UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the transition period from _____ to _____

Commission file number: 001-34292

ORRSTOWN FINANCIAL SERVICES, INC.

(Exact Name of Registrant as Specified in its Charter)

Pennsylvania	**23-2530374**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
77 East King Street, P. O. Box 250, Shippensburg, Pennsylvania	**17257**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant's Telephone Number, Including Area Code: (717) 532-6114

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading symbol(s)	Name of Each Exchange on Which Registered
Common Stock, no par value	**ORRF**	**NASDAQ Stock Market**

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

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 ☐

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☒
		Emerging growth company	☐

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

Indicate by check mark whether the registrant 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 ☒

The aggregate market value of the voting stock held by non-affiliates computed by reference to the price at which the common stock was last sold as of the last business day of the Registrant's most recently completed second fiscal quarter was approximately $245.1 million. For purposes of this calculation, the term "affiliate" refers to all directors and executive officers of the registrant, and all persons beneficially owning more than 5% of the registrant's common stock.

Number of shares outstanding of the Registrant's common stock as of March 9, 2023: 10,725,745.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2023 Annual Meeting of Shareholders are incorporated by reference in Part III of this Form 10-K.

ORRSTOWN FINANCIAL SERVICES, INC.

FORM 10-K

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Glossary of Defined Terms

The following terms may be used throughout this Report, including the consolidated financial statements and related notes.

Term	Definition
ALL	Allowance for loan losses
AFS	Available-for-sale
AOCI	Accumulated other comprehensive income (loss)
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bank	Orrstown Bank, the commercial banking subsidiary of Orrstown Financial Services, Inc.
BHC Act	Bank Holding Company Act of 1965
CDI	Core deposit intangible
CET1	Common Equity Tier 1
CFPB	Consumer Financial Protection Bureau
CMO	Collateralized mortgage obligation
CRA	Community Reinvestment Act
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
ERM	Enterprise risk management
Exchange Act	Securities Exchange Act of 1934, as amended
FASB	Financial Accounting Standards Board
FDIA	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FHC	Financial holding company
FHLB	Federal Home Loan Bank
FRB	Board of Governors of the Federal Reserve System
GAAP	Accounting principles generally accepted in the United States of America
GDP	Gross Domestic Product
GLB Act	Gramm-Leach-Bliley Act
GSE	United States government-sponsored enterprise
Hamilton	Hamilton Bancorp, Inc., and its wholly-owned banking subsidiary, Hamilton Bank (acquired May 1, 2019)
IRC	Internal Revenue Code of 1986, as amended
LHFS	Loans held for sale
LIBOR	London Interbank Offered Rate
MBS	Mortgage-backed securities
Mercersburg	Mercersburg Financial Corporation and its wholly-owned banking subsidiary, First Community Bank of Mercersburg (acquired October 1, 2018)
MPF Program	Mortgage Partnership Finance Program
MSR	Mortgage servicing right
NIM	Net interest margin
OCI	Other comprehensive income
OFA	Orrstown Financial Advisors, a division of the Bank that provides investment and brokerage services
OREO	Other real estate owned (foreclosed real estate)
OTTI	Other-than-temporary impairment
Parent Company	Orrstown Financial Services, Inc., the parent company of Orrstown Bank
2011 Plan	2011 Orrstown Financial Services, Inc. Stock Incentive Plan
PCI loans	Purchased credit impaired loans
PPP	Paycheck Protection Program
Repurchase Agreements	Securities sold under agreements to repurchase
SBA	U.S. Small Business Administration
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933, as amended
SOFR	Secured Overnight Financing Rate
TDR	Troubled debt restructuring
U.S.	United States of America
Wheatland	Wheatland Advisors, Inc., the former Registered Investment Advisor subsidiary of Orrstown Financial Services, Inc.

Unless the context otherwise requires, the terms "Orrstown," "we," "us," "our," and "Company" refer to Orrstown Financial Services, Inc. and its subsidiaries.

