time employees, which equated to 87 full-time equivalent employees.

COMPETITION

The banking business, in all of its phases, is highly competitive. Within its market area, the Bank competes with commercial banks (including local banks and branches or affiliates of other larger banks), savings institutions and credit unions for loans and deposits, with consumer finance companies for loans, and with other financial institutions for various types of financial products and services. There is also competition for commercial and retail banking business from banks and financial institutions located outside the Bank's market area. The competition for deposits depends primarily on interest rates, personalized services, the quality and range of financial services, convenience of office locations and office hours. Factors that impact competition for loans include the general availability of lendable funds and credit, the number and amount of associated fees and charges, general and local economic conditions, current interest rates, and other factors, which are not readily predictable. Additionally, many of the financial

institutions operating in the Bank's market area may offer certain services, such as investment brokerage, that the Bank does not offer and have greater financial resources or have substantially higher lending limits than does the Bank.

To compete with other financial services providers, the Bank relies principally upon local promotional activities, personal relationships established by officers, directors and employees with its customers and specialized services tailored to meet its customers' needs.

For further information about competition in our market areas, see the Risk Factor entitled "*The Bank Operates in a Competitive Market*" in Item 1A of Part I of this annual report.

SUPERVISION AND REGULATION

The following is a summary of the material regulations and policies applicable to the Bank and is not intended to be a comprehensive discussion. Changes in applicable laws and regulations may have a material effect on the business of the Bank.

Banking Regulation

The Bank is a Maryland-chartered commercial bank with the FDIC as its primary federal regulator. The Bank is subject to the banking laws of Maryland and to regulation by the Office of the Maryland Commissioner of Financial Regulation (the "Maryland Commissioner"), who is required by statute to make at least one examination in each calendar year (or at 18-month intervals if the Maryland Commissioner determines that an examination is unnecessary in a particular calendar year). In addition, the Bank is subject to supervision and examination by the FDIC and to the federal laws and regulations that the FDIC is tasked with enforcing, such as the Federal Deposit Insurance Act (the "FDI Act"). Further, there are a myriad of other federal and state laws and regulations that affect and govern the business of banking, including consumer lending and deposit-taking. The Maryland Commissioner and the FDIC have extensive enforcement authority over the institutions they regulate to prohibit or correct activities that violate law, regulations or written agreements with the regulator, or which are deemed to constitute unsafe or unsound practices. Enforcement actions may include the appointment of a conservator or receiver, the issuance of a cease and desist order, the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution-affiliated parties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the removal of, or restrictions on directors, officers, employees and institution-affiliated parties, and the enforcement of any such mechanisms through restraining orders or other court actions.

Loan operations are subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers, the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves, the Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit, the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit report agencies, and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The operations of the Bank are also subject to the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records, and the Electronic Funds Transfer Act and Regulation E of the Board of Governors of the Federal Reserve System (the "FRB") that implements that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services. Additionally, the Bank is subject to certain restrictions on extensions of credit to executive officers, directors, and principal stockholders or any related interest of such persons. These restrictions generally require that such credit extensions be made on substantially the same terms as are available to third parties dealing with the Banks and not involve more than the normal risk of repayment. Other laws tie the maximum amount that may be loaned to any one customer and its related interests to the Bank's capital levels.

The Community Reinvestment Act ("CRA") requires the FDIC, in connection with the examination of financial institutions within its jurisdictions, to evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those banks. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank has a CRA rating of "Satisfactory."

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), each federal banking agency is required to prescribe, by regulation, non-capital safety and soundness standards for institutions under its authority. The standards adopted by federal regulators under this law include standards for internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. An institution that fails to meet those standards may be required by the agency to develop a plan acceptable to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. Management believes that the Bank meets substantially all applicable standards. FDICIA also imposes capital standards on insured depository institutions, which are described below under the caption "Capital Requirements."

The Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which was enacted in July 2010, significantly restructured the financial regulatory regime in the United States. The Dodd-Frank Act established the Consumer Financial Protection Bureau (the “CFPB”), and contains a wide variety of provisions affecting the regulation of depository institutions, including fair lending, fair debt collection practices, mortgage loan origination and servicing obligations, bankruptcy, military service member protections, use of credit reports, privacy matters, and disclosure of credit terms and correction of billing errors. In addition, the Dodd-Frank Act permits states to adopt stricter consumer protection laws and each state attorney general may enforce consumer protection rules issued by the CFPB. Since the enactment of the Dodd-Frank Act, the CFPB, and to some extent, some state attorney generals, have used provisions of the Dodd-Frank Act to bring enforcement actions seeking to curb “unfair, deceptive or abusive acts or practices” (“UDAAP”) in the financial services sector. With a change of leadership at the CFPB, and continued enforcement and regulatory actions at the state level, enforcement and regulatory priorities could change, resulting in increased regulatory compliance burdens and costs and restrictions on the financial products and services that we offer to our customers in the future.

Deposit Insurance

The Bank is a member of the FDIC and pays an insurance premium to the FDIC based upon its average total assets minus average tangible equity on a quarterly basis. Deposits are insured by the FDIC through the Deposit Insurance Fund (the “DIF”) and such insurance is backed by the full faith and credit of the United States Government. Under the Dodd-Frank Act, a permanent increase in deposit insurance to \$250,000 was authorized. The coverage limit is per depositor, per insured depository institution for each account ownership category.

The Federal Deposit Insurance Reform Act of 2005, which created the DIF, gave the FDIC greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments. The FDIC has the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment, if certain conditions are met.

The Dodd-Frank Act also set a new minimum DIF reserve ratio at 1.35% of estimated insured deposits. The FDIC was required to attain this ratio by September 30, 2020. The Dodd-Frank Act required the FDIC to redefine the deposit insurance assessment base for an insured depository institution. As redefined pursuant to the Dodd-Frank Act, an institution’s assessment base is now an amount equal to the institution’s average consolidated total assets during the assessment period minus average tangible equity. Institutions with less than \$1.0 billion in assets at the end of a fiscal quarter, like the Bank, are permitted to report their average consolidated total assets on a weekly basis (rather than on a daily basis) and to report their average tangible equity on an end-of-quarter balance (rather than on an end-of-month balance). Beginning in the third quarter of 2016, the range of initial assessment ranges for all institutions was adjusted downward such that the initial base deposit insurance assessment rate ranges from 3 to 30 basis points on an annualized basis. After the effect of potential base-rate adjustments, the total base assessment rate could range from 1.5 to 40 basis points on an annualized basis. The rule imposed a surcharge on the assessments of depository institutions with \$10 billion or more in assets, beginning with the third quarter of 2016 and continuing through the earlier of the quarter that the reserve ratio first reaches or exceeds 1.35% and December 31, 2018. These surcharges ended in 2019. With the Bank’s assets well below the \$10 billion threshold, the surcharges on larger banks resulted in decreased costs for the Bank in 2020. Small banks were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15% to 1.35% to be applied when the reserve ratio is at least 1.35%. The FDIC began applying the small bank credits with the Bank’s September 30, 2019 deposit insurance assessment invoice, and the Bank received the final credit on the June 30, 2020 deposit insurance assessment.

The Bank expensed \$299,404 and \$198,932 in FDIC deposit insurance premiums in 2022 and 2021, respectively.

The FDIC is authorized to conduct examinations of and require reporting by FDIC-insured institutions. It is also authorized to terminate a depository bank’s deposit insurance upon a finding by the FDIC that the bank’s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the bank’s regulatory agency. The termination of deposit insurance would have a material adverse effect on the Bank’s earnings, operations and financial condition.

Capital Requirements

Federal and state banking laws require the Bank to meet certain minimum capital stock and surplus requirements before establishing a new branch. With each new branch located outside the municipal area of the Bank’s principal banking office, these minimal levels are subject to upward adjustment based on the population size of the municipal area in which the branch will be located. Prior to establishment of the branch, the Bank must obtain approvals from the Maryland Commissioner and the FDIC. If establishment of the branch involves the purchase of a bank building or furnishings, then the total investment in bank buildings and furnishings cannot exceed, with certain exceptions, 50% of the Bank’s unimpaired capital and surplus.

The Bank is subject to other regulatory capital requirements administered by the FDIC. Capital guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the requirements, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution's capital, in turn, is classified in one of two tiers, depending on type:

- Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in equity accounts of consolidated subsidiaries (and, under existing standards, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level), less goodwill, most intangible assets and certain other assets.
- Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for loan and lease losses, subject to limitations.

The Basel Committee on Banking Supervision (the "Basel Committee") is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply. In 2013, the FRB and the FDIC approved amendments to the regulatory risk-based capital rules that were intended to implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. Basel III refers to two consultative documents released by the Basel Committee in December 2009 and the federal banking authorities' related proposals in December 2010 and January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

Some of the most significant aspects of the amended rules are as follows:

- Banks must meet certain risk-based capital and leverage ratios under a revised definition of what constitutes "capital" for purposes of calculating those ratios. The minimum capital level requirements applicable to the Bank are: (i) a common equity Tier 1 capital ("CET1") ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4% for all institutions.
- Banks must maintain a "capital conservation buffer" above the revised regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer began for the Bank January 1, 2016 and was phased-in over four years. In 2019, the minimum buffer was permanently set at 2.5%. This resulted in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.
- Consistent with Basel III, revisions and clarifications were made to the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that no longer qualify as Tier 1 capital, some of which will be phased out over time. Under the amendments, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations like the Bank that are not considered "advanced approaches" banking organizations may make a one-time permanent election to continue to exclude these items.
- A revised prompt corrective action framework was established. This framework is designed to place restrictions on insured depository institutions if their capital levels begin to show signs of weakness are designed to complement the capital conservation buffer. Under the prompt corrective action requirements, insured depository institutions are required to meet the following capital level requirements in order to qualify as "well capitalized": (i) a common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8%; (iii) a total capital ratio of 10%; and (iv) a Tier 1 leverage ratio of 5%.
- Certain changes were made to the manner in which risk-weighted assets are calculated. The rules utilize an increased number of credit risk exposure categories and risk weights and also address: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; and (iv) revised capital treatment for derivatives and repo-style transactions.

The Bank, like other depository institutions, is required to maintain Tier 1 capital and "total capital" (the sum of Tier 1 and Tier 2 capital) equal to at least 4.0% and 8.0%, respectively, of its total risk-weighted assets (including various off-balance-sheet items,

such as letters of credit). In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its Tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively.

The Bank is also required to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization’s Tier 1 capital to its total adjusted quarterly average assets (as defined for regulatory purposes). The requirements necessitate a minimum leverage ratio of 3.0% for banks that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority’s risk-adjusted measure for market risk. All other banks are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its leverage ratio must be at least 5.0%.

On September 17, 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio (“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.

On April 6, 2020, in a joint statement, the FDIC, FRB and the Office of Comptroller of the Currency issued two interim final rules regarding temporary changes to the CBLR framework to implement provisions of the CARES Act. Under the interim final rules, the community bank leverage ratio was reduced to 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 8%, 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 not opted-in to the CBLR framework.

Prompt Corrective Action

The FDI Act requires, among other things, the federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. The FDI Act includes the following five capital tiers: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total capital ratio, the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) “well capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure, (ii) “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not “well capitalized”, (iii) “undercapitalized” if the institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%, (iv) “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%, and (v) “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects for other purposes.

The Basel III Capital Rules revised the prompt corrective action requirements by (i) introducing the CET1 ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being a minimum of 6.5% or greater for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category (other than critically undercapitalized), with the minimum Tier 1 capital ratio for well-capitalized status being 8%; and (iii) eliminating the provision that permitted a bank with a composite supervisory rating of 1 but a leverage ratio of at least 3% to be deemed adequately capitalized.

The FDI Act generally prohibits a depository institution from making any capital distributions (including payment of a dividend) if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. If a depository institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.”

Significantly undercapitalized” depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well capitalized insured depository institution as adequately capitalized. The FDI Act provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

The Bank believes that, as of December 31, 2022, it is “well capitalized” based on the aforementioned ratios. Further information about the Bank’s capital resources is provided in Item 7 of Part II of this annual report under the heading “FINANCIAL CONDITION - Capital Management” and Note 14 to the Bank’s audited consolidated financial statements, which are included in Item 8 of Part II of this annual report.

Liquidity Requirements

The Bank requires cash to fund loans, satisfy obligations under letters of credit, meet the deposit withdrawal demands of customers, and satisfy other monetary obligations. To the extent that deposits are not adequate to fund these requirements, the Bank can rely on the funding sources identified in Item 7 of Part II of this report under the heading, “FINANCIAL CONDITION – Liquidity Management; Contractual Obligations and Off-Balance Sheet Transactions”.

Historically, the regulation and monitoring of bank liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio (“LCR”), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity’s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (“NSFR”), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

Bank Secrecy Act/Anti-Money Laundering

The Bank Secrecy Act (“BSA”), requires financial institutions to develop policies, procedures, and practices which are intended to prevent and deter money laundering, mandates that insured financial institutions have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA.

The program must, at a minimum: (i) provide for a system of internal controls to assure ongoing compliance; (ii) provide for independent testing for compliance; (iii) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (iv) provide training for appropriate personnel. In addition, banks are required to adopt a customer identification program as part of its BSA compliance program. Banks are also required to file Suspicious Activity Reports when they detect certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity or a violation of the BSA.

In addition to complying with the BSA, the Bank is subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA Patriot Act”). The USA Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the United States’ financial system and has significant implications for depository institutions, brokers, dealers, and other businesses involved in the transfer of money. The USA Patriot Act mandates that financial service companies implement additional policies and procedures and take heightened measures designed to address any or all of the following matters: customer identification programs, money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, currency crimes, and cooperation between financial institutions and law enforcement authorities.

Mortgage Lending and Servicing

The Bank's mortgage lending and servicing activities are subject to various laws and regulations that are enforced by the federal banking regulators and the CFPB, such as the Truth in Lending Act, the Real Estate Settlement Procedures Act, and various rules adopted thereunder, including those relating to consumer disclosures, appraisal requirements, mortgage originator compensation, prohibitions on mandatory arbitration provisions under certain circumstances, and the obligation to credit payments and provide payoff statements within certain time periods and provide certain notices prior to interest rate and payment adjustments.

The Bank is required to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Qualified mortgages that are not "higher-priced" are afforded a safe harbor presumption of compliance with the ability to repay rules, while qualified mortgages that are "higher-priced" garner a rebuttable presumption of compliance with the ability to repay rules. In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or a term exceeding 30 years, where the lender determines that the borrower has the ability to repay, and where the borrower's points and fees do not exceed 3% of the total loan amount. "Higher-priced" mortgages must have escrow accounts for taxes and insurance and similar recurring expenses.

Consumer Lending – Military Lending Act

The Military Lending Act (the "MLA"), which was initially implemented in 2007, was amended and its coverage significantly expanded in 2015. The Department of Defense (the "DOD") issued a final rule under the MLA that took effect on October 15, 2015, but financial institutions were not required to take action until October 3, 2016. The types of credit covered under the MLA were expanded to include virtually all consumer loan and credit card products (except for loans secured by residential real property and certain purchase-money motor vehicle/personal property secured transactions). Lenders must now provide specific written and oral disclosures concerning the protections of the MLA to active duty members of the military and dependents of active duty members of the military ("covered borrowers"). The rule imposes a 36% "Military Annual Percentage Rate" cap that includes costs associated with credit insurance premiums, fees for ancillary products, finance charges associated with the transactions, and application and participation charges. In addition, loan terms cannot include (i) a mandatory arbitration provision, (ii) a waiver of consumer protection laws, (iii) mandatory allotments from military benefits, or (iv) a prepayment penalty. The revised rule also prohibits "roll-over" or refinances of the same loan unless the new loan provides more favorable terms for the covered borrower. Lenders may verify covered borrower status using a DOD database or information provided by credit bureaus. The Bank believes it is in compliance with the revised rule.

Cybersecurity

The Bank relies on electronic communications and information systems to conduct operations and store sensitive data. The Bank employs an in-depth approach that leverages people, processes, and technology to manage and maintain cybersecurity controls. In addition, the Bank employs a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of the Bank's defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures.

The federal banking regulators have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution's board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking regulators expect financial institutions to establish lines of defense and to ensure that their risk management processes address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyberattack. If the Bank fails to meet the expectations set forth in this regulatory guidance, then the Bank could be subject to various regulatory actions and may be required to devote significant resources to any required remediation efforts.

Governmental Monetary and Credit Policies and Economic Controls

The earnings and growth of the banking industry and ultimately of the Bank are affected by the monetary and credit policies of governmental authorities, including the FRB. An important function of the FRB is to regulate the national supply of bank credit in order to control recessionary and inflationary pressures. Among the instruments of monetary policy used by the FRB to implement these objectives are open market operations in U.S. Government securities, changes in the federal funds rate, changes in the discount rate of member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth of bank loans, investments and deposits and may also affect interest rates charged on loans or paid for deposits. The monetary policies of the FRB authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to have such an effect in the future. In view of changing conditions in the national economy and in the money markets, as well as the effect of actions by monetary and fiscal authorities, including the

FRB, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or their effect on the business and earnings of the Bank.

Federal Securities Laws

The shares of the Bank's common stock are registered with the FDIC under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Bank is subject to information reporting requirements, proxy solicitation requirements, insider trading restrictions and other requirements of the Exchange Act, including the requirements imposed under the federal Sarbanes-Oxley Act of 2002. Among other things, loans to and other transactions with insiders are subject to restrictions and heightened disclosure, directors and certain committees of the Board must satisfy certain independence requirements, and the Bank is generally required to comply with certain corporate governance requirements.

Section 3(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"), exempts from the definition of "security" any security issued by a bank. As such, Section 5 of the Securities Act, which prohibits the offer and sale of any security unless there is a registration statement in effect with respect to such security, does not apply to offers and sales by the Bank of its common stock. The FDIC, as the Bank's primary federal regulator, likewise does not require the Bank to file a registration statement prior to offering or selling its securities. Notwithstanding the foregoing, the anti-fraud provisions of the Securities Act do apply to offers and sales by the Bank of its common stock.

Future Legislation

Periodically, the federal and state legislatures consider bills with respect to the regulation of financial institutions. Some of these proposals could significantly change the regulation of banks and the financial services industry. The Bank cannot predict whether such proposals will be adopted or the effect on the Bank if they are adopted.

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 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 1A. RISK FACTORS.

The significant risks and uncertainties related to the Bank, its business and its common stock of which the Bank is aware are discussed below. You should carefully consider these risks and uncertainties before making investment decisions in respect of the Bank's common stock. Any of these factors could materially and adversely affect the Bank's business, financial condition, operating results and prospects and could negatively impact the market price of the common stock. If any of these risks materialize, you could lose all or part of your investment in the Bank. Additional risks and uncertainties that we do not yet know of, or that we currently think are immaterial, may also impair the Bank's business operations. You should also consider the other information included elsewhere or incorporated in this annual report, including the Bank's audited consolidated financial statements and the notes thereto, before making investment decisions.

Risks Relating to the Bank's Business

The majority of the Bank's business is concentrated in Maryland; a significant amount of the Bank's business is concentrated in commercial and residential real estate lending.

Most of the Bank's loans are made to Maryland borrowers, and many of these loans are secured by real estate. Accordingly, a decline in local economic conditions would likely have an adverse impact on the Bank's financial condition and results of operations, as well as the market values of the real estate securing these loans. In such case, the impact on the Bank would likely be greater than the impact felt by larger financial institutions whose loan portfolios are geographically diverse. The Bank cannot guarantee that any risk management practices that it implements to address its geographic and loan concentrations will be effective to prevent losses relating to its loan portfolio.

The Bank's concentrations of commercial real estate loans could subject it to increased regulatory scrutiny and directives, which could force us to preserve or raise capital and/or limit future commercial lending activities.