PART I

Caution About Forward-Looking Statements:

Certain statements appearing herein, which are not historical in nature, are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, we may make other written and oral communications, from time to time, that contain such statements. Such forward-looking statements reflect the current views of the Company's management with respect to, among other things, future events and the Company's financial performance. These statements are often, but not always, made through the use of words or phrases such as “may,” “should,” “could,” “predict,” “potential,” “believe,” “will likely result,” “expect,” “continue,” “will,” “anticipate,” “seek,” “estimate,” “intend,” “plan,” “project,” “forecast,” “goal,” “target,” “would” and “outlook,” or the negative variations of those words or other comparable words of a future or forward-looking nature. Forward-looking statements are statements that include projections, predictions, expectations, estimates or beliefs about events or results or otherwise are not statements of historical facts, many of which, by their nature, are inherently uncertain and beyond the Company's control, and include, but are not limited to, statements related to new business development, new loan opportunities, growth in the balance sheet and fee-based revenue lines of business, merger and acquisition activity, cost savings initiatives, reducing risk assets, and mitigating losses in the future. Accordingly, the Company cautions you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements and there can be no assurances that the Company will achieve the desired level of new business development and new loans, growth in the balance sheet and fee-based revenue lines of business, successful merger and acquisition activity and cost savings initiatives, and continued reductions in risk assets or mitigate losses in the future. Factors which could cause the actual results to differ from those expressed or implied by the forward-looking statements include, but are not limited to, the following: ineffectiveness of the Company's strategic growth plan due to changes in current or future market conditions; the effects of competition and how it may impact our community banking model, including industry consolidation and development of competing financial products and services; the integration of the Company's strategic acquisitions; the inability to fully achieve expected savings, efficiencies or synergies from mergers and acquisitions and cost savings initiatives, or taking longer than estimated for such savings, efficiencies and synergies to be realized; changes in laws and regulations; interest rate movements; changes in credit quality; inability to raise capital, if necessary, under favorable conditions; volatility in the securities markets; the demand for our products and services; deteriorating economic conditions; geopolitical tensions; changes in litigation matters, including the failure to obtain Court approval of proposed settlements, the number of plaintiffs who opt-out of proposed settlements and whether a proposed settlement is appealed; operational risks including, but not limited to, cybersecurity incidents, fraud, natural disasters and future pandemics; expenses associated with pending litigation and legal proceedings; and other risks and uncertainties. The foregoing list of factors is not exhaustive.

For a description of factors that we believe could cause actual results to differ materially from such forward-looking statements, you should review our Risk Factors discussion in Item 1A, our Critical Accounting Policies section included in Item 7, and Note 22, Contingencies, in the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. We encourage readers of this report to understand forward-looking statements to be strategic objectives rather than absolute targets of future performance. If one or more events related to these or other risks or uncertainties materialize, or if the Company's underlying assumptions prove to be incorrect, actual results may differ materially from what the Company anticipates. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company does not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New risks and uncertainties arise from time to time, and it is not possible for the Company to predict those events or how they may affect it. In addition, the Company cannot assess the impact of each factor on its 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. All forward-looking statements, expressed or implied, included in this Annual Report on Form 10-K are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that the Company or persons acting on the Company's behalf may issue.

ITEM 1 – BUSINESS

Orrstown Financial Services, Inc., a Pennsylvania corporation, is the financial holding company ("FHC") for its wholly-owned subsidiary Orrstown Bank. The Company's principal executive offices are located at 77 East King Street, Shippensburg, Pennsylvania, with additional executive and administrative offices at 4750 Lindle Road, Harrisburg, Pennsylvania. The Parent Company was organized on November 17, 1987 for the purpose of acquiring the Bank and such other banks and bank-related activities as are permitted by law. The Company provides banking and financial advisory services located in south central Pennsylvania, principally in Berks, Cumberland, Dauphin, Franklin, Lancaster, Perry and York Counties, Pennsylvania, and in Anne Arundel, Baltimore, Howard and Washington Counties, Maryland, as well as Baltimore City, Maryland. The Company's lending area also includes adjacent counties in Pennsylvania and Maryland, as well as Loudon County, Virginia and Berkeley, Jefferson and Morgan Counties, West Virginia.

Business

The Bank was organized in 1919 as a state-chartered bank. On March 8, 1988, in a bank holding company reorganization transaction, the Parent Company acquired 100% ownership of the Bank.

The Parent Company's primary activity consists of owning and supervising its subsidiary, the Bank. Day-to-day management is conducted by its officers, who are also Bank officers. The Parent Company has historically derived most of its income through dividends from the Bank. At December 31, 2022, the Company had total assets of $2.9 billion, total deposits of $2.5 billion and total shareholders' equity of $228.9 million.