The federal banking regulators believe that institutions with particularly high concentrations of commercial real estate loans in their lending portfolios face a heightened risk of financial difficulties in the event of adverse changes in the economy and commercial

real estate markets. Accordingly, through published guidance, these regulators have directed institutions whose concentrations exceed certain percentages of capital to implement heightened risk management practices appropriate to their concentration risk. The guidance provides that banking regulators may require such institutions to reduce their concentrations and/or maintain higher capital ratios than institutions with lower concentrations in commercial real estate. Although management continuously evaluates the Bank's concentration and risk management strategies, management cannot guarantee that any risk management practices the Bank implements will be effective to either keep our commercial real estate concentration below the suggested threshold levels or prevent losses relating to the Bank's commercial real estate portfolio. In addition, management cannot predict the extent to which this guidance will impact our operations or capital requirements in future periods.

The Bank may experience loan losses in excess of its allowance.

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. Management of the Bank maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and judgments about the ultimate collectibility of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectibility is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the bank regulatory authorities require the Bank to increase its allowance for loan losses as a part of its examination process, the Bank's earnings and capital could be significantly and adversely affected. Future adjustments may be necessary if economic conditions differ substantially from the assumptions used by management to make determinations with respect to the allowance for loan losses and/or if adverse developments arise with respect to the Bank's non-performing or performing loans. Material additions to the Bank's allowance for loan losses would result in a decrease in the Bank's net income and capital, and could have a material adverse effect on the Bank.

The Bank depends on the accuracy and completeness of information about customers and counterparties, and inaccurate, incomplete or misleading information provided to Bank by these persons could cause it to suffer losses.

In deciding whether to extend credit or enter into other transactions, the Bank relies on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. The Bank also relies on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on the Bank's business, financial condition and results of operations.

The Bank's accounting estimates and risk management processes rely on analytical and forecasting models, the inadequacy of which could have a material adverse effect on the Bank's financial condition and/or results of operations.

The processes that the Bank uses to estimate expected credit losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation, including flaws caused by failures in controls, data management, human error or from the reliance on technology. If the models the Bank uses for interest rate risk and asset-liability management are inadequate, then the Bank may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models the Bank uses for estimating expected credit losses are inadequate, then the allowance for credit losses may not be sufficient to support future charge-offs. If the models that the Bank uses to measure the fair value of financial instruments are inadequate, then the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Bank could realize upon sale or settlement of such financial instruments. Any such failure in the Bank's analytical or forecasting models could have a material adverse effect on its business, financial condition and results of operations.

The Bank may be adversely affected by recent changes in tax laws.

The Tax Cuts and Jobs Act (the "Tax Act"), which was enacted in December 2017, is likely to have both positive and negative effects on the Bank's financial performance. Beginning in 2018, the Tax Act reduces the federal tax rate for corporations from 35% to 21%, but it also enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for certain home equity loans, (iii) a limitation on the deductibility of business interest expense, and (iv) a limitation on the deductibility of property taxes and state and local income taxes. These limitations could have the effect of reducing consumer demand for loans secured by real estate, which could adversely impact the Bank's financial condition and results of operations. The Bank will continue to evaluate the Tax Act and its impact on the Bank's financial performance.

A new accounting standard will likely require the Bank to increase the allowance for loan losses and may have a material adverse effect on the Bank's financial condition and results of operations.

The Financial Accounting Standards Board adopted a new accounting standard that will be effective for the Bank beginning with its first full fiscal year beginning after December 15, 2022. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans and held-to-maturity investment securities, and recognize the expected credit losses as allowances for credit losses. This standard will change the current method of providing allowances for loan losses that are probable, which would likely require the Bank to increase the allowance for credit losses, and to greatly increase the types of data the Bank would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in the allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on the Bank's financial condition and results of operations. See Note 18 - Accounting Standards Updates in the notes to consolidated financial statements included in Item 8. Financial Statements and Supplementary Data elsewhere in this report for further information regarding pending accounting standards updates.

Interest rates and other economic conditions could impact the Bank's financial conditions and results of operations.

The Bank's net income depends primarily upon net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds. The level of net interest income is primarily a function of the average balance of interest-earning assets, the average balance of interest-bearing liabilities, and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of the Bank's interest-earning assets and the Bank's interest-bearing liabilities which, in turn, are impacted by such external factors as the local economy, competition for loans and deposits, the monetary policy of the Federal Open Market Committee of the FRB, and market interest rates.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. The Bank expects to periodically experience gaps in the interest rate sensitivities of our assets and liabilities. That means either interest-bearing liabilities will be more sensitive to changes in market interest rates than interest-earning assets, or vice versa. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets, an increase in market rates of interest could reduce the Bank's net interest income. Likewise, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could reduce the Bank's net interest income. The Bank is unable to predict changes in market interest rates, which are affected by many factors beyond the Bank's control, including inflation, deflation, recession, unemployment, money supply, domestic and international events and changes in the United States and other financial markets.

The Bank also attempts to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact. A rapid increase or decrease in interest rates could adversely affect the Bank's results of operations and financial performance.

Changes to LIBOR may adversely impact the value of, and the return on, our loans which are indexed to LIBOR.

We have certain loans indexed to LIBOR to calculate the loan interest rate. On July 27, 2017, the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it will no longer persuade or compel banks to submit rates for the calculation of LIBOR to the LIBOR administrator after 2021. The announcement also indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide LIBOR submissions to the LIBOR administrator or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable benchmark for certain loans and liabilities including our subordinated notes, what rate or rates may become accepted alternatives to LIBOR or the effect of any such changes in views or alternatives on the values of the loans and liabilities, whose interest rates are tied to LIBOR. Uncertainty as to the nature of such potential changes, alternative reference rates, the elimination or replacement of LIBOR, or other reforms may adversely affect the value of, and the return on, our loans indexed to LIBOR.

The market value of the Bank's investments could decline.

As of December 31, 2022 and December 31, 2021, the Bank has classified all of its investment securities as held-to-maturity. Investment securities that are classified as held-to-maturity are stated at amortized cost.

Management believes that several factors will affect the market values of the Bank's investment portfolio. These include, but are not limited to, changes or expectations of changes in interest rates, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates).

Also, the passage of time will affect the market values of our investment securities, in that the closer they are to maturing, the closer the market price should be to par value. These and other factors may impact specific categories of the portfolio differently, and management cannot predict the effect these factors may have on any specific category.

Impairment of investment securities, restricted equity securities, goodwill, other intangible assets, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

The Bank is required to record a non-cash charge to earnings when management determines that an investment security is other-than-temporarily impaired (“OTTI”). In assessing whether the impairment of investment securities is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the Bank’s intent and ability to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Further information about the Bank’s accounting policy for OTTI is provided in Note 1 to the Bank’s audited consolidated financial statements, which are included in Item 8 of Part II of this annual report.

The Bank’s holdings include restricted equity securities, which are carried at cost, adjusted for other-than-temporary impairment, and grouped with other assets. Restricted equity securities include stock issued by the FHLBA. As a member of the FHLBA, the Bank is required to purchase stock of that bank based on the Bank’s total assets as of year-end and how much it borrows from the FHLBA system. In evaluating FHLBA stock for impairment, its value is based on the ultimate recovery of the par value. From time to time, some FHLB banks have stopped paying dividends on and redeeming FHLB stock, which has caused the banking industry to periodically become concerned about the financial strength of the banks in the FHLB system. There can be no guaranty that the FHLBA will declare a dividend on its stock for the quarter ended December 31, 2022 or for any future quarter. The FHLBA paid four dividends for the year ended December 31, 2022 totaling \$13,152. This compares to four dividends paid totaling \$16,785 for the year ended December 31, 2021. The Bank does not consider its FHLBA stock holding to be other-than-temporarily impaired at December 31, 2022 or at December 31, 2021 and no impairment has been recognized for the years ended December 31, 2022 or December 31, 2021.

Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Bank had no goodwill at either December 31, 2022 or December 31, 2021.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Assessing the need for, or the sufficiency of, a valuation allowance requires management to evaluate all available evidence, both negative and positive, including the recent trend of quarterly earnings. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carryback and carryforward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g., cumulative losses in recent years, history of operating loss or tax credit carryforwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At December 31, 2022, the Bank’s net deferred tax assets were \$980,031, compared to \$994,192 at December 31, 2021. Further information about the Bank’s net deferred tax assets is provided in Note 12 to the Bank’s audited consolidated financial statements, which are included in Item 8 of Part II of this annual report.

The impact of each of these impairment matters could have a material adverse effect on the Bank’s business, results of operations, and financial condition.

The Bank operates in a competitive market.

The Bank operates in a competitive environment, competing for loans, deposits, and customers with commercial banks, savings associations and other financial entities. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market and mutual funds and other investment alternatives. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions and other financial intermediaries. Many of these competitors are much larger in terms of total assets and capitalization, have greater access to capital markets, and/or offer a broader range of financial services than those offered by the Bank. Banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers. In addition, current banking laws facilitate interstate branching and merger activity among banks. Since September 1995, certain bank holding companies have been authorized to acquire banks throughout the United States. Beginning June 1, 1997, certain banks have been permitted to merge with banks organized under the laws of different states. As a result of these changes, interstate banking is now an accepted element of competition in the banking industry and the Bank may be brought into competition with institutions with which it does not presently compete.

The banking industry is heavily regulated; significant regulatory changes could adversely affect the Bank’s operations.

The Bank's operations are and will be affected by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. The Bank is subject to supervision by the FDIC and the Maryland Commissioner. Banking regulations, designed primarily for the safety of customers, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. The Bank is also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that the Bank is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on the Bank's future business and earnings prospects. Management also cannot predict the nature or the extent of the effect on the Bank's business and earnings of future fiscal or monetary policies, economic controls, or new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect the Bank's ability to operate profitably.

The Consumer Financial Protection Bureau may continue to reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices. Compliance with any such change may impact our business operations.

The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers. The CFPB has also been directed to adopt rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The concept of what may be considered to be an "abusive" practice is fluid and can change based on politically-appointed leadership at the CFPB. The full scope of the impact of this authority has not yet been determined as the CFPB has not finalized all supervisory guidance. The CFPB's rules, both those that have been adopted and those that are yet to be adopted, will require the Bank to dedicate significant personnel and resources to ensuring compliance, which could have a material adverse effect on the Bank's operations.

Bank regulators and other regulations, including the Basel III Capital Rules, may require higher capital levels, impacting our ability to pay dividends or repurchase our stock.

The capital standards to which the Bank is subject, including the standards created by the Basel III Capital Rules, may materially limit the Bank's ability to use the Bank's capital resources and/or could require the Bank to raise additional capital by issuing common stock. The issuance of additional shares of common stock could dilute existing stockholders.

Customer concern about deposit insurance may cause a decrease in deposits held at the Bank, which could adversely impact our funding sources.

Customers are concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits from the Bank in an effort to ensure that the amount they have on deposit with the Bank is fully insured. Decreases in deposits may adversely affect the Bank's liquidity, funding costs and net income.

The Bank's funding sources may prove insufficient to replace deposits and support our future growth.

The Bank relies on customer deposits, advances from the FHLBA, and lines of credit at other financial institutions to fund its operations. Although the Bank has historically been able to replace maturing deposits and advances if desired, no assurance can be given that the Bank would be able to replace such funds in the future if the Bank's financial condition or the financial condition of the FHLBA or market conditions were to change. The Bank's financial flexibility will be severely constrained if it is unable to maintain its access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Finally, if the Bank is required to rely more heavily on more expensive funding sources to support future growth, the Bank's revenues may not increase proportionately to cover its costs. In this case, the Bank's profitability would be adversely affected.

There can be no assurance that FHLBA borrowings and other current sources of liquidity will be available or, if available, sufficient to provide adequate funding for operations. Accordingly, the Bank may have to seek additional higher-cost debt in the future to achieve its long-term business objectives. Additional borrowings, if sought, may not be available to the Bank or, if available, may not be available on favorable terms. If additional financing sources are unavailable or are not available on reasonable terms, the Bank's growth and future prospects could be adversely affected.

The Bank is subject to liquidity risk.

The Bank requires liquidity to meet its deposit and debt obligations as they come due. The Bank's access to funding sources in amounts adequate to finance its activities or on terms that are acceptable to it could be impaired by factors that affect it specifically or the financial services industry or economy generally. Factors that could reduce its access to liquidity sources include a downturn in the local market, difficult credit markets or adverse regulatory actions against the Bank. The Bank's access to deposits may also be affected by the liquidity needs of its depositors. In particular, a substantial majority of the Bank's liabilities are demand, savings,

interest checking and money market deposits, which are payable on demand or upon several days' notice, while by comparison, a substantial portion of its assets are loans, which cannot be called or sold in the same time frame. The Bank may not be able to replace maturing deposits and advances as necessary in the future, especially if a large number of its depositors sought to withdraw their accounts, regardless of the reason. A failure to maintain adequate liquidity could have a material adverse effect on the Bank's business, financial condition and results of operations.

The Bank may need to raise additional capital in the future, and such capital may not be available when needed or at all.

The Bank may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs including complying with new regulatory capital rules, particularly if its asset quality or earnings were to deteriorate significantly. The Bank's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of its control, and its financial condition. Economic conditions and the loss of confidence in financial institutions may limit access to certain customary sources of capital, and increase the Bank's cost of raising capital.

The Bank cannot assure that such capital will be available on acceptable terms or at all. Any occurrence that may limit the Bank's access to the capital markets, such as a decline in the confidence of depositors, investors or counterparties participating in the capital markets may adversely affect the Bank's capital costs and its ability to raise capital and, in turn, its liquidity. Moreover, if the Bank needs to raise capital in the future, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on the Bank's business, financial condition and results of operations.

The loss of key personnel could disrupt the Bank's operations and result in reduced earnings.

The Bank's growth and profitability will depend upon its ability to attract and retain skilled managerial, marketing and technical personnel. Competition for qualified personnel in the financial services industry is intense, and there can be no assurance that the Bank will be successful in attracting and retaining such personnel. The Bank's current executive officers provide valuable services based on their many years of experience and in-depth knowledge of the banking industry. Due to the intense competition for financial professionals, these key personnel would be difficult to replace and an unexpected loss of their services could result in a disruption to the continuity of operations and a possible reduction in earnings.

As a community bank, the Bank's ability to maintain its reputation is critical to the success of the business.

As a community banking institution, the Bank's reputation is one of the most valuable components of the Bank's business. A key component of the Bank's business strategy is to rely on the Bank's reputation for customer service and knowledge of local markets to expand the Bank's presence by capturing new business opportunities from existing and prospective customers in the Bank's current market and contiguous areas. As such, the Bank strives to conduct its business in a manner that enhances its reputation. This is done, in part, by recruiting, hiring and retaining employees who share the Bank's core values of being an integral part of the communities the Bank serves, delivering superior service to the Bank's customers and caring about the Bank's customers and associates. If the Bank's reputation is negatively affected by the actions of its employees, by its inability to conduct its operations in a manner that is appealing to current or prospective customers, or otherwise, the Bank's business and, therefore, its operating results may be materially and adversely affected.

The Bank's lending activities subject it to the risk of environmental liabilities.

A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The Bank's environmental reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect the Bank's financial condition and results of operations.

The Bank is and might in the future be subject to claims and the costs of defensive actions, and such claims and costs could materially and adversely impact the Bank's financial condition and results of operations.

Persons with whom the Bank does business may sue the Bank for losses due to alleged breaches of fiduciary duties, errors and omissions of employees, officers and agents, incomplete documentation, the failure of the Bank to comply with applicable laws and regulations, or many other reasons. Also, the employees of the Bank may knowingly or unknowingly violate laws and regulations. Bank management may not be aware of any violations until after their occurrence. This lack of knowledge may not

insulate the Bank from liability. Claims and legal actions may result in legal expenses and liabilities that may reduce the Bank's profitability and hurt its financial condition.

As discussed in Item 3 of Part I of this report, the Bank has been sued by Sheira Brown. This lawsuit will likely be time consuming and involve significant defense and other costs. We cannot predict what expenses we might incur in connection with this lawsuit. If decided adversely to us, this lawsuit could result in significant monetary damages and reputational harm. Our insurance policies might not cover all expenses and/or claims that have been or might be brought against us, and insurance coverage might not continue to be available to us at a reasonable cost. As a result, the Bank is exposed to the possibility of substantial uninsured liabilities in connection with this lawsuit that could materially and adversely affect our business, prospects, results of operations and financial condition.

The Bank may not be able to keep pace with developments in technology.

The Bank uses various technologies in conducting its businesses, including telecommunication, data processing, computers, automation, internet-based banking, and debit cards. The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The Bank's future success depends, in part, on its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Bank's operations. Many of the Bank's competitors have substantially greater resources to invest in technological improvements. The Bank may not be able to effectively implement new technology driven products and services or be successful in marketing these products and services to its customers. In addition, the Bank's implementation of certain new technologies, such as those related to artificial intelligence, automation and algorithms, in the Bank's business processes may have unintended consequences due to their limitations or the Bank's failure to use them effectively. In addition, cloud technologies are also critical to the operation of the Bank's systems, and the Bank's reliance on cloud technologies is growing. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse effect on the Bank's business, financial condition and results of operations.

The Bank's information systems may experience an interruption or a breach in security, including due to cyberattacks.

The Bank's business depends heavily on the use of computer systems, the Internet and other means of electronic communication and recordkeeping. In the ordinary course of business, the Bank collects and stores sensitive data, including proprietary business information and personally identifiable information of our customers and employees in systems and on networks. Moreover, the Bank uses third party vendors to provide products and services necessary to conduct day-to-day operations, which exposes the Bank to the risk that these vendors will not perform in accordance with the service arrangements, including by failing to protect the confidential information the Bank entrusts to them. The secure processing, maintenance, and use of the Bank's and the Bank's customers' information is critical to the Bank's operations and business strategy. Any failure, interruption, or breach in security or operational integrity of the Bank's communications or operations systems could result in failures or disruptions in the Bank's customer relationship management, general ledger, deposit, loan, and other systems. Although the Bank has invested in various technologies and continually reviews processes and practices that are designed to protect the Bank's networks, computers, and data from damage or unauthorized access, the Bank's computer systems and infrastructure, and those of the Bank's third-party vendors, may nevertheless be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions. Further, cyber-attacks can originate from a variety of sources and the techniques used are increasingly sophisticated. A breach of any kind could compromise the Bank's systems and those of the Bank's vendors, and the information stored there could be accessed, damaged, or disclosed. A breach in security or other failure could result in legal claims, regulatory penalties, disruptions in operations, increased expenses, loss of customers and business partners, and damage to the Bank's reputation, which could in turn adversely affect the Bank's business, financial condition and/or results of operations. Furthermore, as cyber threats continue to evolve and increase, the Bank may be required to expend significant additional financial and operational resources to modify or enhance the Bank's protective measures, or to investigate and remediate any identified information security vulnerabilities.

A material weakness or significant deficiency in the Bank's disclosure or internal controls could have an adverse effect on the Bank.

The Bank is required by the Sarbanes-Oxley Act of 2002 to establish and maintain disclosure controls and procedures and internal control over financial reporting. These control systems are intended to provide reasonable assurance that material information relating to the Bank is made known to our management and reported as required by the Exchange Act, to provide reasonable assurance regarding the reliability and preparation of our financial statements, and to provide reasonable assurance that fraud and other unauthorized uses of our assets are detected and prevented. The Bank may not be able to maintain controls and procedures that are effective at the reasonable assurance level. If that were to happen, the Bank's ability to provide timely and accurate information about the Bank, including financial information, to investors could be compromised and the Bank's results of operations could be harmed. Moreover, if the Bank or its independent registered public accounting firm were to identify a material weakness or significant deficiency in any of those control systems, the Bank's reputation could be harmed and investors could lose confidence in the Bank, which could cause the market price of the Bank's stock to decline and/or limit the trading market for the Bank's common stock.

An outbreak of another highly infectious or contagious disease could adversely affect the Bank's business, financial condition and results of operations.

The Bank's business is dependent upon the willingness and ability of its customers to conduct banking and other financial transactions. As seen with the COVID-19 pandemic, the spread of another highly infectious or contagious disease could cause severe disruptions in the U.S. economy, which could in turn disrupt the business, activities, and operations of the Bank's customers, as well as our business and operations. The spread of such a disease could result in a significant decrease in business and/or cause our customers to be unable to meet existing payment or other obligations to the Bank, particularly in the event of a spread of or outbreak in our market area. The spread or outbreak of another contagious disease could also negatively impact the availability of Bank's key personnel necessary to conduct our business. Such a spread or outbreak could also negatively impact the business and operations of third-party service providers who perform critical services for our business. If another highly infectious or contagious disease spreads or the response to contain that disease is unsuccessful, then we could experience a material adverse effect on our business, financial condition, and results of operations.

Risks Relating to the Bank's Common Stock

The Bank's ability to pay dividends is limited.

Both federal and Maryland laws impose restrictions on the ability of the Bank to pay dividends. Furthermore, the declaration and payment of dividends and the amounts thereof are at the discretion of the Bank's Board of Directors. Thus, even at times when the Bank is legally permitted to pay dividends, neither the payment of such dividends nor the amounts thereof can be guaranteed. Further information about these limitations is contained in Item 5 of Part II of this annual report under the heading, "Market Price Analysis and the Discussion on Dividends".

The Bank's common stock is not insured.

Investments in the shares of the Bank's common stock are not deposits and are not insured against loss by the government.

The Bank's stock is not heavily traded and the stock price may be volatile.

The Bank's common stock is not traded on any exchange. Certain brokers may make a market in the common stock by trading shares in the over-the-counter market, but such transactions are infrequent and the volume of shares traded is relatively small. Prices on stock that is not heavily traded, such as the Bank's common stock, can be more volatile than stock trading in an active public market. Factors such as the Bank's financial results, the introduction of new products and services by the Bank or its competitors, and various factors affecting the banking industry generally may have a significant impact on the market price of the Bank's common stock. Likewise, events that are unrelated to the Bank but that affect the equity markets generally, such as international health crises, wars, political instability and similar factors, could also have a significant impact on the market price and trading volume of the shares of common stock. Management cannot predict whether an active public market for the Bank's common stock will develop or be sustained in the future. Therefore, the Bank's stockholders may not be able to sell their shares at the volumes, prices, or times that they desire.

The Bank could choose to terminate the registration of its common stock under the Exchange Act, which could reduce the market for the Bank's common stock and adversely affect stock prices.

The Jumpstart Our Business Startups Act (the "JOBS Act") was signed into law in April 2012 and made several significant changes to federal securities laws. Among other things, the JOBS Act amended Section 12(g) of the Exchange Act to permit a bank with a class of equity securities that is registered under Section 12(g) to terminate that registration once the number of record holders of that class of equity securities drops below 1,200 persons. As of February 28, 2023, there were approximately 625 record holders of the Bank's common stock. Accordingly, the Bank could choose to terminate the registration of its common stock under Section 12(g) of the Exchange Act, in which case the Bank would no longer be required to file periodic and other reports, such as this annual report, with the FDIC. Securities professionals may be less likely to make a market in securities of companies that do not file quarterly and annual reports with a regulatory agency, such as the FDIC. Thus, the termination of the Bank's Section 12(g) registration could further reduce the trading volume of the common stock, could increase stock price volatility and could result in reported market prices that do not accurately reflect the true market value of the common stock.

The Bank's Articles of Incorporation and By-Laws and Maryland law may discourage a corporate takeover.

The Bank's Articles of Incorporation and By-Laws contain certain provisions designed to enhance the ability of the Board of Directors to deal with attempts to acquire control of the Bank. First, the Board is permitted, without stockholder approval, to increase the aggregate number of shares of stock of the Bank or the number of shares of stock of any class that the Bank has authority to issue. Second, the Board is permitted, without stockholder approval, to issue the Bank's securities. The Board could

use these powers to issue a significant number of shares to a person or persons affiliated with or otherwise friendly to management. Third, the By-Laws require any stockholder who desires to nominate a director to abide by strict notice requirements.

Maryland laws include provisions that could discourage a sale or takeover of the Bank. The Maryland Business Combination Act generally prohibits, subject to certain limited exceptions, corporations from being involved in any “business combination” (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities) with any “interested shareholder” for a period of five years following the most recent date on which the interested shareholder became an interested shareholder. An interested shareholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% percent or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock. The Maryland Control Share Acquisition Act applies to acquisitions of “control shares”, which, subject to certain exceptions, are shares the acquisition of which entitle the holder, directly or indirectly, to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors within any of the following ranges of voting power: one-tenth or more, but less than one-third of all voting power; one-third or more, but less than a majority of all voting power; or a majority or more of all voting power. Control shares have limited voting rights. Maryland banking law provides that the Maryland Commissioner must approve certain acquisitions of the common stock of the Bank, and this law imposes penalties on persons who effect such acquisitions without approval.

Although these provisions do not preclude a takeover, they may have the effect of discouraging, delaying or deferring a tender offer or takeover attempt that a stockholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the common stock. Such provisions will also render the removal of the Board of Directors and of management more difficult and, therefore, may serve to perpetuate current management. These provisions could potentially adversely affect the market price of our common stock.

Item 1B. UNRESOLVED FDIC COMMENTS.

Not applicable.

Item 2. PROPERTIES.

The Bank has eight branch locations and one non-branch office in Harford County, Maryland, and two branch locations in Cecil County, Maryland. The locations are described as follows:

Office	Location
Aberdeen Branch Office/Operations Center	8 West Bel Air Avenue, Aberdeen, Maryland 21001
Bel Air Branch Office	505 S. Main Street, Bel Air, Maryland 21014
Joppatowne Branch Office	501 Riviera Drive, Joppa, Maryland 21085
Havre de Grace Branch Office	960 Revolution Street, Havre de Grace, Maryland 21078
Hickory Branch Office	1610 Conowingo Road, Bel Air, Maryland 21014
Marketplace Branch Office	545 Marketplace Drive, Bel Air, Maryland 21014
Abingdon Branch Office	2905 Emmorton Road, Abingdon, Maryland 21009
Elkton Branch Office	133 North Bridge Street, Elkton, Maryland 21921
Southfield Branch Office	305 Augustine Herman Highway, Elkton, Maryland 21921
Jarrettsville Branch Office	3891 Jarrettsville Pike, Jarrettsville, Maryland 21084
Jarrettsville Non-branch Office	1124 Baldwin Mill Road, Jarrettsville, Maryland 21084

The Bank owns without encumbrance the eight offices located in Aberdeen, Bel Air, Jarrettsville, Joppatowne, Havre de Grace, Hickory and Marketplace. The Bank leases the three offices located in Abingdon and Elkton. Real estate tax expense for the above referenced properties owned by the Bank totaled \$154,370 for 2022 and \$157,636 for 2021. Rent expense for the leased branch locations totaled \$222,383 for 2022 and \$220,341 for 2021.

The Bank's executive offices are in the Aberdeen Office/Operations Center location, and our telephone number is (410) 272-5000.

Other than as described above, there are no encumbrances on any of these properties or leases. Bank management believes that all of these properties are adequately insured, and that its properties are suitable and adequate for its present needs.

Item 3. LEGAL PROCEEDINGS.

On January 12, 2021, Sheira Brown filed a complaint, which she subsequently amended, against the Bank in the United States District Court for the Northern District of Maryland, docketed as Sheira Brown v. Harford Bank, Case No. 1:21-cv-00096-ELH, in which she alleged that, in refusing to cash a check that was issued to her, the Bank engaged in certain discriminatory conduct in violation of 42 U.S.C. § 1981 and 15 U.S.C. § 1691, conversion, and reckless and/or intentional infliction of emotional distress (the "Brown Litigation"). Ms. Brown has demanded an unspecified amount of damages, including punitive damages, costs, and attorneys' fees. On March 4, 2022, the court dismissed Ms. Brown's claims under 15 U.S.C. § 1691 and for reckless and/or intentional infliction of emotional distress. The Bank believes that Ms. Brown's claims lack merit and is vigorously defending the Brown Litigation. The Bank maintains insurance coverages that it believes will cover portions of the legal expenses associated with the Brown Litigation and any damages that might be awarded to Ms. Brown. It is not possible at this time for the Bank to assess the likelihood of success of any of its defenses or, thus, the outcome of the Brown Litigation, or the amount of legal fees that it will incur in defending the Brown Litigation.

The Bank is at times, in the ordinary course of business, subject to other legal actions. Management, upon the advice of counsel, believes that losses, if any, resulting from the settlement or other disposition of these other legal actions will not have a material adverse effect on the financial condition of the Bank.

Item 4. MINE SAFETY DISCLOSURES.

This item is not applicable to the Bank.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market Price Analysis and the Discussion on Dividends

As of February 28, 2023, the shares of the common stock of the Bank were held by approximately 625 stockholders of record. Although most trades occur through privately-negotiated transactions, the shares of the Bank's common stock are traded in the over-the-counter market by certain broker-dealers and price quotations are available through the OTC Markets Group's OTC Pink Market (the "Pink Market") under the symbol "HFBK". Price quotations reported through the Pink Market reflect inter-dealer prices, without retail mark-up, mark-down, or commission, and may not necessarily represent actual transactions.

Cash dividends are typically declared on a quarterly basis and are at the discretion of the Board of Directors, based upon such factors as operating results, financial condition, capital adequacy, regulatory requirements, and stockholder return. The Bank's ability to declare and pay dividends is limited by federal and state banking laws and state corporate laws. Under Maryland law, a cash dividend may be declared only from the Bank's undivided profits or, with the prior approval of the Maryland Commissioner, its surplus in excess of 100% of its required capital stock. A stock dividend may be declared only if the Bank's surplus, after the increase in capital stock, is equal to at least 20% of the outstanding capital stock as increased. Moreover, if the surplus of the Bank, after the increase in capital stock, is less than 100% of its capital stock as increased, the Bank is required to annually transfer to surplus at least 10% of its net earnings until the surplus is 100% of its capital stock as increased. A dividend of property may be declared only if, after giving effect to the distribution, (i) the Bank can pay its indebtedness as the indebtedness becomes due in the usual course of business, and (ii) the Bank's total assets are greater than the sum of the Bank's total liabilities, plus, unless the Bank's charter permits otherwise, the amount that would be needed, if the Bank were to be dissolved at the time of distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution. Additionally, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. FDIC regulations also impose certain minimum capital requirements that affect the amount of cash available for the payment of dividends by regulated banking institutions such as the Bank. In addition to these specific restrictions, the Bank's regulators have the ability to prohibit proposed dividends that would otherwise be permitted under applicable regulations if the regulatory body determines that such distribution would constitute an unsafe or unsound practice. There can be no guarantee that dividends will be declared in any fiscal quarter.

The Bank has adopted a Dividend Reinvestment Plan (“DRIP”) that permits stockholders to reinvest the cash dividends paid on their shares of the Bank’s common stock in additional shares. Stockholders who elect to reinvest their dividends will receive the number of shares equal to the amount of the dividend divided by the applicable purchase price per share.

Recent Sales of Unregistered Securities

Section 3(a)(2) of the Securities Act exempts securities issued by a bank from the definition of “security”, 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 DRIP, upon the exercise of stock options granted under its various stock option plans, and pursuant to the Harford Bank 2020 Employee Stock Purchase Plan (the “2020 ESPP”). Because of the foregoing exemption, all sales of common stock by the Bank are considered to be unregistered sales. During the fourth quarter of 2022, (i) a total of 1,988 shares of common stock were issued pursuant to the DRIP at an average price of \$32.70 per share, (ii) a total of 0 shares of common stock were issued upon the exercise of stock options at an average exercise price of \$0.00 per share, and (iii) a total of 501 shares of common stock were allocated to participants in the 2020 ESPP at a purchase price of \$31.21 per share.

Issuer Repurchases of Equity Securities

The following table provides information with respect to shares of the Bank’s common stock that were purchased by the Bank and/or its affiliated purchasers (as defined by Rule 10b-18 under the Exchange Act) during the quarter ended December 31, 2022:

Period	Total Number of Shares (or Units) Purchased (1)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
October 2022	0	\$0	0	N/A
November 2022	0	\$0	0	N/A
December 2022	347	\$32.70	0	N/A
Total	347	\$32.70	0	N/A

Notes:

- (1) The shares were purchased in open-market transactions for the purpose of funding participant investments under the Bank’s Dividend Reinvestment Plan using cash dividends that would otherwise be payable to such participants. The Board of Directors has authorized the Bank to purchase up to 3,000 of the shares needed to fund dividend reinvestments for each dividend payment event through open-market purchases. Purchases in excess of 3,000 shares must be approved by the Board.

Equity Compensation Plan Information

Pursuant to Securities and Exchange Commission’s Regulation S-K Compliance and Disclosure Interpretation 106.01, the information regarding the Bank’s equity compensation plans required by this Item pursuant to Item 201(d) of Regulation S-K is located in Item 12 of Part III of this annual report and is incorporated herein by reference.

Item 6. [RESERVED]

Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

The following discussion and analysis presents the more significant factors affecting the Bank’s financial condition at December 31, 2022 and 2021 and results of operations for the years ended December 31, 2022 and 2021. This discussion and analysis should be read in conjunction with the audited consolidated financial statements and notes thereto, which are included in Item 8 of Part II of this annual report, and the other financial and statistical information included elsewhere in this annual report.

Taxable equivalent adjustments are the result of increasing the income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable, making tax-exempt yields comparable to taxable asset yields.

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 either on quoted market prices or are provided by other third-party sources, when available.

The most significant accounting policies followed by the Bank are presented in Note 1 to the audited consolidated financial statements, which are included in Item 8 of Part II of this annual report. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the 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 loan losses as the accounting area that requires the most subjective or complex judgments, and as such should be most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses 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 impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, 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 audited consolidated financial statements describes the methodology used to determine the allowance for loan losses.

PAYCHECK PROTECTION PROGRAM

The U.S. Government's Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") established the Small Business Administration ("SBA") Paycheck Protection Program ("PPP"), which provided small businesses in 2020 and 2021 with resources to maintain payroll, hire back employees who may have been laid off, and to cover applicable overhead expenses. During 2021, we made \$41 million of PPP loans. We received approximately \$2.9 million in fees net of related origination costs which will be amortized into interest income over the life of the related PPP loans. All PPP loans are 100% guaranteed by the SBA. At December 31, 2022, \$369,000 of PPP loans were outstanding compared to \$19,301,845 at December 31, 2021.

RESULTS OF OPERATIONS

The Bank recorded \$5,125,679 in net income for the year ended December 31, 2022, compared to \$5,340,997 for 2021, representing a decrease of \$215,318 or 4.0%. The decrease in net income when comparing 2022 to 2021 was due primarily to the decrease in noninterest income of \$148,632 and the increase in noninterest expense of \$2,501,376, partially offset by the increase in net interest income of \$1,756,521, the recovery of loan loss provision of \$455,000, and the decrease in income tax expense of \$223,169. Net interest income in 2022 increased due to the increase in rates earned on cash and investments, coupled with the increase in investment and loan balances for the year ended December 31, 2022. Loan loss recovery in 2022 was due to the reduction of qualitative factors of the allowance that had been increased in 2020 due to anticipated adverse events affecting our loan portfolio, including those arising from the COVID-19 pandemic. Non-interest expenses increased in 2022 primarily due to increases in employee compensation and benefits incurred to attract and retain quality employees during the year ended December 31, 2022.

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

Basic net income per share for 2022 decreased to \$3.51, from \$3.71 for 2021. Diluted net income per share for 2022 decreased to \$3.49, from \$3.69 for 2021. Basic and diluted net income per share decreased in 2022 when compared to 2021 due to the decrease in net income earned coupled with the increase in the weighted average number of common shares outstanding in 2022 when compared to 2021.

Net Interest Income and Net Interest Margin

The following table presents the Bank's average volume of interest-earning assets and interest-bearing liabilities for the years ended December 31, 2022 and 2021 and related interest income and yields and interest expense and rates, respectively.

	Average Balances, Interest, and Yields					
	2022			2021		
	Average balance	Interest	Yield/Rate	Average balance	Interest	Yield/Rate
Assets						
FRB interest-bearing deposits	\$ 81,300,000	\$ 1,272,903	1.57%	\$ 65,280,874	\$ 89,855	0.14%
Other interest-bearing deposits	19,851	380	1.91%	13,557	-	0.00%
Federal funds sold	-	-	0.00%	-	-	0.00%
Time deposits in other banks	2,768,233	13,696	0.49%	2,202,813	26,265	1.19%
Other	320,813	15,824	4.93%	305,879	11,827	3.87%
Investment securities:						
U.S. Treasury	20,188,967	222,228	1.10%	9,962,115	94,059	0.94%
U.S. government agency	37,264,262	486,298	1.30%	19,940,417	193,377	0.97%
Mortgage-backed	40,827,429	726,757	1.78%	27,432,102	306,746	1.12%
SBA asset-backed	12,838,291	166,182	1.29%	9,914,856	94,205	0.95%
State and municipal	3,578,477	67,242	1.88%	3,357,421	63,673	1.90%
Total investment securities	114,697,426	1,668,707	1.45%	70,606,911	752,060	1.07%
Loans						
Overdrafts	49,530	-	-	80,190	-	-
Consumer	8,489,655	418,200	4.93%	6,692,469	375,213	5.61%
Credit lines	12,901,501	586,292	4.54%	11,628,346	358,613	3.08%
Commercial	45,352,828	2,944,405	6.49%	71,562,286	4,828,837	6.75%
Real estate	317,487,119	13,459,621	4.24%	282,064,496	12,527,884	4.44%
Other loan fees	-	272,122	-	-	298,847	-
Total loans *	384,280,633	17,680,640	4.60%	372,027,787	18,389,394	4.94%
Allowance for loan losses	(5,009,748)			(5,098,705)		
Total loans, net of allowance *	379,270,885	17,680,640	4.66%	366,929,082	18,389,394	5.01%
Total interest-earning assets	578,377,208	20,652,150	3.57%	505,339,116	19,269,401	3.81%
Noninterest-bearing cash	4,361,637			6,173,165		
Premises and equipment	10,031,110			9,238,820		
Other assets	10,540,901			11,715,076		
Total assets	\$ 603,310,856			\$ 532,466,177		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Interest-bearing demand deposits	\$ 137,561,842	84,686	0.06%	\$ 107,661,801	78,281	0.07%
Savings	67,957,665	100,600	0.15%	59,256,399	79,357	0.13%
Money market	95,123,359	165,041	0.17%	61,942,412	103,500	0.17%
Time deposits	88,593,233	728,029	0.82%	110,575,623	1,288,250	1.17%
Total interest-bearing deposits	389,236,099	1,078,356	0.28%	339,436,235	1,549,388	0.46%
Borrowed overnight funds	30	1	3.33%	33	-	0.00%
FRB PPPLF advances	-	-	0.00%	-	-	0.00%
FHLB advances	-	-	0.00%	-	-	0.00%
Total borrowed funds	30	1	3.33%	33	-	0.00%
Total interest bearing deposits and borrowed funds	389,236,129	1,078,357	0.28%	339,436,268	1,549,388	0.46%
Noninterest-bearing demand deposits	160,058,780			142,238,592		
Other liabilities	2,384,107			2,953,381		
Stockholders' equity	51,631,840			47,837,936		
Total liabilities and stockholders' equity	\$ 603,310,856			\$ 532,466,177		
Net interest spread			3.29%			3.35%
Net interest income		\$ 19,573,793			\$ 17,720,013	
Net yield on interest-earning assets			3.38%			3.51%

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

* Includes non-accrual loans and deferred loan fees and costs.