The Company operates in the community banking segment and engages in lending activities, including commercial, residential, commercial mortgages, construction, municipal, and various forms of consumer lending and deposit services, including checking, savings, time and money market deposits. The Company also provides fiduciary, investment advisory, insurance and brokerage services. These activities engaged in by the Bank are authorized by the Pennsylvania Banking Code of 1965. The Company and the Bank are subject to regulation by certain federal and state agencies and undergo periodic examinations by such regulatory authorities. The concentrations of credit by type of loan are included in Note 3, Loans and Allowance for Loan Losses, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data." The Bank maintains a diversified loan portfolio and evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon the extension of credit, is based on management's credit evaluation of the client pursuant to collateral standards established in the Bank's credit policies and procedures.

Human Capital

At December 31, 2022, the Bank had 404 full-time and 15 part-time employees compared to 412 full-time and 17 part-time employees at December 31, 2021. At December 31, 2022, approximately 65% of our workforce was female and 35% were male. Our average tenure is approximately seven years. The Parent Company has no employees. Its 12 executive officers are employees of the Bank, who represent a mix of newer and more seasoned employees with diverse experience and have an average tenure of nine years.

We encourage and support the growth and development of our employees. Continuous learning and career development is advanced through ongoing performance and development conversations with employees, internally created training programs, including development and advancement training offered through Orrstown University, customized corporate training engagements and educational reimbursement and certification programs. Training opportunities are available both online and in-person, and all employees have online access to courses for professional development provided by a third-party. During 2022, we also hired five employees to participate in our new Management Associate Program. This program provides a structured learning experience that focuses on the commercial line of business and credit administration.

Employee evaluations are conducted on at least an annual basis. Those evaluations focus on job performance, achievement of goals and employee and career development. In addition, the Company monitors employee satisfaction and engagement through periodic employee surveys.

The safety, health and wellness of our employees is a top priority. The COVID-19 pandemic presented a unique challenge with regard to maintaining employee safety while continuing successful operations. Through teamwork and the adaptability of our management and staff, our remote work options have evolved as expectations surrounding the COVID-19 pandemic shifted. Starting in 2021, many of our employees effectively worked a hybrid schedule from the Company office and remote locations to ensure a safely-distanced working environment for our employees and clients, which was continued throughout 2022. We continue to highlight the importance of the safety, health and wellness of our employees. We also introduced a number of new initiatives that focus on both physical and mental health.

The Company believes that it is critically important that its employee base reflects the communities that we serve. Since 2020, the Company's Diversity, Equity & Inclusion Council has taken concrete steps to diversify the job applicant pool. In addition to the Company's website, social media platforms and through talent recruiting efforts by third-party recruiters, job openings were posted directly at Historically Black Colleges and Universities within the Company's market area. The Company's President and Chief Executive Officer also signed the CEO ACTION for Diversity & Inclusion Pledge, which makes commitments to continue making our workplaces trusting places, implementing and expanding unconscious bias education, sharing best practices and creating and sharing strategic inclusion and diversity plans with our Board of Directors. Our Diversity, Equity and Inclusion Council continued to take impactful steps in 2022. The council provided educational opportunities to employees throughout the year and also represented the Company during Harrisburg's PrideFest and India Day.

The Company offers competitive compensation to attract and further strengthen employee engagement and encourage retention. Compensation packages include market-competitive salary, healthcare and retirement benefits, paid time off, and may also include bonuses or sales commissions and short-term and long-term equity incentives.

We deploy numerous methods to foster employee engagement, including regular company-wide calls, weekly communication through our Orrstown Connections publications, employee recognitions and service anniversaries, community service and leadership programs, annual events for all employees and off-site events with family and friends.

Lending

Federal bank regulatory agencies have adopted uniform regulations prescribing standards for extensions of credit that are secured by liens or interests in real estate or made for the purpose of financing permanent improvements to real estate. Under these regulations, all insured depository institutions, such as the Bank, must adopt and maintain written policies establishing appropriate limits and standards for extensions of credit that are secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value limits) that are clear and measurable, loan administration procedures and documentation, and approval and reporting requirements. The real estate lending policies must reflect consideration of the federal bank regulatory agencies' Interagency Guidelines for Real Estate Lending Policies.

All secured loans are supported with appraisals or evaluations of collateral. Business equipment and machinery, inventories, accounts receivable, and farm equipment are considered appropriate security, provided borrowers meet acceptable standards for liquidity and marketability. Loans secured by real estate generally do not exceed 85% of the appraised value of the property. Loan to collateral values are monitored as part of the loan review process, and appraisals are updated as deemed appropriate under the circumstances.