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 volume 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 volume of interest-earning assets and interest-bearing liabilities is affected by the ability to manage the earning-asset portfolio (which includes loans), and the availability of particular sources of funds, such as noninterest-bearing deposits.

The average balance of total interest-earning assets increased \$73,039,208, or 14.5%, for the year ended December 31, 2022 when compared to the same period in 2021. The increase was due primarily to the \$67,620,049, or 14.0%, increase in total deposit liabilities and borrowings for the year ended December 31, 2022 when compared to the same period in 2021. The weighted average rate earned on total interest-earning assets for the year ended December 31, 2022 decreased 24 basis points to 3.57%, from 3.81% for the same period in 2021. The decrease was due primarily to the decrease in the yield earned on the loan portfolio coupled with lower yielding interest-bearing deposits and investments representing larger percentages of interest-earning assets for the year ended December 31, 2022 when compared to the same period in 2021, partially offset by the increase in rates paid on interest-bearing deposits by the FRB and rates offered on investments acquired during the year ended December 31, 2022 when compared to the same period in 2021.

The average balance of interest-bearing deposits at the FRB and the FHLBA, federal funds sold, and time deposits in other banks was \$84,088,084, an increase of \$16,590,840, or 24.6%, for the year ended December 31, 2022 when compared to the same period in 2021. The weighted average rate earned on these interest-earning deposits for the year ended December 31, 2022 increased 136 basis points to 1.53%, from 0.17% for the same period in 2021.

The average balance of investment securities for the year ended December 31, 2022 was \$114,697,426, an increase of \$44,090,515, or 62.4%, when compared to the same period in 2021. The weighted average rate earned on investments for the year ended December 31, 2022 increased 38 basis points to 1.45%, from 1.07% for the same period in 2021.

The average balance of total loans for the year ended December 31, 2022 was \$384,280,633, an increase of \$12,252,846, or 3.3%, when compared to the same period in 2021. The weighted average rate earned on total loans for the year ended December 31, 2022 decreased 34 basis points to 4.60%, from 4.94% for the same period in 2021, and was due primarily to the reduction in PPP fees recognized for the year ended December 31, 2022 when compared to the same period in 2021.

The average balance of interest-earning assets for the year ended December 31, 2022 was \$578,377,208, an increase of \$73,038,092, or 14.5%, when compared to the same period in 2021. The rate earned on interest-earning assets for the year ended December 31, 2022 decreased 24 basis points to 3.57%, from 3.81% for the year ended December 31, 2021.

The average balance of interest-bearing deposit liabilities for the year ended December 31, 2022 was \$389,236,099, an increase of \$49,799,864, or 14.7%, when compared to the same period in 2021. The weighted average rate paid on interest-bearing deposit liabilities for the year ended December 31, 2022 decreased 18 basis points to 0.28%, from 0.46% for the year ended December 31, 2021. The decrease in the rate paid on interest-bearing deposit liabilities was due primarily to the 35 basis point decrease in rates paid on time deposits for the year ended December 31, 2022 when compared to the same period in 2021.

Tax equivalent net interest income for the year ended December 31, 2022 was \$19,573,793, an increase of \$1,853,780, or 10.5%, when compared to the same period in 2021. The Bank's net interest margin (its tax equivalent net interest income divided by average earning assets) represents the net yield on earning assets and is managed through loan and deposit pricing and asset/liability strategies. The Bank's net interest margin for the year ended December 31, 2022 was 3.38%, compared to 3.51% for the same period in 2021. The Bank's net interest spread, which is the difference between the average yield on earning assets and the average rate paid on interest bearing liabilities, was 3.29% for the year ended December 31, 2022, compared to 3.35% for the same period in 2021.

Return on average assets was 0.85% for the year ended December 31, 2022, compared to 1.00% for the same period in 2021. Return on average stockholders' equity was 9.93% for the year ended December 31, 2022, compared to 11.16% for the same period in 2021. Comparing the year ended December 31, 2022 to the year ended December 31, 2021, average total assets increased 13.3% to \$603,310,856, average net loans increased 3.4% to \$379,270,885, average deposit liabilities increased 14.0% to \$549,294,879, and average stockholders' equity increased 7.9% to \$51,631,840.

The following table presents the changes in tax equivalent net interest income and identifies the changes due to differences in the average balance of interest-bearing assets and liabilities and changes due to differences in the average interest rate on those assets and liabilities.

Analysis of Changes in Net Interest Income		2022 Compared to 2021		
		Income variance due to:		
		Volume	Rate	Total
Interest-earning assets				
FRB interest-bearing deposits	\$	22,049	\$ 1,160,999	\$ 1,183,048
Other interest-bearing deposits		-	380	380
Federal funds sold		-	-	-
Time deposits in other banks		6,742	(19,311)	(12,569)
Other		577	3,420	3,997
Investment securities:				
U.S. Treasury		96,559	31,610	128,169
U.S. government agency		168,002	124,919	292,921
Mortgage-backed		149,787	270,224	420,011
SBA asset-backed		27,777	44,200	71,977
State and municipal		4,192	(623)	3,569
Total investment securities		<u>446,317</u>	<u>470,330</u>	<u>916,647</u>
Loans:				
Consumer		100,759	(57,772)	42,987
Credit lines		39,264	188,415	227,679
Commercial		(1,768,546)	(115,886)	(1,884,432)
Real estate		1,573,294	(641,557)	931,737
Other loan fees		(26,725)	-	(26,725)
Total loans		<u>(81,954)</u>	<u>(626,800)</u>	<u>(708,754)</u>
Total interest revenue		<u>393,731</u>	<u>989,018</u>	<u>1,382,749</u>
Interest-bearing liabilities				
Interest-bearing demand deposits		21,740	(15,335)	6,405
Savings		11,653	9,590	21,243
Money market		55,442	6,099	61,541
Time deposits		(256,104)	(304,117)	(560,221)
Total interest-bearing deposits		<u>(167,269)</u>	<u>(303,763)</u>	<u>(471,032)</u>
Borrowed overnight funds		-	1	1
FRB PPPLF advances		-	-	-
FHLB advances		-	-	-
Total borrowed funds		<u>-</u>	<u>1</u>	<u>1</u>
Total interest expense		<u>(167,269)</u>	<u>(303,762)</u>	<u>(471,031)</u>
Net interest income	\$	<u>561,000</u>	<u>\$ 1,292,780</u>	<u>\$ 1,853,780</u>

Changes in net interest income due to variances in both rate and volume are allocated to the change due to rate.

Tax equivalent income on total investment securities increased \$916,647 to \$1,668,707 for the year ended December 31, 2022 when compared to 2021. Of the total increase for 2022, \$446,317 was attributable to the increase in average balance on investment securities (volume), and \$470,330 was attributable to the increase in interest rates earned on investment securities (rate).

Tax equivalent income on total loans decreased \$708,754 to \$17,680,640 for the year ended December 31, 2022 when compared to 2021. Of the total decrease for 2022, \$81,954 was attributable to the increase in average balance on loans as well as the change in mix among loan types, and \$626,800 was attributable to the decrease in interest rates earned on loans.

Interest expense on interest-bearing deposit liabilities for the year ended December 31, 2022 decreased \$471,032 to \$1,078,356 when compared to 2021. Of the total decrease for 2022, \$167,269 was attributable to the increase in average balances on interest-bearing deposit liabilities as well as the change in mix among deposit types, and \$303,763 was attributable to the decrease in interest rates paid on deposits.

Provision for Loan Losses

The provision for, or recovery of, loan losses is determined by management as the amount to be added to, or subtracted from, respectively, the allowance for loan losses after net charge-offs (charge-offs less recoveries) have been deducted to bring the allowance for loan losses to a level which, in management's best estimation, is necessary to absorb probable losses inherent in the existing loan portfolio.

For the year ended December 31, 2022, the Bank recorded recovery of provision expense for loan losses of \$455,000, compared to provision expense for loan losses of \$0 recorded for the same period of 2021, a decrease of \$455,000. The recovery of provision expense for the year ended December 31, 2022 when compared to the same period in 2021 was due primarily to the fact that, in 2022, the Bank reduced the significantly increased provisioning in the qualitative analysis related to the COVID-19 pandemic and lowered the specific reserve related to one large commercial loan relationship.

Noninterest Revenue

The following table presents the primary components of noninterest revenue for the years ended December 31.

Noninterest Revenue	2022	2021
Service charges on deposit accounts	\$ 653,964	\$ 565,447
Debit card income	514,409	430,980
Earnings on bank owned life insurance	133,865	133,894
Recovery on restricted stock previously written off	4,356	-
Other fees and commissions	510,651	835,556
Total noninterest revenue	<u>\$ 1,817,245</u>	<u>\$ 1,965,877</u>
Noninterest revenue as a percentage of average total assets	<u>0.30%</u>	<u>0.37%</u>

Noninterest revenue for the year ended December 31, 2022 decreased \$148,632, or 7.6%, when compared to 2021. This decrease was due to decreases of \$324,905 in other fees and commissions and \$29 in earnings on bank owned life insurance, partially offset by increases of \$88,517 in deposit service charges and \$83,429 in debit card income, and the recovery on restricted stock previously written off of \$4,356. The decrease in other fees and commissions was due primarily to decreases in fees collected on third-party mortgage referrals for the year ended December 31, 2022 when compared to the same period in 2021.

Noninterest Expense

The following table presents the principal components of noninterest expense for the years ended December 31.

Noninterest Expense	2022	2021
Salaries and benefits	\$ 8,903,260	\$ 7,020,825
Occupancy	1,109,664	1,024,366
Furniture and equipment	873,620	650,405
Data processing expense	969,346	1,035,100
Internet banking fees	375,962	171,772
Professional fees	596,031	509,618
Director and committee fees	382,192	301,418
Stationery and supplies	87,525	113,976
FDIC and state assessments	363,170	255,127
Advertising	231,244	173,590
Net expenses, losses and write-downs on repossessed assets and foreclosed real estate	-	(191)
Loss on disposal of fixed assets	24,826	-
Other operating	942,556	1,102,014
Total noninterest expense	<u>\$ 14,859,396</u>	<u>\$ 12,358,020</u>
Noninterest expense as a percentage of average total assets	<u>2.46%</u>	<u>2.32%</u>

Noninterest expense for the year ended December 31, 2022 increased \$2,501,376, or 20.2%, when compared to 2021. This increase was due primarily to increases of \$1,882,435 in salaries and benefits, \$223,215 in furniture and equipment, \$204,190 in internet banking fees, and \$108,043 in FDIC and state assessments for the year ended December 31, 2022 when compared to the same period in 2021.

When comparing results for the year ended December 31, 2022 to the same period in 2021, the increase in salaries and benefits was due primarily to increases in the number of employees, annual merit increases and bonuses, and increases in employee benefit expenses, the increase in furniture and equipment was due primarily to replacement of selected items, the increase in internet banking fees was due primarily to a contract termination fee incurred in connection with the Bank's planned migration to a new internet banking platform, and the increase in FDIC insurance was due primarily to the increase in total assets.

Income Taxes

Income tax expense for the year ended December 31, 2022 was \$1,635,180, compared to \$1,858,349 for the year ended December 31, 2021, a decrease of \$223,169, or 12.0%. The decrease was primarily due to the decrease in pre-tax income in 2022 when compared to 2021, combined with the 1.62% decrease in the effective tax rate on earnings to 24.19% for the year ended December 31, 2022 from 25.81% for the year ended December 31, 2021.

Further information on the components of income tax expense is provided in Note 12 to the audited consolidated financial statements.

FINANCIAL CONDITION

Assets

Total assets increased \$20,294,182, or 3.5%, to \$595,469,294 at December 31, 2022, from \$575,175,112 at December 31, 2021. Average total assets for the year ended December 31, 2022 were \$603,310,856, compared to \$532,466,177 for the same period in 2021, an increase of \$70,844,679, or 13.3%. The average net loan portfolio, which is the primary source of income for the Bank, represented 65.6% of average earning assets for the year ended December 31, 2022, compared to 72.6% for the same period in 2021. The increase in total assets in 2022 when compared to 2021 was due primarily to the increase in deposit liabilities in 2022 when compared to 2021. The decrease in loans as a percentage of average earning assets was due primarily to interest-bearing deposits and investments representing larger percentages of interest-earning assets for the year ended December 31, 2022 when compared to the same period in 2021.

Interest-Bearing Deposits with Other Banks and Federal Funds Sold

The Bank invests excess cash balances in interest-bearing accounts and federal funds sold to its correspondent banks. These liquid deposits are maintained at a level that management believes is necessary to meet the immediate and short-term liquidity needs of the Bank. The balance of interest-bearing deposits with other banks and federal funds sold decreased \$53,426,855, or 65.6%, to \$28,038,220 at December 31, 2022, from \$81,465,075 for the same period in 2021.

Investment Securities

Investment securities at December 31, 2022 were \$120,090,930, an increase of \$14,200,409, or 13.4%, when compared to investment securities at December 31, 2021. At December 31, 2022 and 2021, all of the Bank's investment securities were classified as held to maturity and carried at cost adjusted for amortization of premiums and accretion of discounts.

The following table sets forth the stated maturities and weighted average yields of the investment securities portfolio as of December 31, 2022 and December 31, 2021.

	2022		2021	
	Amortized Cost	Yield	Amortized Cost	Yield
U.S. Treasury securities				
One year or less	\$ 3,511,186	0.56%	\$ 1,001,263	1.66%
After one year through 5 years	17,386,048	1.20%	12,946,957	0.64%
After 5 years through 10 years	-	0.00%	2,065,962	1.07%
After 10 years	-	0.00%	-	0.00%
Total U.S. Treasury securities	<u>20,897,234</u>	1.09%	<u>16,014,182</u>	0.76%
U.S. government agency securities				
One year or less	2,007,846	1.30%	3,466,290	1.59%
After one year through 5 years	22,855,062	0.65%	23,994,766	0.64%
After 5 years through 10 years	7,995,018	1.94%	7,994,519	1.94%
After 10 years	<u>3,917,047</u>	3.92%	-	0.00%
Total U.S. government agency securities	<u>36,774,973</u>	1.32%	<u>35,455,575</u>	1.03%
State and municipal securities				
One year or less	-	0.00%	-	0.00%
After one year through 5 years	1,363,097	1.28%	-	0.00%
After 5 years through 10 years	1,167,445	1.50%	1,794,084	1.34%
After 10 years	<u>1,040,000</u>	2.23%	<u>1,791,228</u>	1.92%
Total state and municipal securities	<u>3,570,542</u>	1.63%	<u>3,585,312</u>	1.63%
Mortgage-backed securities	46,856,593	2.23%	37,712,616	1.45%
Asset-backed securities	<u>11,991,588</u>	2.24%	<u>13,122,836</u>	1.92%
	<u>\$ 120,090,930</u>	1.73%	<u>\$ 105,890,521</u>	1.27%

As indicated by the table, \$5,519,031, or 4.6%, of the investment securities held at December 31, 2022 had a stated maturity of one year or less, compared to \$4,467,552, or 4.2%, of the investment securities held at December 31, 2021.

Further information about investments is provided in Note 3 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

Loans and Allowance for Loan Losses

Loans, net of deferred fees and costs, and net of the allowance for loan losses, increased \$60,899,583, or 16.8%, to \$423,920,559 at December 31, 2022, from \$363,020,976 at December 31, 2021. The majority of the loan portfolio is comprised of loans which are secured by commercial and residential real estate. Real estate loans made up 89.5% of gross loans at December 31, 2022, compared to 87.9% of gross loans at December 31, 2021. The Bank did not transfer any loans into foreclosed real estate in either 2022 or 2021.

The following table sets forth the composition of the Bank's loan portfolio as of December 31 of the years indicated.

	2022		2021	
	Amount	Percent of Total	Amount	Percent of Total
Real estate				
Construction, development and other land	\$ 21,239,232	5.0%	\$ 13,597,178	3.7%
Secured by farmland	9,169,852	2.1%	7,730,157	2.1%
Commercial	226,820,382	52.8%	202,068,811	54.7%
Residential	<u>126,777,277</u>	<u>29.6%</u>	<u>101,000,867</u>	<u>27.4%</u>
Total real estate	384,006,743	89.5%	324,397,013	87.9%
Commercial and industrial				
Commercial	28,595,832	6.7%	17,877,822	4.9%
Paycheck Protection Program	369,000	0.1%	19,301,845	5.2%
Mobile home	2,603,029	0.6%	3,011,002	0.8%
Other consumer	13,372,328	3.1%	4,592,221	1.2%
Overdrafts	<u>49,705</u>	<u>0.0%</u>	<u>52,307</u>	<u>0.0%</u>
Gross loans	428,996,637	<u>100.0%</u>	369,232,210	<u>100.0%</u>
Deferred (fees) costs	(380,310)		(1,131,091)	
Allowance for loan losses	<u>(4,695,768)</u>		<u>(5,080,143)</u>	
Net loans	<u>\$ 423,920,559</u>		<u>\$ 363,020,976</u>	

The following table sets forth the maturity distribution of the Bank's gross loan portfolio as of December 31, 2022. The table also presents the portion of loans with fixed interest rates or variable interest rates that will fluctuate over the life of the loans in accordance with changes in the Bank's current offering rates for that adjustment interval at the time of repricing.

At December 31, 2022	Due in One Year Or Less	After One, But Within Five Years	After Five, But Within Fifteen Years	After Fifteen Years	Total
Loans with fixed interest rates:					
Construction, development and other land	\$ 3,619,670	\$ -	\$ 81,335	\$ 106,720	\$ 3,807,725
Commercial real estate and farmland	5,813,869	8,761,351	4,763,153	1,945,476	21,283,849
Residential real estate	39,281	898,502	21,544,051	43,593,537	66,075,371
Commercial and industrial	239,888	11,065,078	6,284,900	-	17,589,866
Mobile home	7,677	258,649	1,676,956	659,747	2,603,029
Other consumer and overdraft	<u>139,764</u>	<u>2,423,591</u>	<u>1,981,883</u>	<u>8,562,042</u>	<u>13,107,280</u>
Total	<u>\$ 9,860,149</u>	<u>\$ 23,407,171</u>	<u>\$ 36,332,278</u>	<u>\$ 54,867,522</u>	<u>\$ 124,467,120</u>
Loans with variable interest rates:					
Construction, development and other land	\$ 8,433,162	\$ 1,635,657	\$ 4,156,422	\$ 3,206,266	\$ 17,431,507
Commercial real estate and farmland	1,146,677	1,494,386	63,230,651	148,834,671	214,706,385
Residential real estate	1,946,505	863,352	13,864,276	44,027,773	60,701,906
Commercial and industrial	5,309,067	1,337,634	4,334,534	393,731	11,374,966
Mobile home	-	-	-	-	-
Other consumer and overdraft	<u>4,648</u>	<u>114,110</u>	<u>195,995</u>	<u>-</u>	<u>314,753</u>
Total	<u>\$ 16,840,059</u>	<u>\$ 5,445,139</u>	<u>\$ 85,781,878</u>	<u>\$ 196,462,441</u>	<u>\$ 304,529,517</u>
Total Loans:					
Construction, development and other land	\$ 12,052,832	\$ 1,635,657	\$ 4,237,757	\$ 3,312,986	\$ 21,239,232
Commercial real estate and farmland	6,960,546	10,255,737	67,993,804	150,780,147	235,990,234
Residential real estate	1,985,786	1,761,854	35,408,327	87,621,310	126,777,277
Commercial and industrial	5,548,955	12,402,712	10,619,434	393,731	28,964,832
Mobile home	7,677	258,649	1,676,956	659,747	2,603,029
Other consumer and overdraft	<u>144,412</u>	<u>2,537,701</u>	<u>2,177,878</u>	<u>8,562,042</u>	<u>13,422,033</u>
Total	<u>\$ 26,700,208</u>	<u>\$ 28,852,310</u>	<u>\$ 122,114,156</u>	<u>\$ 251,329,963</u>	<u>\$ 428,996,637</u>

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 audited consolidated financial statements included elsewhere in this report describe the accounting policies related to nonperforming loans and charge-offs and foreclosed and repossessed assets, describe the methodologies used to develop the allowance for loan losses, and describe the credit quality indicators, loan restructurings and other details related to loans and the allowance for loan losses. Management believes the policies governing nonperforming loans and charge-offs are consistent with regulatory standards. The allowance is increased by provisions for loan losses charged to expense and recoveries of loans previously charged-off. Provisions for loan losses are made to bring the allowance for loan losses within the range of balances that are considered appropriate based upon the allowance methodology and to reflect management's estimate of losses inherent in the loan portfolio as of the balance sheet date.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loan delinquency may be an indication of a borrower experiencing stress, and generally results in increased monitoring of the loan relationship and other actions by the Bank to mitigate the potential of loss. Loans 90 days and more past due are in various stages of workout including possible foreclosure. The following table summarizes the Bank's loan delinquency as of December 31 of the years indicated.

Loan Delinquency	2022	2021
Loans 30-59 days past due	\$ 200,238	\$ 220,999
Loans 60-89 days past due	-	-
Loans 90 days and more past due	102,286	2,780,280
Total loans 30 days and more past due	<u>\$ 302,524</u>	<u>\$ 3,001,279</u>
Loans 90 days and more past due and accruing	<u>\$ 101,520</u>	<u>\$ -</u>

As of December 31, 2022, \$766 of loans that were 90 days or more past due were included in non-accrual loans. As of December 31, 2021, \$2,780,280 of loans that were 90 days or more past due were included in non-accrual loans.

Non-Performing Assets: Non-performing assets include non-accrual loans and foreclosed assets. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed and charged to current year operations. Subsequent receipts on non-accrual loans are recorded as a reduction of principal. Loans may be considered for return to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following table summarizes the Bank's non-performing assets as of December 31 of the years indicated.

Non-Performing Assets	2022	2021
Non-accrual loans	\$ 6,996,567	\$ 7,790,367
Foreclosed real estate	-	-
Repossessed assets	-	-
Total	<u>\$ 6,996,567</u>	<u>\$ 7,790,367</u>

Restructured Loans: A troubled debt restructuring ("TDR") is the restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty. A loan will be classified as a TDR if the Bank restructures the loan's terms (i.e., interest rate, payment amount, amortization period and/or maturity date) after determining that the borrower is experiencing financial difficulties. The Bank had \$6,076,183 in TDRs outstanding at December 31, 2022, compared to \$4,280,972 at December 31, 2021. TDRs included in non-accrual loans were \$6,076,183 at December 31, 2022, compared to \$4,280,972 at December 31, 2021.

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Bank will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for loans that management considers to be of little risk and of similar nature and on an individual basis for other loans. If an individually-evaluated loan is determined to be impaired, then it is measured for impairment. A specific valuation allowance is allocated if there is measured impairment. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured. Impaired loans, or portions thereof, are charged off when deemed uncollectible. TDRs are included in impaired loans.

Allowance for Loan Losses: The allowance for loan losses is a reserve established through a provision for loan losses charged to expense. The adequacy of the allowance for loan losses is determined based upon management's best estimate of the inherent risks associated with lending activities, and includes consideration of factors such as estimated fair value of collateral, past experience and present indicators such as loan delinquency trends, non-accrual loans and current market conditions. Management and the Board of Directors are actively funding and continually monitoring the allowance for loan losses to mitigate any future loan losses due to a weakened economy and troubled loans, and the process is designed to account for credit deterioration as it occurs. Even so, examination of the loan portfolio and subsequent evaluation of the adequacy of the allowance for loan losses by the Bank's regulators, auditors, and consultants engaged by the Bank may result in the need for additional provisions based upon information available at the time of examination.

The allowance for loan losses at December 31, 2022 was \$4,695,768, a decrease of \$384,375, or 7.6%, when compared to December 31, 2021. The components of the decrease were recoveries of provision expense of \$455,000 and amounts charged-off of \$63,011, partially offset by recoveries of amounts previously charged-off of \$133,636.

At December 31, 2022, the allowance for loan losses was 1.09% of gross loans. At December 31, 2021, the allowance for loan losses was 1.38% of gross loans.

The table below provides an allocation of the allowance for loan losses to each major loan portfolio classification at December 31, 2022 and 2021.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial and Industrial	Mobile Home	Other Consumer	Overdrafts	Total Gross Loans
December 31, 2022									
Loan balances by portfolio:	\$ 21,239,232	\$ 21,239,232	\$ 235,990,234	\$ 126,777,277	\$ 28,964,832	\$ 2,603,029	\$ 13,372,328	\$ 49,705	\$ 428,996,637
As % of total gross loans:		4.95%	55.01%	29.55%	6.75%	0.61%	3.12%	0.01%	100.0%
Allowance for loan losses:	\$ 13,670	\$ 446,024	\$ 2,550,667	\$ 986,573	\$ 452,861	\$ 97,402	\$ 121,136	\$ 27,435	\$ 4,695,768
As % of portfolio:	0.00%	2.10%	1.08%	0.78%	1.56%	3.74%	0.91%	55.20%	1.09%
December 31, 2021									
Loan balances by portfolio:	\$ 13,597,178	\$ 13,597,178	\$ 209,798,968	\$ 101,000,867	\$ 37,179,667	\$ 3,011,002	\$ 4,592,221	\$ 52,307	\$ 369,232,210
As % of total loans:		3.68%	56.83%	27.35%	10.07%	0.82%	1.24%	0.01%	100.0%
Allowance for loan losses:	\$ 46,680	\$ 292,339	\$ 3,355,417	\$ 883,184	\$ 334,073	\$ 116,912	\$ 35,500	\$ 16,038	\$ 5,080,143
As % of portfolio:	0.00%	2.15%	1.60%	0.87%	0.90%	3.88%	0.77%	30.66%	1.38%

The table below provides credit ratio information at December 31, 2022 and 2021.

At and for the years ended:	December 31, 2022	December 31, 2021
Non-accrual loans	\$ 6,996,567	\$ 7,790,367
Total gross loans	428,996,637	369,232,210
Non-accrual loans to total gross loans	1.63%	2.11%
Allowance for loan and lease losses	\$ 4,695,768	\$ 5,080,143
Non-accrual loans	6,996,567	7,790,367
Allowance for loan and lease losses to non-accrual loans	67.12%	65.21%
Net charge-offs (recoveries)	\$ (70,625)	\$ 36,554
Average total loans	384,280,633	372,027,787
Net charge-offs (recoveries) to average total loans	-0.02%	0.01%

Further information about loans and the allowance for loan losses is provided in Note 4 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

Deposits

Total deposits at December 31, 2022 were \$538,521,175, an increase of \$16,196,697, or 3.1%, over total deposits at December 31, 2021. The Bank primarily utilizes deposits to fund its earning assets. For the year ended December 31, 2022, average deposits provided funding for approximately 95.0% of average earning assets compared to 95.3% for 2021. Average total deposits increased \$67,620,052, or 14.0%, in 2022 when compared to 2021. The average balance of noninterest-bearing demand deposits increased \$17,820,188, or 12.5%, in 2022 when compared to 2021. The average balance of interest-bearing checking and money market accounts increased \$63,080,988, or 37.2%, in 2022 when compared to 2021. The average balance of savings deposits increased \$8,701,266, or 14.7%, in 2022 when compared to 2021. The average balance of time deposits decreased \$21,982,390, or 19.9%, in 2022 when compared to 2021. The weighted-average cost of average total deposits decreased 12 basis points to 0.20% in 2022 from 0.32% in 2021. This decrease was primarily due to the decrease in higher rate time deposit balances, which changed the mix of total deposits in 2022 when compared to 2021.

The following table sets forth the Bank's deposits by category as of December 31 for the years indicated.

Deposits by Category	2022		2021	
	Amount	Percent of Total	Amount	Percent of Total
Noninterest-bearing demand	\$ 151,548,167	28.1%	\$ 153,557,695	29.4%
Interest-bearing checking and Money Market	238,897,337	44.4%	197,672,460	37.8%
Savings	68,631,963	12.7%	62,996,093	12.1%
Time deposits	79,443,708	14.8%	108,098,230	20.7%
Total deposits	<u>\$ 538,521,175</u>	<u>100.0%</u>	<u>\$ 522,324,478</u>	<u>100.0%</u>

The maturity distribution of the Bank's time deposits that exceed the \$250,000 FDIC deposit insurance limit at December 31 for the years indicated is shown in the following table.

Maturities of Time Deposits in excess of \$250,000	2022	2021
Three months or less	\$ 795,843	\$ 13,638,560
After three months to one year	8,894,907	21,216,723
After one year to three years	10,117,619	4,438,131
After three years to five years	1,342,799	271,297
Total	<u>\$ 21,151,168</u>	<u>\$ 39,564,711</u>

The estimated amount of total uninsured deposits at December 31, 2022 was \$270,805,143. The estimated amount of total uninsured deposits at December 31, 2021 was \$262,452,388.

Federal Home Loan Bank credit facility

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, subject to collateral availability. The line of credit interest rate is a variable rate set daily by the FHLBA. 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.

Further information is provided in Note 9 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

Capital Management

The Bank continues to maintain capital at levels in excess of the minimum risk-based capital requirements adopted by the federal banking agencies, and the most recent notification from the Bank's primary regulator categorized the Bank as a "well-capitalized" institution. Total stockholders' equity increased \$4,500,153, or 9.1%, to \$54,046,688 at December 31, 2022 from \$49,546,535 at December 31, 2021. The components of this increase were net income of \$5,125,679, stock options exercised and net dividends reinvested in the amount of \$443,716, and stock-based compensation expense totaling \$55,659, reduced by cash dividends declared of \$1,124,901.

The following table compares the Bank's capital ratios as of December 31 of the years indicated to the regulatory requirements.

(\$ in thousands)	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2022	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$58,743	13.79%	\$42,612	10.00%	\$34,089	8.00%	\$44,742	10.50%
Tier 1 capital	54,047	12.68%	34,089	8.00%	25,567	6.00%	36,220	8.50%
Common equity Tier 1 capital	54,047	12.68%	27,697	6.50%	19,175	4.50%	29,828	7.00%
Tier 1 leverage capital	54,047	8.78%	30,762	5.00%	24,610	4.00%	24,610	4.00%

December 31, 2021	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$53,926	15.43%	\$34,959	10.00%	\$27,967	8.00%	\$36,707	10.50%
Tier 1 capital	49,547	14.17%	27,967	8.00%	20,975	6.00%	29,715	8.50%
Common equity Tier 1 capital	49,547	14.17%	22,723	6.50%	15,732	4.50%	24,471	7.00%
Tier 1 leverage capital	49,547	8.66%	28,606	5.00%	22,885	4.00%	22,885	4.00%

The DRIP contemplates that the shares necessary to fund dividend reinvestments will be either newly issued shares or shares that the Bank, in its capacity as administrator, purchases in the open market or in privately negotiated transactions (collectively "open-market purchases"). The Bank uses its ability to fund dividend reinvestment requirements with open-market purchases to manage its capital position and the dilutive effect of issuing new shares. The Board has authorized Executive Management to acquire up to 3,000 of the shares needed to fund reinvestments for each dividend payment event through open-market purchases. Open-market purchases in excess of 3,000 shares up to 100% of shares needed must be approved by the Board. During 2022, the Bank acquired 3,369 shares at an average price of \$31.76 to fund dividend reinvestment. During 2021, the Bank acquired 5,861 shares at an average price of \$27.29 to fund dividend reinvestment.

Further information about the Bank's capital and capital standards is provided in Note 14 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

Liquidity Management; Contractual Obligations and Off-Balance Sheet Transactions

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 of time deposits in other banks, maturities and calls 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 the short-term funds markets. The Bank has arrangements with a correspondent bank whereby it has \$3,000,000 available in an unsecured federal funds line of credit and \$5,000,000 in a secured federal funds line of credit. The Bank is also a member of the FHLBA, CDARS-The Certificate of Deposit Account Registry Service, and the Federal Reserve Bank Discount window, which provide additional resources of liquidity. Further information about these arrangements is provided in Note 9 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

At December 31, 2022, the Bank's net loans to deposit ratio was 78.7%, compared to 69.5% at December 31, 2021, with the increase due primarily to loan growth outpacing deposit growth in 2022. Cash and cash equivalents were \$28,444,396 at December 31, 2022, which represented a decrease of \$53,986,563 when compared to the amount outstanding at December 31, 2021. Time deposits in other banks were \$2,545,624 at December 31, 2022, which was a decrease of \$286,785 when compared to the amount outstanding at December 31, 2021.

In addition to its deposit liabilities, the Bank has various financial obligations, including contractual obligations and commitments that may require future cash payments. 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, 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. Since 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. Further information about these arrangements is provided in Note 5 to the audited consolidated financial statements, which are contained in Item 8 of Part II of this annual report.

Management does not believe that any of the foregoing arrangements have or are reasonably likely to have a current or future effect on the Bank's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. Management is not aware of any demands, commitments, events or uncertainties that will materially affect the Bank's ability to maintain liquidity at satisfactory levels.

The following table presents, as of December 31, 2022, significant fixed and determinable contractual obligations to third parties by payment date. Payments for deposits and borrowings do not include interest. Payments on leases are based on actual payments specified in the underlying contracts.

Contractual Obligations	One year or less	Over 1 to 3 years	Over 3 to 5 years	Over 5 years	Total
Deposits with stated maturity dates	\$ 48,010,291	\$ 26,309,100	\$ 5,124,317	\$ -	\$ 79,443,708
Operating leases	172,960	200,790	27,614	-	401,364
Total	<u>\$ 48,183,251</u>	<u>\$ 26,509,890</u>	<u>\$ 5,151,931</u>	<u>\$ -</u>	<u>\$ 79,845,072</u>

The following table presents credit commitments as of December 31, 2022. Loan commitments and letters of credit are presented at contractual amounts.

Credit Commitments	One year or less	Over 1 year	Total
Commitments to extend credit	\$ 73,827,214	\$ 25,227,973	\$ 99,055,187
Letters of credit	4,349,155	-	4,349,155
Total	<u>\$ 78,176,369</u>	<u>\$ 25,227,973</u>	<u>\$ 103,404,342</u>

Market Risk

Market risk refers to the risk of loss arising from changes in interest rates and other relevant market rates and prices. The risk of loss can be assessed from the perspective of changes in fair values, cash flows, and future earnings. Due to the nature of its operations, the Bank's principal market risk is the fluctuation of interest rates and the impact such fluctuation would have on the Bank's lending, investing and deposit activities. Interest rate risk on the Bank's balance sheet consists of repricing, option and basis risks. Repricing risk results from differences in the maturity or repricing of asset and liability portfolios. Option risk arises from the embedded options present in many financial instruments such as the loan prepayment options, investment security call options and deposit early withdrawal options. These options permit the counterparty to benefit when interest rates change, which typically results in lower revenue or higher costs for the Bank. Basis risk results from changes in the underlying relationship between market rates and indices, causing a narrowing of the profit spread on the earning asset or liability. Basis risk extends to administered rate liabilities such as savings, interest-bearing checking, and money market accounts where historical pricing relationships to market rates may change.

The Bank seeks to avoid fluctuations in its net interest margin and to maximize net interest income within acceptable levels of risk through periods of changing interest rates. The Bank's Asset/Liability Committee ("ALCO") oversees the management of market risk management and interest rate sensitivity. ALCO's actions include establishing and monitoring risk measures, limits and policy guidelines for managing market risk and its effect on the Bank's net interest income and capital. These efforts affect the loan pricing and deposit rate policies of the Bank as well as the mix of assets and liabilities, volume guidelines, durations of assets and liabilities, liquidity and capital planning.

The Bank utilizes an earning simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effect of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model measures the impact on net interest income of hypothetical fluctuations in interest rates over the next 12 months. These simulations include assumptions regarding balance sheet growth and mix, pricing, repricing, maturity, prepayment characteristics of the existing and projected balance sheet, as well as the magnitude and timing of interest rate changes.

When actual changes in interest rates occur, the changes in interest earning assets and interest bearing liabilities may differ from the assumptions used in the model.

At December 31, 2022, the model simulations projected the following percentage changes in net interest income from the base case (no change in rates) over the next 12 months for the various interest rate change scenarios listed in the table below.

	+400	+300	+200	+100	-100	-200
Change in interest rates:	Basis points	Basis points	Basis points	Basis points	Basis points	Basis points
Change in net interest income	2.68%	2.59%	1.96%	1.02%	-4.00%	-7.84%

Accounting Standards Updates

See Note 18 to the audited consolidated financial statements contained in Item 8 of Part II of this annual report.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

The Bank is a “smaller reporting company” as defined in Rule 12b-2 under the Exchange Act and, as such, is not required to present the information required by this item. Certain market risk information is presented in Item 7 of Part II of this report under the heading “Market Risk”.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Financial statements and schedules:

Reports of Independent Registered Public Accounting Firms

Consolidated Statements of Condition at December 31, 2022 and 2021

Consolidated Statements of Income for years ended December 31, 2022 and 2021

Consolidated Statements of Changes in Stockholders' Equity for years ended December 31, 2022 and 2021

Consolidated Statements of Cash Flows for years ended December 31, 2022 and 2021

Notes to Consolidated Financial Statements



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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Harford Bank
Aberdeen, Maryland

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of condition of Harford Bank and Subsidiary (the Bank) as of December 31, 2022, the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 2022, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of December 31, 2022, and the results of its operations and its cash flows for the year ended December 31, 2022, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the Bank's financial statements based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Bank in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex judgements. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – Qualitative Factors

As described in Note 1 – Summary of Significant Accounting Policies and Note 4 – Loans to the consolidated financial statements, the Bank maintains an allowance for loan losses that management believes will be adequate to absorb probable losses inherent in the loan portfolio. For loans that are not specifically identified for impairment, management determines the allowance for loan losses based on historical loss experience adjusted for qualitative factors. Qualitative adjustments to the historical loss experience are established by applying a loss percentage to the loan segments established by management based on their assessment of shared risk characteristics within groups of similar loans.

Qualitative factors are determined based on management's continuing evaluation of inputs and assumptions underlying the quality of the loan portfolio. Management evaluates qualitative factors by loan segment, primarily considering current economic conditions, changes in concentrations, nature and volume of loans, delinquency trends, collateral values, and lending policies and procedures, and may also consider the experience and tenure of the lending team, loan review system, and other external factors. Qualitative factors contribute significantly to the allowance for loan losses. Management exercised significant judgement when assessing the qualitative factors in estimating the allowance for loan losses. We identified the assessment of the qualitative factors as a critical audit matter as auditing the qualitative factors involved especially complex and subjective auditor judgement in evaluating management's assessment of the inherently subjective estimates.

The primary audit procedures we performed to address this critical audit matter included:

- Substantively testing management's process, including evaluating their judgements and assumptions for developing the qualitative factors, which included:
 - Evaluating the completeness and accuracy of data inputs used as a basis for the qualitative factors.
 - Evaluating the reasonableness of management's judgements related to the determination of qualitative factors.
 - Evaluating the qualitative factors for directional consistency in comparison to prior periods and reasonableness in comparison to underlying supporting data.
 - Testing the mathematical accuracy of the allowance calculation, including the application of the qualitative factors.

Gorant, Hyde & Barbour, P.C.