Commercial Lending

The Bank originates commercial real estate, equipment, construction, working capital and other commercial purpose loans to commercial clients throughout the Bank's various markets. The Bank has significant market share in south central Pennsylvania and has been expanding its presence geographically in recent years. Currently, growth markets include the Harrisburg region, Lancaster County and Maryland markets. The Bank's commercial lending is focused in these geographic regions or with borrowers headquartered in these geographic regions; however, the Company's lending area has also expanded into adjacent counties in Pennsylvania and Maryland, as well as Loudon County, Virginia and Berkeley, Jefferson and Morgan Counties, West Virginia.

The Bank's credit policy dictates the underwriting requirements for the various types of commercial loans the Bank makes available to borrowers. The policy covers such requirements as debt coverage ratios, advance rates against different forms of collateral, loan-to-value ratios and maximum term.

A majority of the Company's loans are for business purposes. At December 31, 2022, approximately 79% of the loan portfolio was comprised of commercial loans.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security ("CARES") Act was enacted, which established the SBA PPP. The SBA PPP provided economic relief to small businesses nationwide adversely impacted under the COVID-19 Emergency Declaration issued on March 13, 2020. The SBA PPP, which began on April 3, 2020 and ended on May 31, 2021, provided small businesses with funds to cover up to 24 weeks of payroll costs and other expenses, including benefits. It also provided for forgiveness of up to the full principal amount of qualifying loans. During 2020 and 2021, the Bank closed and funded almost 6,500 loans for a total gross loan amount of $699.4 million.

Consumer Lending

The Bank originates home equity loans, home equity lines of credit and other consumer loans, primarily through its branch network and client service center. A large majority of the consumer loans are secured by either a first or second lien position on the borrower's primary residential real estate. The Bank requires a loan-to-value ratio of no greater than 85% of the value of the real estate being taken as collateral with a minimum credit score of 710. The Bank also, at times, purchases consumer loans to help diversify credit risk in our loan portfolio.

Residential Lending

The Bank originates residential mortgages throughout its various markets referred from retail branches and through a network of mortgage loan officers. Residential mortgages originated by the Bank may be sold to secondary market investors, which include both GSE and non-GSE investors. All mortgages, regardless of being sold or held in the Bank's portfolio, are generally underwritten to secondary market industry standards for prime mortgages. For loans originated for investment, the Bank requires pricing adjustments commensurate with the risk, and the real estate taken as collateral generally results in the Bank holding a first lien on the property. The loan-to-value ratio requirements of the real estate being taken as collateral varies per the Credit Policy, and may require the borrower to obtain private mortgage insurance.

Loan Review

The Company has a loan review policy and program, which is designed to identify and monitor risk in the lending function. The Management ERM Committee, comprised of executive and senior officers and loan department personnel, is charged with the oversight of overall credit quality and risk exposure of the Company's loan portfolio. This includes the monitoring of the lending activities of all Company personnel with respect to underwriting and processing new loans and the timely follow-up and corrective action for loans showing signs of deterioration in quality. A loan review program provides the Company with an independent review of the commercial loan portfolio on an ongoing basis. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as extended delinquencies, bankruptcy, repossession or death of the borrower occurs, which heightens awareness as to a possible credit event.

Internal loan reviews are completed annually on all commercial relationships with a committed loan balance in excess of $1.0 million, which includes confirmation of risk rating by an independent credit officer. In addition, all commercial relationships greater than $500 thousand rated substandard, doubtful or loss are reviewed quarterly and corresponding risk ratings are changed or reaffirmed by the Company's Problem Loan Committee, with subsequent reporting to the Management ERM Committee and the Board of Directors.

The Bank outsources its independent loan review to a third-party provider, who monitors and evaluates borrowers on a quarterly basis utilizing risk-rating criteria established in the credit policy in order to identify deteriorating trends and detect conditions which might indicate potential problem loans. The results of the third-party loan review are reported quarterly to the Management and Board ERM Committees for review. The loan ratings provide the basis for evaluating the adequacy of the ALL.

Deposit Products

The Bank offers deposit products to retail, commercial, non-profit and government clients through its retail branch network. Product offerings for retail clients include checking accounts, money market, savings and certificates of deposit. The Bank offers a strong suite of treasury management solutions for businesses that help them to forecast and manage their cash and receivables. The Bank is committed to advancing digital capabilities for all clients, to ensure scalability and optimization of financial performance within the organizations. A robust treasury management online banking platform allows clients to send and collect money electronically using ACH and wire transfer origination services, deposit checks via mobile or desktop capture, and mitigate fraud through check and ACH positive pay services. Wire transfers may be sent and also received domestically, as well as internationally in most currencies. Online bill-pay services allow check and electronic payments, with same day, next day and future dated payments. Additionally, business clients can automatically move money between Bank accounts using various automated sweep services. Using strategic partnerships, the Bank is able to offer best-in-class lockbox services, armored cash logistic solutions, credit cards, purchasing cards, and merchant card processing services.