We have served as the Bank's auditor since 2022.

Baltimore, Maryland
March 15, 2023



Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors
Harford Bank and Subsidiary

Opinion on the Financial Statements

We have audited the accompanying consolidated statement of condition of Harford Bank and Subsidiary (the “Company”) as of December 31, 2021, the related consolidated statement of income, changes in stockholders’ equity, and cash flows for the year then ended, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2021, and the results of its operations and its cash flows for the year ended December 31, 2021, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audit.

We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audit, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

FORVIS,LLP

(Formerly, Dixon Hughes Goodman LLP)

We served as the Company’s auditor from 2016 to 2022.

Richmond, Virginia
March 16, 2022

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CONDITION

At December 31,	2022	2021
ASSETS		
Cash and due from banks	\$ 2,951,800	\$ 3,798,293
Federal Reserve Bank deposit	25,466,624	78,615,598
Federal funds sold and Federal Home Loan Bank deposit	<u>25,972</u>	<u>17,068</u>
Total cash and cash equivalents	28,444,396	82,430,959
Time deposits in other banks	2,545,624	2,832,409
Investment securities held to maturity (fair value of \$108,252,713 in 2022 and \$105,141,946 in 2021)	120,090,930	105,890,521
Federal Home Loan Bank stock, at cost	330,100	285,500
Total loans, including deferred fees net of costs	428,616,327	368,101,119
Less: Allowance for loan losses	<u>(4,695,768)</u>	<u>(5,080,143)</u>
Net loans	423,920,559	363,020,976
Bank premises and equipment	9,817,299	10,167,594
Income taxes refundable	146,070	7,441
Accrued interest receivable	1,418,195	1,355,966
Deferred income taxes	980,031	994,192
Bank owned life insurance	6,406,523	6,272,657
Other assets	<u>1,369,567</u>	<u>1,916,897</u>
Total assets	<u>\$ 595,469,294</u>	<u>\$ 575,175,112</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 151,548,167	\$ 153,557,695
Interest-bearing	<u>386,973,008</u>	<u>368,766,783</u>
Total deposits	538,521,175	522,324,478
Accrued interest payable	88,851	130,139
Other liabilities	<u>2,812,580</u>	<u>3,173,960</u>
Total liabilities	<u>541,422,606</u>	<u>525,628,577</u>
Stockholders' equity		
Common stock, par value \$10 per share; authorized 5,000,000 shares; issued and outstanding 1,470,446 shares in 2022, and 1,451,175 shares in 2021	14,704,460	14,511,750
Surplus	17,674,158	17,367,493
Undivided profits	<u>21,668,070</u>	<u>17,667,292</u>
Total stockholders' equity	<u>54,046,688</u>	<u>49,546,535</u>
Total liabilities and stockholders' equity	<u>\$ 595,469,294</u>	<u>\$ 575,175,112</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31,	2022	2021
Interest revenue		
Loans, including fees	\$ 17,604,650	\$ 18,300,294
Investment securities held to maturity	1,602,933	719,260
Federal funds sold and Federal Home Loan Bank deposit	354	1
Federal Reserve Bank deposit	1,189,943	84,000
Time deposits in other banks	13,694	26,267
Other	14,793	11,055
Total interest revenue	<u>20,426,367</u>	<u>19,140,877</u>
Interest expense		
Deposits	1,078,356	1,549,388
Borrowed funds	1	-
Total interest expense	<u>1,078,357</u>	<u>1,549,388</u>
Net interest income	<u>19,348,010</u>	<u>17,591,489</u>
Provision for (recovery of) loan losses	<u>(455,000)</u>	<u>-</u>
Net interest income after provision for (recovery of) loan losses	<u>19,803,010</u>	<u>17,591,489</u>
Noninterest revenue		
Service charges on deposit accounts	653,964	565,447
Debit card income	514,409	430,980
Earnings on bank owned life insurance	133,865	133,894
Recovery on restricted stock previously written off	4,356	-
Other fees and commissions	510,651	835,556
Total noninterest revenue	<u>1,817,245</u>	<u>1,965,877</u>
Noninterest expense		
Salaries and benefits	8,903,260	7,020,825
Occupancy	1,109,664	1,024,366
Furniture and equipment	873,620	650,405
Data processing expense	969,346	1,035,100
Internet banking fees	375,962	171,772
Professional fees	596,031	509,618
Director and committee fees	382,192	301,418
Stationery and supplies	87,525	113,976
FDIC and state assessments	363,170	255,127
Advertising	231,244	173,590
Net expenses, (gains), losses and write-downs on repossessed assets and foreclosed real estate	-	(191)
Loss on disposal of fixed assets	24,826	-
Other operating	942,556	1,102,014
Total noninterest expense	<u>14,859,396</u>	<u>12,358,020</u>
Income before income taxes	<u>6,760,859</u>	<u>7,199,346</u>
Income taxes	<u>1,635,180</u>	<u>1,858,349</u>
Net income	<u>\$ 5,125,679</u>	<u>\$ 5,340,997</u>
Basic net income per common share	\$ 3.51	\$ 3.71
Diluted net income per common share	\$ 3.49	\$ 3.69

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2022 and 2021

	Common stock <u>Shares</u>	<u>Par value</u>	<u>Surplus</u>	Undivided <u>profits</u>	Total Stockholders' <u>Equity</u>
Balance, January 1, 2021	1,433,781	\$ 14,337,810	\$ 17,062,149	\$ 13,796,538	\$ 45,196,497
Net income				5,340,997	5,340,997
Cash dividends, \$1.02 per share				(1,470,243)	(1,470,243)
Common stock issued					
Shares issued under stock-based compensation plans and related tax effects	7,704	77,040	85,002	-	162,042
Stock sold and dividend reinvestment plan (DRIP)	15,551	155,510	278,495	-	434,005
Stock-based compensation expense			43,169	-	43,169
Stock acquired for DRIP administration	(5,861)	(58,610)	(101,322)	-	(159,932)
Balance, December 31, 2021	<u>1,451,175</u>	<u>\$ 14,511,750</u>	<u>\$ 17,367,493</u>	<u>\$ 17,667,292</u>	<u>\$ 49,546,535</u>
Balance, January 1, 2022	1,451,175	\$ 14,511,750	\$ 17,367,493	\$ 17,667,292	\$ 49,546,535
Net income				5,125,679	5,125,679
Cash dividends, \$0.77 per share				(1,124,901)	(1,124,901)
Common stock issued					
Shares issued under stock-based compensation plans and related tax effects	12,934	129,340	113,524	-	242,864
Stock sold and dividend reinvestment plan (DRIP)	9,706	97,060	210,808	-	307,868
Stock-based compensation expense			55,659	-	55,659
Stock acquired for DRIP administration	(3,369)	(33,690)	(73,326)	-	(107,016)
Balance, December 31, 2022	<u>1,470,446</u>	<u>\$ 14,704,460</u>	<u>\$ 17,674,158</u>	<u>\$ 21,668,070</u>	<u>\$ 54,046,688</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31,	2022	2021
Cash flows provided by (used in) operating activities		
Interest received	\$ 21,095,140	\$21,661,793
Fees and commissions received	2,617,454	2,668,386
Interest paid	(1,119,645)	(1,619,390)
Cash paid to suppliers and employees	(14,178,739)	(11,027,163)
Income taxes paid	(1,759,648)	(2,378,069)
Net cash provided by (used in) operating activities	<u>6,654,562</u>	<u>9,305,557</u>
Cash flows provided by (used in) investing activities		
Proceeds from maturities of time deposits in other banks	250,000	1,500,000
Purchases of time deposits in other banks	-	(2,602,085)
Proceeds from calls and maturities of investment securities	13,738,270	20,240,376
Purchases of investment securities	(28,627,547)	(79,034,079)
Redemption (purchase) of FHLB stock	(44,600)	96,600
Loans originated, net of principal repayments	(59,693,803)	(1,697,214)
Net increase (decrease) in deferred loan fees and costs	(1,556,338)	(2,638,153)
Proceeds from sale of bank premises and equipment	-	1,800
Purchases of bank premises and equipment	(222,619)	(1,814,463)
Net cash provided by (used in) investing activities	<u>(76,156,637)</u>	<u>(65,947,218)</u>
Cash flows provided by (used in) financing activities		
Net increase (decrease) in time deposits	(28,654,522)	(6,046,685)
Net increase (decrease) in other deposits	44,851,219	90,553,467
Dividends paid	(1,124,901)	(1,470,243)
Dividends reinvested	307,868	434,005
Shares issued under stock-based compensation plans and related tax effects	242,864	162,042
Stock acquired for DRIP administration	(107,016)	(159,932)
Net cash provided by (used in) financing activities	<u>15,515,512</u>	<u>83,472,654</u>
Net increase (decrease) in cash and cash equivalents	(53,986,563)	26,830,993
Cash and cash equivalents at beginning of period	<u>82,430,959</u>	<u>55,599,966</u>
Cash and cash equivalents at end of period	\$ 28,444,396	\$ 82,430,959

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

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

For the Years Ended December 31,	2022	2021
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 5,125,679	\$ 5,340,997
Adjustments to reconcile net income to net cash provided by operating activities		
Net amortization and accretion on loan fees and costs	805,558	2,495,998
Net amortization and accretion on time deposits in other banks	36,785	19,676
Net amortization and accretion on investment securities	688,868	684,335
Depreciation and amortization on fixed assets and software	545,643	506,677
Earnings on bank owned life insurance	(133,865)	(133,893)
Provision for (recovery of) loan losses	(455,000)	-
Loss (gain) on disposition of bank premises and equipment	24,826	(1,800)
Stock-based compensation expense	55,659	43,169
Decrease (increase) in		
Deferred income taxes	14,161	46,642
Accrued interest receivable	(62,229)	25,216
Income taxes refundable	(138,629)	(7,441)
Other assets	549,774	(83,729)
Increase (decrease) in		
Accrued interest payable	(41,288)	(70,002)
Income taxes payable	-	(558,921)
Other liabilities	(361,380)	998,633
	<u>\$ 6,654,562</u>	<u>\$ 9,305,557</u>

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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 surrounding areas of 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. The estimates related to the allowance for loan losses, fair value of financial instruments and income taxes are particularly subject to change.

Reclassifications

Certain reclassifications have been made to the 2021 consolidated financial statement presentation to conform to the current year's format. Total equity and net income are unchanged due to these reclassifications.

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 typically 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.

Credit declines in the fair value of individual held to maturity investment securities below their amortized cost that are determined to be other than temporary result in write-downs of the individual securities to their fair value. The related write downs are included in earnings as realized losses. Factors that management considers in determining if other than temporary impairment has been incurred include the length of time and the extent to which the fair value has been less than amortized cost, the financial condition and prospects of the issuer, and the intent and ability of the Bank to hold the investment securities for a period of time sufficient to allow for recovery in fair value.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies - continued

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, because there is a minimal market for the stock. Therefore, when evaluating FHLBA stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Bank does not consider this investment to be other-than-temporarily impaired as of December 31, 2022, and no impairment has been recognized.

Loans and allowance for loan losses

Loans are stated at unpaid principal balance adjusted for any amounts partially charged-off, the allowance for loan losses, 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 considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms. Generally, loans are reviewed for impairment 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 restructured in a troubled debt restructuring ("TDR"). A TDR is the restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty.

The allowance for loan losses represents an amount, which in management's judgment, will be adequate to absorb losses inherent in the loan portfolio. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrower's ability to pay, overall portfolio quality, and review of specific problem areas. If the current economy or real estate market were to suffer a severe downturn, the estimate for uncollectible accounts would need to be increased. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are individually evaluated for impairment and for which impairment is determined to exist. The general component covers the remaining loan portfolio and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies - continued

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 loan losses. Subsequent reductions in the estimated value of the real estate property or other collateral are included in noninterest expense.

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.

Net income per common share

Basic net income 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 net income per common share is computed using the weighted-average number of common shares determined for the basic net income 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 Financial Accounting Standards Board ("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

FASB 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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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.

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	Unrealized Gains	Unrealized Losses	Fair Value
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>
December 31, 2021				
U.S. Treasury securities	\$ 16,014,182	\$ 14,489	\$ 174,681	\$ 15,853,990
U.S. government agency securities	35,455,575	39,217	305,836	35,188,956
Agency RMBS	36,276,433	175,178	304,842	36,146,769
Agency CMO securities	1,436,183	-	49,114	1,387,069
SBA asset-backed securities	13,122,836	102,780	223,239	13,002,377
State and municipal securities	3,585,312	17,449	39,976	3,562,785
	<u>\$ 105,890,521</u>	<u>\$ 349,113</u>	<u>\$ 1,097,688</u>	<u>\$ 105,141,946</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.

	December 31, 2022		December 31, 2021	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing				
In one year or less	\$ 5,519,031	\$ 5,369,120	\$ 4,467,552	\$ 4,491,411
Over one to five years	41,604,207	38,361,992	36,941,723	36,522,295
Over five to ten years	9,162,464	7,660,678	11,854,566	11,810,367
Greater than ten years	4,957,047	4,232,729	1,791,228	1,781,658
Mortgage-backed, CMO and asset-backed securities	<u>58,848,181</u>	<u>52,628,194</u>	<u>50,835,452</u>	<u>50,536,215</u>
	<u>\$ 120,090,930</u>	<u>\$ 108,252,713</u>	<u>\$ 105,890,521</u>	<u>\$ 105,141,946</u>
 Pledged securities	 <u>\$ 85,650,747</u>	 <u>\$ 75,899,055</u>	 <u>\$ 44,797,072</u>	 <u>\$ 44,497,990</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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	Gross	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized	Value	Unrealized
		Losses		Losses		Losses
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>
December 31, 2021						
U.S. Treasury securities	\$ 14,337,600	\$ 174,681	\$ -	\$ -	\$ 14,337,600	\$ 174,681
U.S. government agency securities	26,620,070	288,496	582,660	17,340	27,202,730	305,836
Agency RMBS	27,361,709	253,301	1,748,895	51,541	29,110,604	304,842
Agency CMO securities	738,433	26,013	648,636	23,101	1,387,069	49,114
SBA asset-backed securities	7,237,425	149,727	2,265,455	73,512	9,502,880	223,239
State and municipal securities	2,482,533	39,976	-	-	2,482,533	39,976
	<u>\$ 78,777,770</u>	<u>\$ 932,194</u>	<u>\$ 5,245,646</u>	<u>\$ 165,494</u>	<u>\$ 84,023,416</u>	<u>\$ 1,097,688</u>

The investment securities experiencing unrealized losses as of December 31, 2022 are considered to be temporarily impaired. Management has the intent and ability to hold and does not believe they will be required to sell these investment securities until maturity. Unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying investments were purchased. 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 mortgage-backed 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. Management does not believe that any of the securities are experiencing unrealized losses due to reasons of credit quality, and concludes the unrealized losses detailed in the above table are temporary.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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:	December 31, 2022	December 31, 2021
Real estate		
Construction, development and other land	\$ 21,239,232	\$ 13,597,178
Secured by farmland	9,169,852	7,730,157
Commercial	226,820,382	202,068,811
Residential	126,777,277	101,000,867
Commercial and industrial		
Commercial	28,595,832	17,877,822
Paycheck Protection Program	369,000	19,301,845
Mobile home	2,603,029	3,011,002
Other consumer	13,372,328	4,592,221
Overdrafts	49,705	52,307
Gross loans	428,996,637	369,232,210
Deferred fees net of costs	(380,310)	(1,131,091)
Allowance for loan losses	(4,695,768)	(5,080,143)
Net loans	<u>\$ 423,920,559</u>	<u>\$ 363,020,976</u>
Principal balance of pledged loans	<u>\$ 186,022,819</u>	<u>\$ 150,460,364</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.

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.

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.

Commercial loans are generally secured by inventories, equipment and other assets of the business. Personal guarantees of the borrowers are generally required. In the second quarter of 2020, the Bank began making loans to small businesses under the SBA's Paycheck Protection Program ("PPP") for, among other things, payroll, group health care benefit costs and qualifying mortgage, rent and utility payments. These loans carry an SBA guarantee, and the borrower may receive forgiveness of the loan if the loan's proceeds are used in a manner that qualifies the borrower for forgiveness.

The Bank makes mobile home loans in amounts up to 90% of the lower of the purchase price or the National Appraisal Guides value with original maturities of up to 20 years. To mitigate the risk of loss, the Bank makes loans only for mobile homes located in a mobile home park or sited on land owned by the borrower.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

4. Loans - continued

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.

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

At:	December 31, 2022	December 31, 2021
Maturing		
In one year or less	\$ 26,700,208	\$ 16,943,319
After one year to five years	28,852,310	42,609,931
After five years to fifteen years	122,114,156	125,498,922
After fifteen years	251,329,963	184,180,038
Gross loans	<u>\$ 428,996,637</u>	<u>\$ 369,232,210</u>
Variable rate loans included above	<u>\$ 304,529,517</u>	<u>\$ 257,647,958</u>

The following table analyzes the status of loans for the periods 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
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	-
Mobile homes	9,334	-	101,520	110,854	2,492,175	2,603,029	101,520
Other consumer & overdrafts	2,857	-	-	2,857	13,419,176	13,422,033	-
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>
December 31, 2021							
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ 13,597,178	\$ 13,597,178	\$ -
Commercial real estate & farmland	108,934	-	2,780,280	2,889,214	206,909,754	209,798,968	-
Residential real estate	41,691	-	-	41,691	100,959,176	101,000,867	-
Commercial & industrial	20,100	-	-	20,100	37,159,567	37,179,667	-
Mobile homes	45,746	-	-	45,746	2,965,256	3,011,002	-
Other consumer & overdrafts	4,528	-	-	4,528	4,640,000	4,644,528	-
Total	<u>\$ 220,999</u>	<u>\$ -</u>	<u>\$ 2,780,280</u>	<u>\$ 3,001,279</u>	<u>\$ 366,230,931</u>	<u>\$ 369,232,210</u>	<u>\$ -</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

4. Loans - continued

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”. Loans with this grade are at the lower end of the acceptable quality range that exhibit weaknesses that require closer oversight and attention.

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.

The following table presents risk-rated loans for the periods indicated. Risk-rated loans include loans in Risk Grades 3W, 4, and 5.

	Pass Watch Grade 3W	Special Mention Grade 4	Substandard Grade 5	Total
December 31, 2022				
Construction, development and other land	\$ 1,176,418	\$ 148,625	\$ -	\$ 1,325,043
Commercial real estate and 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 and 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>
December 31, 2021				
Construction, development and other land	\$ 1,493,723	\$ 152,115	\$ 49,189	\$ 1,695,027
Commercial real estate and farmland	20,951,410	5,087,899	10,590,812	36,630,121
Residential real estate	6,994,003	-	562,896	7,556,899
Commercial and industrial	1,835,367	25	160,226	1,995,618
Mobile home	-	-	58,685	58,685
Other consumer	124,184	-	-	124,184
	<u>\$ 31,398,687</u>	<u>\$ 5,240,039</u>	<u>\$ 11,421,808</u>	<u>\$ 48,060,534</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

4. Loans - continued

The following table presents allowance for loan losses activity allocated by loan class for the 12-month periods ended December 31, 2022 and 2021, the allocation of allowance for loan losses for loans that were individually and collectively evaluated for impairment, and the loan balances by loan class for loans that were individually and collectively evaluated for impairment at December 31, 2022 and 2021.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
December 31, 2022									
Allowance for loan losses:									
Beginning balance	\$ 46,680	\$ 292,339	\$ 3,355,417	\$ 883,184	\$ 334,073	\$ 116,912	\$ 35,500	\$ 16,038	\$ 5,080,143
Charge-offs	-	-	-	-	-	(23,662)	-	(39,349)	(63,011)
Recoveries	-	-	44,688	6,000	71,105	2,318	-	9,525	133,636
Provision or (recovery of provision)	(33,010)	153,685	(849,438)	97,389	47,683	1,834	85,636	41,221	(455,000)
Ending balance	<u>\$ 13,670</u>	<u>\$ 446,024</u>	<u>\$ 2,550,667</u>	<u>\$ 986,573</u>	<u>\$ 452,861</u>	<u>\$ 97,402</u>	<u>\$ 121,136</u>	<u>\$ 27,435</u>	<u>\$ 4,695,768</u>
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 325,000	\$ -	\$ 2,131	\$ -	\$ -	\$ -	\$ 327,131
Collectively evaluated									
for impairment	<u>13,670</u>	<u>446,024</u>	<u>2,225,667</u>	<u>986,573</u>	<u>450,730</u>	<u>97,402</u>	<u>121,136</u>	<u>27,435</u>	<u>4,368,637</u>
	<u>\$ 13,670</u>	<u>\$ 446,024</u>	<u>\$ 2,550,667</u>	<u>\$ 986,573</u>	<u>\$ 452,861</u>	<u>\$ 97,402</u>	<u>\$ 121,136</u>	<u>\$ 27,435</u>	<u>\$ 4,695,768</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ -</u>	<u>\$ 8,052,262</u>	<u>\$ 338,543</u>	<u>\$ 133,191</u>	<u>\$ 143,375</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,667,371</u>
Collectively evaluated									
for impairment		<u>\$ 21,239,232</u>	<u>\$ 227,937,972</u>	<u>\$126,438,734</u>	<u>\$28,831,641</u>	<u>\$ 2,459,654</u>	<u>\$13,372,328</u>	<u>\$ 49,705</u>	<u>\$ 420,329,266</u>
December 31, 2021									
Allowance for loan losses:									
Beginning balance	\$ 7,332	\$ 227,883	\$ 3,526,826	\$ 779,782	\$ 298,577	\$ 174,713	\$ 37,900	\$ 63,684	\$ 5,116,697
Charge-offs	-	-	(81,045)	-	-	-	(259)	(44,053)	(125,357)
Recoveries	-	-	70,763	3,900	400	7,600	-	6,140	88,803
Provision or (recovery of provision)	39,348	64,456	(161,127)	99,502	35,096	(65,401)	(2,141)	(9,733)	-
Ending balance	<u>\$ 46,680</u>	<u>\$ 292,339</u>	<u>\$ 3,355,417</u>	<u>\$ 883,184</u>	<u>\$ 334,073</u>	<u>\$ 116,912</u>	<u>\$ 35,500</u>	<u>\$ 16,038</u>	<u>\$ 5,080,143</u>
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 730,000	\$ -	\$ 3,012	\$ -	\$ -	\$ -	\$ 733,012
Collectively evaluated									
for impairment	<u>46,680</u>	<u>292,339</u>	<u>2,625,417</u>	<u>883,184</u>	<u>331,061</u>	<u>116,912</u>	<u>35,500</u>	<u>16,038</u>	<u>4,347,131</u>
	<u>\$ 46,680</u>	<u>\$ 292,339</u>	<u>\$ 3,355,417</u>	<u>\$ 883,184</u>	<u>\$ 334,073</u>	<u>\$ 116,912</u>	<u>\$ 35,500</u>	<u>\$ 16,038</u>	<u>\$ 5,080,143</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ -</u>	<u>\$ 8,692,924</u>	<u>\$ 261,643</u>	<u>\$ 160,226</u>	<u>\$ 58,685</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,173,478</u>
Collectively evaluated									
for impairment		<u>\$ 13,597,178</u>	<u>\$ 201,106,044</u>	<u>\$100,739,224</u>	<u>\$37,019,441</u>	<u>\$ 2,952,317</u>	<u>\$ 4,592,221</u>	<u>\$ 52,307</u>	<u>\$ 360,058,732</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

4. Loans - continued

The following table presents the recorded investment and the current balance of impaired loans segmented by those with and without a related allowance recorded at December 31, 2022 and 2021. The average recorded investment and interest income recognized is presented for the time during which the loans were impaired within the 12-month periods then ended.

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
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	-	-	-	-	-
Mobile home	179,687	143,375	-	151,322	2,672
Other consumer	-	-	-	-	-
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
Mobile home	-	-	-	-	-
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
Mobile home	179,687	143,375	-	151,322	2,672
Other consumer	-	-	-	-	-
	<u>\$ 9,718,158</u>	<u>\$ 8,667,371</u>	<u>\$ 327,131</u>	<u>\$ 9,526,136</u>	<u>\$ 88,237</u>
December 31, 2021					
With no related allowance recorded:					
Construction, development & other land	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate & farmland	5,296,638	4,932,179	-	5,015,600	63,168
Residential real estate	465,525	261,643	-	293,333	2,456
Commercial & industrial	-	-	-	-	-
Mobile home	90,002	58,685	-	67,558	3,079
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	4,081,519	3,760,745	730,000	3,797,731	-
Residential real estate	-	-	-	-	-
Commercial & industrial	160,226	160,226	3,012	167,311	9,376
Mobile home	-	-	-	-	-
Other consumer	-	-	-	-	-
Total:					
Construction, development & other land	-	-	-	-	-
Commercial real estate & farmland	9,378,157	8,692,924	730,000	8,813,331	63,168
Residential real estate	465,525	261,643	-	293,333	2,456
Commercial & industrial	160,226	160,226	3,012	167,311	9,376
Mobile home	90,002	58,685	-	67,558	3,079
Other consumer	-	-	-	-	-
	<u>\$ 10,093,910</u>	<u>\$ 9,173,478</u>	<u>\$ 733,012</u>	<u>\$ 9,341,533</u>	<u>\$ 78,079</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

4. Loans - continued

Under a TDR, the Bank has granted a concession that it would not otherwise make to a borrower who has experienced financial difficulty. At the time of the restructuring, the borrower is expected to pay the amounts due under the renegotiated terms.

The table below shows troubled debt restructured loans outstanding by classification included in impaired loans at the respective dates. The Bank has no requirement to lend additional funds under a line of credit arrangement to borrowers who have received a TDR.

	<u>December 31, 2022</u>		<u>December 31, 2021</u>	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	<u>5</u>	<u>\$ 6,076,183</u>	<u>4</u>	<u>\$ 4,280,972</u>

During the 12-month period ended December 31, 2022, the Bank modified the terms of one commercial real estate loan with a balance of \$1,945,476 to provide a period of interest only payments. The Bank did not record any new TDRs or modify any loans that were classified as TDRs during the 12-month period ended December 31, 2021.

There were no loans that the Bank modified in the 12 months preceding the period ended December 31, 2022 for which there was a payment default during the 12-month period ended December 31, 2022. There were no loans that the Bank modified in the 12 months preceding the period ended December 31, 2021 for which there was a payment default during the 12-month period ended December 31, 2021. Payment default is defined as any time the loan was more than 60 days past due.

The following table summarizes non-accrual loans at December 31, 2022 and 2021, and the amount of gross interest income that would have been recorded during the 12-month periods then ended had the non-accrual loans been current and performing according to terms.

At:	<u>December 31, 2022</u>	<u>December 31, 2021</u>
Non-accrual loans by classification		
Commercial real estate	\$ 6,897,574	\$ 7,543,655
Residential real estate	82,273	217,406
Mobile home	<u>16,720</u>	<u>29,306</u>
Total non-accrual loans	<u>\$ 6,996,567</u>	<u>\$ 7,790,367</u>

Year to Date Through:

	<u>December 31, 2022</u>	<u>December 31, 2021</u>
Interest not accrued on non-accrual loans	<u>\$ 326,977</u>	<u>\$ 283,129</u>

Consumer mortgage loans secured by residential real estate property that are in the process of foreclosure totaled \$0 at December 31, 2022. Consumer mortgage loans secured by residential real estate property that are in the process of foreclosure totaled \$0 at December 31, 2021.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

5. Credit Commitments

Loan commitments, unused lines of credit, and letters of credit outstanding at the respective dates are as follows:

At:	December 31, 2022	December 31, 2021
Commitments to extend credit		
Loan origination commitments	\$ 16,492,548	\$ 16,964,179
Unused consumer real estate construction	2,722,091	949,725
Unused home equity lines of credit	18,354,652	15,597,761
Unused overdraft lines of credit	6,873,321	6,353,912
Unused commercial lines of credit	56,546,751	45,743,060
	<u>\$ 100,989,363</u>	<u>\$ 85,608,637</u>
Letters of credit	<u>\$ 4,349,155</u>	<u>\$ 3,609,206</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.

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. Management is not aware of any accounting loss to be incurred by funding these commitments.

6. Related Party Transactions

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

Year to Date Through:	December 31, 2022	December 31, 2021
Beginning balance	\$ 17,710,130	\$ 14,901,010
Advances	2,263,410	5,701,118
Changes in related party	(289,558)	-
Payments	<u>(2,408,172)</u>	<u>(2,891,998)</u>
Ending balance	<u>\$ 17,275,810</u>	<u>\$ 17,710,130</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, officers and directors of the Bank have \$3,498,889 in unused loans committed but not funded as of December 31, 2022, and \$3,177,666 in unused loans committed but not funded as of December 31, 2021.

The Bank obtains goods and services from firms in which owners are also members of the Board of Directors. Amounts paid to these related parties totaled \$13,864 during the year ended December 31, 2022. Amounts paid to these related parties totaled \$12,831 during the year ended December 31, 2021.

The Bank has a wealth management referral relationship with the firm of a director. The Bank recognized \$10,350 of income from the referral relationship during the year ended December 31, 2022. The Bank recognized \$0 income from the referral relationship during the year ended December 31, 2021.

Deposits from the officers and directors of the Bank were \$8,073,801 at December 31, 2022. Deposits from the officers and directors of the Bank were \$4,990,872 at December 31, 2021.

Harford Bank and Subsidiary **Notes to Consolidated Financial Statements**

7. Bank Premises and Equipment

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

	Useful Lives	December 31, 2022	December 31, 2021
Land		\$ 3,632,621	\$ 3,632,621
Building and improvements	15 - 39 years	8,714,774	8,995,247
Leasehold improvements	5 - 19 years	588,014	584,131
Furniture, fixtures, and equipment	3 - 10 years	2,675,554	2,779,714
		15,610,963	15,991,713
Accumulated depreciation		5,793,664	5,824,119
Net bank premises and equipment		\$ 9,817,299	\$ 10,167,594

For the Years Ended:

	December 31, 2022	December 31, 2021
Depreciation expense	\$ 539,750	\$ 497,108

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

	Useful Life	December 31, 2022	December 31, 2021
Computer software	3 years	\$ 66,393	\$ 273,003
Accumulated amortization		58,280	267,335
Net computer software		\$ 8,113	\$ 5,668

For the Years Ended:

	December 31, 2022	December 31, 2021
Amortization expense	\$ 5,893	\$ 9,569

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

8. Lease Commitments

The Bank leases certain banking facilities under operating leases expiring on various dates through 2026. 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. At December 31, 2021, the Bank had lease liabilities totaling \$526,930 included in other liabilities and right-of-use lease assets totaling \$526,930 included in other assets related to these leases.

The weighted-average discount rate on operating lease balances outstanding at December 31, 2022 was 2.13%. The weighted-average discount rate on operating lease balances outstanding at December 31, 2021 was 2.04%. The weighted-average remaining lease term of operating leases outstanding at December 31, 2022 was 2.5 years. The weighted-average remaining lease term of operating leases outstanding at December 31, 2021 was 3.4 years.

Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for the year ended December 31, 2022 was \$222,383. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, for year ended December 31, 2021 was \$220,341.

As of December 31, 2022, future minimum lease payments, by year and in the aggregate, of operating leases are as follows:

Year	Amount
2023	\$ 172,960
2024	153,451
2025	47,339
2026	<u>27,614</u>
Total undiscounted lease payments	401,364
Discount on cash flows	<u>(38,718)</u>
Total lease liability	<u><u>\$ 362,646</u></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 was required to purchase shares of capital stock in the FHLBA as a condition to obtaining the line of credit. Based on the value of available collateral as of December 31, 2022, the Bank could borrow \$98,749,608 from the FHLBA.

The Bank is eligible to borrow from the Federal Reserve Bank ("FRB") Discount Window. This credit line is secured by the Bank's consumer loan portfolio. Based on the value of available collateral as of December 31, 2022, the Bank could borrow \$5,594,911 from the FRB Discount Window.

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 borrow up to 10% of reported total assets as of December 31, 2022, or \$59,546,929.

The Bank has secured and unsecured credit lines with correspondent banks, 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

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. In 2021, the Bank made accruals based on a budgeted discretionary amount. Effective January 1, 2022, 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 year ended December 31, 2022, the Bank recognized \$242,065 of expense associated with the 401(k) Plan. For the year ended December 31, 2021, the Bank recognized \$201,000 of expense associated with the 401(k) Plan.

In 2006, and in the second quarter of 2017, the Bank entered into agreements under its Supplemental Executive Retirement Plans (“SERP”) to certain executive officers providing 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 \$1,174,379 related to these benefits at December 31, 2022. The Bank has recorded a liability of \$1,152,947 related to these benefits at December 31, 2021. SERP expense for the year ended December 31, 2022 was \$102,816. SERP expense for the year ended December 31, 2021 was \$97,057.

11. Interest-Bearing Deposits

Major classifications of interest-bearing deposits at:	December 31, 2022	December 31, 2021
Interest-bearing checking and Money Market	\$ 238,897,337	\$ 197,672,460
Savings	68,631,963	62,996,093
Certificates of deposit	79,443,708	108,098,230
	<u>\$ 386,973,008</u>	<u>\$ 368,766,783</u>
 Maturities of certificates of deposit at:	 December 31, 2022	 December 31, 2021
Maturing within twelve months	\$ 48,010,291	\$ 79,934,374
Maturing after one year to three years	26,309,100	23,064,089
Maturing after three years to five years	5,124,317	5,099,767
	<u>\$ 79,443,708</u>	<u>\$ 108,098,230</u>
 Certificates of deposit of \$250,000 or greater included above:	 <u>\$ 21,151,168</u>	 <u>\$ 39,564,711</u>
 Interest expense for for the year ended:	 December 31, 2022	 December 31, 2021
Interest-bearing checking and Money Market	\$ 249,727	\$ 181,781
Savings	100,600	79,357
Certificates of deposit	728,029	1,288,250
	<u>\$ 1,078,356</u>	<u>\$ 1,549,388</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

12. Income Taxes

The components of income tax expense are as follows:

For the year ended:	December 31, 2022	December 31, 2021
Current		
Federal	\$ 1,271,367	\$ 1,273,427
State	349,652	538,280
	<u>1,621,019</u>	<u>1,811,707</u>
Deferred		
Federal	3,248	57,979
State	10,913	(11,337)
	<u>14,161</u>	<u>46,642</u>
	<u>\$ 1,635,180</u>	<u>\$ 1,858,349</u>

The components of deferred income tax expense (benefit) are as follows:

For the year ended:	December 31, 2022	December 31, 2021
Provision for loan losses	\$ 36,769	\$ (24,442)
Interest revenue	(47,395)	(20,600)
Nonqualified employee benefit	(5,898)	(1,651)
Nonqualified stock option expense	(3,092)	(6,927)
Debit card rewards program liability	(4,592)	-
Depreciation	(5,203)	93,706
Deferred loan origination costs	43,572	6,556
	<u>\$ 14,161</u>	<u>\$ 46,642</u>

The components of the net deferred tax asset are as follows:

At:	December 31, 2022	December 31, 2021
Deferred tax assets		
Allowance for loan losses	\$ 1,050,655	\$ 1,087,424
Non-accrual interest	103,260	55,865
Nonqualified employee benefit	323,160	317,262
Nonqualified stock option expense	53,887	50,795
Debit card rewards program liability	4,592	-
Lease liability	99,791	144,998
	<u>1,635,345</u>	<u>1,656,344</u>
Deferred tax liabilities		
Depreciation	439,930	445,133
Deferred loan origination costs	115,593	72,021
Right of use asset	99,791	144,998
	<u>655,314</u>	<u>662,152</u>
	<u>\$ 980,031</u>	<u>\$ 994,192</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

12. Income Taxes - continued

The Bank reported net deferred tax assets of \$980,031 and \$994,192 at December 31, 2022 and 2021, respectively, which relate primarily to the allowance for loan losses and employee benefits. Management believes it is more likely than not that all of the deferred tax assets will be realized.

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

For the year ended:	December 31, 2022		December 31, 2021	
Statutory federal income tax rate	21.00	%	21.00	%
Increase (decrease) resulting from				
State income taxes, net of federal income tax benefit	4.26		5.80	
Tax-exempt income	(1.10)		(1.06)	
Nondeductible expenses and other	0.03		0.07	
	24.19	%	25.81	%

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, and have a 10-year exercise period. On April 9, 2015, a new director stock option plan with 80,000 shares authorized was approved by the Board of Directors to replace the director stock option plan which expired in 2014. 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. During 2021, the remaining unvested options in the officer plan vested.

The total number of shares originally authorized for active director stock option plans and inactive director and officer plans with outstanding options was 249,890. At December 31, 2022, a total of 28,002 shares remain available for grant under the active director option plan.

A summary of activity for stock option activity for the year ended December 31, 2022 is presented in the following table.

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2022	72,499	\$ 24.39		
Options granted	9,120	30.99		
Options exercised	(16,791)	21.88		
Options forfeited or expired	(4,379)	24.72		
Outstanding at December 31, 2022	60,449	\$ 26.06	5.72 years	\$ 410,422
Exercisable at December 31, 2022	60,449	\$ 26.06	5.72 years	\$ 410,422

The intrinsic value of options exercised during the year ended December 31, 2022 was \$159,804. The intrinsic value of options exercised during the year ended December 31, 2021 was \$42,061.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

13. Stock Option and Stock Purchase Plans - continued

The weighted average fair value of options granted during the years ended December 31, 2022 and 2021 was \$6.10 and \$3.67, respectively, and was estimated using the Black-Scholes option pricing model with the following assumptions:

	2022	2021
Dividend yield	2.45%	2.82%
Risk-free interest rate	2.98%	0.88%
Expected volatility	24.1%	22.6%
Weighted average volatility	24.1%	22.6%
Expected term (in years)	5.0	5.0

For the year ended December 31, 2022, the Bank recorded stock-based compensation expense of \$55,659. For the year ended December 31, 2021, the Bank recorded stock-based compensation expense of \$43,169.

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. The 2020 ESPP commenced on July 1, 2020.

A total of 2,103 shares of stock were issued at a weighted average price of \$30.50 pursuant to the 2020 ESPP for the 12 months ended December 31, 2022. A total of 1,941 shares of stock were issued at a weighted average price of \$25.72 pursuant to the 2020 ESPP for the 12 months ended December 31, 2021. At December 31, 2022, a total of 94,579 shares remain available for grant under the 2020 ESPP.

14. Capital Standards

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 Board of Governors of the Federal Reserve System 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).

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

14. Capital Standards - continued

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 loan losses. 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.

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	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2022								
Total capital	\$58,743	13.79%	\$42,612	10.00%	\$34,089	8.00%	\$44,742	10.50%
Tier 1 capital	54,047	12.68%	34,089	8.00%	25,567	6.00%	36,220	8.50%
Common equity Tier 1 capital	54,047	12.68%	27,697	6.50%	19,175	4.50%	29,828	7.00%
Tier 1 leverage capital	54,047	8.78%	30,762	5.00%	24,610	4.00%	24,610	4.00%

December 31, 2021	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$53,926	15.43%	\$34,959	10.000%	\$27,967	8.00%	\$36,707	10.50%
Tier 1 capital	49,547	14.17%	27,967	8.000%	20,975	6.00%	29,715	8.50%
Common equity Tier 1 capital	49,547	14.17%	22,723	6.500%	15,732	4.50%	24,471	7.00%
Tier 1 leverage capital	49,547	8.66%	28,606	5.000%	22,885	4.00%	22,885	4.00%

At December 31, 2022 and December 31, 2021, 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

15. Net Income per Common Share

The calculation of basic and diluted net income per common share is presented below for the periods indicated:

For the years ended December 31:	2022	2021
Basic net income per share:		
Net income	\$ 5,125,679	\$ 5,340,997
Weighted-average common shares outstanding	1,460,865	1,439,678
Basic net income per common share	<u>\$ 3.51</u>	<u>\$ 3.71</u>
 Diluted net income per share:		
Net income	\$ 5,125,679	\$ 5,340,997
Weighted-average common shares outstanding	1,460,865	1,439,678
Dilutive common stock equivalents	<u>9,545</u>	<u>6,408</u>
Dilutive EPS shares	<u>1,470,410</u>	<u>1,446,086</u>
Diluted net income per common share	<u>\$ 3.49</u>	<u>\$ 3.69</u>
 Anti-dilutive shares	<u>8,360</u>	<u>26,691</u>

16. Fair Value Measurements

FASB 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. FASB 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

16. Fair Value Measurements - continued

During the 12-month periods ended December 31, 2022 and 2021, the Bank did not measure any assets or liabilities at fair value on a recurring basis.

The following table presents impaired 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
December 31, 2022				
Impaired loans (net of impairment)	\$ -	\$ -	\$ 3,944,669	\$ 3,944,669
December 31, 2021				
Impaired loans (net of impairment)	\$ -	\$ -	\$ 3,646,169	\$ 3,646,169

The Bank does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses 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 impaired loan is less than the recorded investment in the loan. When an impaired 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 impaired 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 impaired loan as a nonrecurring fair value measurement classified as Level 3. Impaired 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 impaired loans at December 31, 2022 and December 31, 2021:

	Fair Value Estimate	Valuation Techniques	Unobservable Inputs	Discount
December 31, 2022				
Impaired loans (net of impairment)	\$ 3,944,669	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	10%
December 31, 2021				
Impaired loans (net of impairment)	\$ 3,646,169	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	19%

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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)
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:					
Interest-bearing deposits	386,973,008	384,426,824	-	-	384,426,824
Noninterest-bearing deposits	151,548,167	151,548,167	-	151,548,167	-
Accrued interest payable	88,851	88,851	-	88,851	-
December 31, 2021					
Financial assets:					
Cash and cash equivalents	\$ 82,430,959	\$ 82,430,959	\$ 82,430,959	\$ -	\$ -
Time deposits in other banks	2,832,409	2,822,503	-	2,565,395	257,108
Investment securities held to maturity					
U.S. Treasury securities	16,014,182	15,853,990	15,853,990	-	-
U.S. government agencies	35,455,575	35,188,956	-	35,188,956	-
Agency RMBS	36,276,433	36,146,769	-	36,146,769	-
Agency CMBS	-	-	-	-	-
Agency CMO securities	1,436,183	1,387,069	-	1,387,069	-
SBA asset-backed securities	13,122,836	13,002,377	-	13,002,377	-
State and municipal securities	3,585,312	3,562,785	-	3,562,785	-
Loans, net	363,020,976	370,799,119	-	-	370,799,119
Accrued interest receivable	1,355,966	1,355,966	-	1,355,966	-
Bank owned life insurance	6,272,657	6,272,657	-	6,272,657	-
Financial liabilities:					
Interest-bearing deposits	368,766,783	369,297,287	-	-	369,297,287
Noninterest-bearing deposits	153,557,695	153,557,695	-	153,557,695	-
Accrued interest payable	130,139	130,139	-	130,139	-

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

16. Fair Value Measurements - continued

Time deposits in other banks

The fair value of non-negotiable time deposits in correspondent banks is estimated based on interest rates currently offered for deposits of similar remaining maturities, as there is no demonstrable market for non-negotiable time deposits. The fair value of negotiable time deposits is estimated based on quoted market prices, when available. If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data.

Investment securities held to maturity

The fair value of investment securities held to maturity is estimated based on quoted market prices, when available. If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data.

Loans, net

The carrying value of loans is net of deferred fees and costs and the allowance for loan losses. In accordance with the adoption of Accounting Standards Update (“ASU”) 2016-01, the fair value of loans was measured using an exit price notion.

Deposits

The fair value of interest-bearing checking, savings, and money market deposit accounts is estimated to equal the carrying amount. The fair value of fixed-maturity time deposits is estimated based on interest rates currently offered for deposits of similar remaining maturities. The fair value of noninterest-bearing checking deposit accounts is estimated to equal the carrying amount.

Fed Funds Sold and Fed Funds Purchased

Due to the overnight nature of Fed Funds Sold and Fed Funds Purchased, the fair value of these instruments is estimated to equal the carrying amount.

Commitments to extend credit, lines of credit, and letters of credit

It is not practicable to estimate the fair value of outstanding loan commitments, unused lines of credit, and letters of credit.

17. Legal Proceedings

On January 12, 2021, Sheira Brown filed a complaint, which she subsequently amended, against the Bank in the United States District Court for the Northern District of Maryland, docketed as Sheira Brown v. Harford Bank, Case No. 1:21-cv-00096-ELH, in which she alleged that, in refusing to cash a check that was issued to her, the Bank engaged in certain discriminatory conduct in violation of 42 U.S.C. § 1981 and 15 U.S.C. § 1691, conversion, and reckless and/or intentional infliction of emotional distress (the “Brown Litigation”). Ms. Brown has demanded an unspecified amount of damages, including punitive damages, costs, and attorneys’ fees. On March 4, 2022, the court dismissed Ms. Brown’s claims under 15 U.S.C. § 1691 and for reckless and/or intentional infliction of emotional distress. The Bank believes that Ms. Brown’s claims lack merit and is vigorously defending the Brown Litigation. The Bank maintains insurance coverages that it believes will cover portions of the legal expenses associated with the Brown Litigation and any damages that might be awarded to Ms. Brown. It is not possible at this time for the Bank to assess the likelihood of success of any of its defenses or, thus, the outcome of the Brown Litigation, or the amount of legal fees that it will incur in defending the Brown Litigation.

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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

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 guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. In July 2019, the FASB proposed changes to the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities. On October 16, 2019, the FASB approved its proposal to delay the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities, and subsequently issued ASU 2019-10 *“Financial Instruments – Credit Losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842): Effective Dates”* which extended the implementation date to 2023 for SEC registered smaller reporting companies and private companies. The Bank is a smaller reporting company. Upon adoption, transition adjustments will be made to record an increase in the reported amount of the allowance for credit losses on loans, recognize a liability for credit losses on commitments to extend credit, and reduce total equity of the Bank. The final cumulative effect of the transition adjustments is still subject to completion by the Bank but is estimated to reduce opening undivided profits on January 1, 2023, by a reasonable range of \$0.3 million to \$0.8 million. No adjustment will be required for the held-to-maturity investment portfolio. Subsequent to adoption, the Bank will record adjustments to its allowance(s) for credit losses and reserves for unfunded commitments through the provision 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 loan 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.

ASU 2019-12, *“Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes.”* The guidance issued in this update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. ASU 2019-12 also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. ASU 2019-12 became effective for the Bank on January 1, 2021 and did not have a significant impact on the Bank’s financial statements.

ASU 2020-08, *“Codification Improvements to Subtopic 310-20, Receivables - Nonrefundable Fees and Other Costs.”* ASU 2020-08 clarifies the accounting for the amortization of purchase premiums for callable debt securities with multiple call dates. ASU 2020-08 became effective for the Bank on January 1, 2021 and did not have a significant impact on the Bank’s financial statements.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements

18. Accounting Standard Updates - continued

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 is not expected to have a material impact on the Bank’s financial statements.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

Item 9A. 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 Exchange Act with the FDIC, such as this annual 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 the principal executive officer ("PEO") and the 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.

An evaluation of the effectiveness of these disclosure controls as of December 31, 2022 was carried out under the supervision and with the participation of the Bank's management, including the PEO and the PFO. Based on that evaluation, the Bank's management, including the PEO and the PFO, has concluded that the Bank's disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

During the fourth quarter of 2022, there was no change in the Bank's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

As required by Section 404 of the Sarbanes-Oxley Act of 2002, management has performed an evaluation and testing of the Bank's internal control over financial reporting as of December 31, 2022. Management's report on the Bank's internal control over financial reporting is included on the following page.

Management's Report on Internal Control Over Financial Reporting

Management of Harford Bank (the "Bank") is responsible for the preparation, integrity and fair presentation of the consolidated financial statements incorporated by reference in this annual report. The Bank's audited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, as such, include some amounts that are based on the best estimates and judgments of management.

The Bank's management is responsible for establishing and maintaining adequate internal control over financial reporting. This internal control system is designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of the Bank's financial reporting and the preparation and presentation of consolidated financial statements for external reporting purposes in conformity with accounting principles generally accepted in the United States of America, as well as to safeguard assets from unauthorized use or disposition. The system of internal control over financial reporting is evaluated for effectiveness by management and tested for reliability through a program of internal audit with actions taken to correct potential deficiencies as they are identified. Because of inherent limitations in any internal control system, no matter how well designed, misstatement due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the effectiveness of the Bank's internal control over financial reporting as of December 31, 2022 based upon criteria set forth in "2013 Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission.

Based on this assessment, management has concluded that, as of December 31, 2022, the Bank's internal control over financial reporting is effective based on those criteria.

This annual report does not include an attestation report of the Bank's independent registered public accounting firm regarding internal controls over financial reporting. Management's report was not subject to attestation by the Bank's independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Bank to provide only management's report.

March 15, 2023

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

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

Item 9B. OTHER INFORMATION.

None.

Item 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT DISCLOSURE.

Not applicable.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The Bank has adopted a code of ethics that applies to all of its directors and executive officers, including its principal executive officer and principal financial officer. The Bank will provide a copy of the Code of Ethics free of charge upon written request to Harford Bank, 8 West Bel Air Avenue, P.O. Box 640, Aberdeen, Maryland 21001, Attention: Neil L. Christ, CFO.

All other information required by this item is incorporated herein by reference to the sections of the Bank's definitive proxy statement for the 2023 Annual Meeting of Stockholders to be filed with the FDIC pursuant to Regulation 14A entitled "Election of Directors (Proposal 1)", "Executive Officers", "Delinquent Section 16(a) Reports", and "Corporate Governance Matters" (under the heading, "Board Committees").

Item 11. EXECUTIVE COMPENSATION.

The information required by this item is incorporated herein by reference to the sections of the Bank's definitive proxy statement for the 2023 Annual Meeting of Stockholders to be filed with the FDIC pursuant to Regulation 14A entitled "Director Compensation" and "Executive Compensation" (excluding the information under the subheading "Pay Versus Performance").

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The Bank has outstanding stock options under three equity compensation plans: (i) the 2004 Director Non-Qualified Stock Option Plan (the "2004 Plan"); (ii) 2008 Key Employee Stock Option Plan; and (iii) the 2015 Director Stock Option Plan (the "2015 Plan"). The 2004 Director Non-Qualified Stock Option Plan and the 2008 Key Employee Stock Option Plan have expired and no further grants may be made thereunder, although they will remain in place until all previously granted options are exercised, expire or are forfeited. All plans other than the 2004 Plan and the 2015 Plan were approved by the Bank's stockholders, and information about the 2015 Plan is provided in the following paragraph. The terms of the 2015 Plan are identical to those of the 2004 Plan in all material respects.

In 2015, the Bank replaced the 2004 Plan which had expired in 2014 with the 2015 Plan, for which shareholder approval was not required. The 2015 Plan permits the grant of non-qualified stock options to purchase up to 80,000 shares of common stock (subject to adjustment for dividends, recapitalizations, and similar capital events and the expiration of unexercised options). Directors who have served for at least one year and have a Board meeting attendance record of at least 50% during the 12 months preceding participation are eligible to participate. Options granted under the 2015 Plan vest according to the agreement granting the options and thereafter generally remain exercisable for 10 years from the date of grant. If a participant's service with the Bank terminates for cause, then the unexercised portions of his or her options immediately lapse. If a participant's service is terminated because of death or permanent disability, then the unexercised portions of his or her options lapse unless exercised within one year of termination. If a participant's service is terminated for any other reason, then the unexercised portions of his or her options lapse unless exercised within three months of termination. In the event of an Extraordinary Event (as defined in the 2015 Plan), all outstanding unexercised options become immediately exercisable (whether vested or not). If a participant fails to exercise his or her options upon an Extraordinary Event, then the Bank is required to take such action as may be necessary to enable each participant to receive, upon exercise, securities or other assets as were issuable or payable upon the Extraordinary Event in respect of, or in exchange for, the shares of common stock subject to those options. The Board may amend, suspend, discontinue or terminate the 2015 Plan at any time and from time to time, except that such action may not alter or impair the existing rights of any participant without his or her consent. The 2015 Plan, including the form of agreement used to grant stock options, was filed as Exhibit 10.1 to the Bank's Quarterly Report on Form 10-Q for the period ended June 30, 2015.

At the annual meeting of stockholders held on May 20, 2020, the Bank's stockholders approved 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. A summary of these terms is set forth in the Bank's definitive proxy statement on Schedule 14A for the 2020 annual meeting of stockholders, which was filed with the FDIC on April 11, 2020.

The following table provides information about shares of common stock that may be issued (all upon the exercise of options) under all of the Bank's equity compensation plans as of December 31, 2022.

Equity Compensation Plan Category	Number of shares to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of shares remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	12,398	\$25.58	94,579
Equity compensation plans not requiring security holder approval	<u>48,051</u>	\$26.18	<u>28,002</u>
Total	<u>60,449</u>	<u>\$26.06</u>	<u>122,581</u>

All other information required by this item is incorporated herein by reference to the section of the Bank's definitive proxy statement for the 2023 Annual Meeting of Stockholders to be filed with the FDIC pursuant to Regulation 14A entitled "Beneficial Ownership of Common Stock".

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this item is incorporated herein by reference to the sections of the Bank's definitive proxy statement for the 2023 Annual Meeting of Stockholders to be filed with the FDIC pursuant to Regulation 14A entitled "Certain Relationships and Related Transactions" and "Corporate Governance Matters" (under the heading, "Director Independence").

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this item is incorporated herein by reference to the section of the Bank's definitive proxy statement for the 2023 Annual Meeting of Stockholders to be filed with the FDIC pursuant to Regulation 14A entitled "Audit Fees and Services".

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a)(1) and (2), and (c). Financial statements and schedules:

Reports of Independent Registered Public Accounting Firms

Consolidated Statements of Condition at December 31, 2022 and 2021

Consolidated Statements of Income for years ended December 31, 2022 and 2021

Consolidated Statements of Changes in Stockholders' Equity for years ended December 31, 2022 and 2021

Consolidated Statements of Cash Flows for years ended December 31, 2022 and 2021

Notes to Consolidated Financial Statements

(a)(3) and (b). Exhibits required to be filed by Item 601 of Regulation S-K:

The exhibits that are filed or furnished with this annual report are listed in the following Exhibit Index.

<u>Exhibit No.</u>	<u>Description</u>
3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Bank's Annual Report on Form 10-KSB for the year ended December 31, 2001).
3.2	Third Amended and Restated By-Laws (incorporated by reference to Exhibit 3.1 to the Bank's Current Report on Form 8-K filed with the FDIC on July 22, 2021).
10.1	Harford Bank 2004 Director Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.4 to the Bank's Annual Report on Form 10-KSB for the year ended December 31, 2004).
10.2	Harford Bank 2008 Key Employee Stock Option Plan (incorporated by reference to Appendix B of the Bank's definitive proxy statement for the 2008 Annual Meeting of Stockholders).
10.3	Harford Bank Directors' Deferral Plan (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on August 8, 2006).
10.4	Rabbi Trust for the Directors' Deferral Plan (incorporated by reference to Exhibit 10.2 to the Bank's Current Report on Form 8-K filed with the FDIC on August 8, 2006).
10.5	Form of Director Joint Beneficiary Designation Agreement dated July 20, 2006 (incorporated by reference to Exhibit 10.3 to the Bank's Current Report on Form 8-K filed with the FDIC on August 8, 2006).
10.6	Form of Executive Joint Beneficiary Designation Agreement dated July 20, 2006 for Sandra Osborn (incorporated by reference to Exhibit 10.6 to the Bank's Current Report on Form 8-K filed with the FDIC on August 8, 2006).
10.7	Harford Bank Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.7 to the Bank's Current Report on Form 8-K filed with the FDIC on August 8, 2006).
10.8	Amended and Restated Supplemental Executive Retirement Plan Agreement for Charles H. Jacobs, Jr. (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on January 7, 2008).
10.9	First Form of First Amendment to Amended and Restated Executive Supplemental Retirement Plan Agreement between Harford Bank and Charles H. Jacobs, Jr. (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed on April 29, 2009).
10.10	Harford Bank 2015 Director Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Bank's Quarterly Report on Form 10-Q for the period ended June 30, 2015).
10.11	Supplemental Executive Retirement Plan Agreement for Neil L. Christ (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on May 2, 2017).
10.12	Harford Bank 2020 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Bank's definitive proxy statement on Schedule 14A in respect of the 2020 annual meeting of stockholders that was filed with the FDIC on April 11, 2020).
10.13	Employment Agreement, dated as of May 5, 2021, between Harford Bank and Michael F. Allen (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on May 14, 2021).
10.14	Employment Agreement, dated as of September 1, 2022, between Harford Bank and Neil L. Christ (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on September 6, 2022).
10.15	Employment Agreement, dated as of March 30, 2022, between Harford Bank and Lorrie A. Schenning (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed with the FDIC on March 8, 2023).
21	Subsidiaries of the Bank (filed herewith).

- 31.1 Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certifications of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of the Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
- 99.1 Harford National Bank Dividend Reinvestment Plan (incorporated herein by reference to Harford National Bank's registration statement on Form S-3 filed with the Office of the Comptroller of the Currency on January 25, 1999).

Item 16. FORM 10-K SUMMARY.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of 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

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

Date: March 15, 2023

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 15, 2023.

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

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

/s/ John S. Karas
John S. Karas
Chairman of the Board

/s/ Tony L. Bennett
Tony L. Bennett
Director

/s/ Daniel M. Driver
Daniel Driver
Director

/s/ Carolyn W. Evans
Carolyn W. Evans
Director

/s/ Richard F. Foard, Jr.
Richard F. Foard, Jr.
Director

/s/ Jeffrey W. Foulk
Jeffrey W. Foulk
Director

/s/ Stephanie Novak Hau
Stephanie Novak Hau
Director

/s/ Henry S. Holloway
Henry S. Holloway
Director

/s/ Timothy N. Hopkins
Timothy N. Hopkins
Director

/s/ Charles H. Jacobs, Jr.
Charles H. Jacobs, Jr.
Director

/s/ Bryan E. Kelly
Bryan E. Kelly, CFP
Director

/s/ Stephen K. Nolan
Stephen K. Nolan
Director

/s/ Wayne Tapscott
Wayne Tapscott
Director

Subsidiaries of Harford Bank

HB Trust is a Maryland statutory trust of which Harford Bank is the sole beneficiary.

**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 annual report on Form 10-K 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 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. 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
 - 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 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: March 15, 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, certify that:

1. I have reviewed this annual report on Form 10-K 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 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. 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
 - 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 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: March 15, 2023

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

**Certification of 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 Annual Report of Harford Bank on Form 10-K for the year ended December 31, 2022 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: March 15, 2023

/s/ Michael F. Allen

Michael F. Allen
President
(Principal Executive Officer)

Date: March 15, 2023

/s/ Neil L. Christ, CPA

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