Digital capability for consumers includes person-to-person (P2P) payment, bill pay, and mobile deposit capture and domestic money transfer services. Traditional domestic and international wire transfer services are also offered via branch. In addition to opening accounts and communicating with employees via traditional branch or call-center engagement, digital online account opening, online loan and credit card application processing, online mortgage pre-qualification and mortgage application processing, automated telephone services, and online chat features provide consumers with convenient digital alternatives to more traditional products and services.

The Bank competes for deposits similarly on the basis of a combination of value and service and by providing convenience through a banking network of branches, ATMs, card services, and digital service channels.

Investment Services

Through its trust department, the Bank renders services as trustee, executor, administrator, guardian, managing agent, custodian, investment advisor, and other fiduciary activities authorized by law under the trade name Orrstown Financial Advisors, or OFA. OFA offers retail brokerage services through a third-party broker/dealer arrangement with Cetera Advisor Networks LLC. At December 31, 2022, average assets under management by OFA totaled $1.7 billion.

Competition

The Bank's principal market area consists of south central Pennsylvania, the greater Baltimore region, and Washington County, Maryland. The Bank serves a substantial number of depositors in this market area and its contiguous counties.

The Bank competes with other banks and less heavily regulated financial services companies, such as credit unions and finance and trust companies, as well as mortgage banking companies, mutual funds, investment advisors, and brokerage firms, both within and outside of its primary market areas. Financial technology companies, or FinTechs, are also providing nontraditional, but increasingly strong, competition for the Bank's borrowers, depositors, and other clients.

The Bank competes for loans primarily on the basis of a combination of value and service by building client relationships as a result of addressing its clients' banking needs, demonstrating expertise, and providing convenience to its clients.

The Bank competes for deposits similarly on the basis of a combination of value and service and by providing convenience through a banking network of branches and ATMs within its markets and digital service channels such as mobile banking.

The Company implements strategic initiatives focused on expanding its core businesses and exploring, on an ongoing basis, acquisition, divestiture, and joint venture opportunities to the extent permitted by its regulators and in alignment with its strategic goals. The Company analyzes each of the Bank's products and businesses in the context of shareholder return, client demands, competitive advantages, industry dynamics, and growth potential. The Company's management believes its market area will support growth in assets and deposits in the future, which it expects to contribute to the Company's ability to maintain or grow profitability.

Regulation and Supervision

The Parent Company is a bank holding company registered with the FRB and has elected status as a FHC. The Bank is a Pennsylvania-chartered commercial bank and a member bank of the Federal Reserve System.

Regulatory Environment

The banking industry is highly regulated, and Orrstown is subject to supervision, regulation, and examination by the FRB, as its primary federal regulator, and the Pennsylvania Department of Banking and Securities. The statutory and regulatory framework that governs the Company is generally intended to protect depositors and clients, the FDIC's Deposit Insurance Fund, the U.S. banking and financial system, and financial markets as a whole by ensuring the safety and soundness of bank holding companies ("BHCs") and banks. Bank regulators regularly examine the operations of BHCs and banks. Regulators have broad supervisory and enforcement authority over BHCs and banks, including the power to impose nonpublic supervisory agreements, issue cease and desist orders, impose fines and other civil and criminal penalties, terminate deposit insurance, and appoint a conservator or receiver.

Engaging in unsafe or unsound practices or failing to comply with applicable laws, regulations, and supervisory agreements could subject the Company and its respective officers, directors, and institution-affiliated parties to the remedies described above, and other sanctions. In addition, the FDIC may terminate a bank's deposit insurance upon a finding that the bank's financial condition is unsafe or unsound or that the bank has engaged in unsafe or unsound practices or has violated an applicable rule, regulation, order, or condition enacted or imposed by the bank's regulatory agency.

Banking statutes, regulations, and policies are continually under review by Congress, state legislatures, and federal and state regulatory agencies. In addition to laws and regulations, state and federal bank regulatory agencies may issue policy statements, interpretive letters, and similar written guidance applicable to Orrstown. Any change in statutes, regulations, or regulatory policies applicable to us, including changes in their interpretation or implementation, could have a material effect on our business or organization.

The Parent Company is also subject to the disclosure and regulatory requirements of the Securities Act and the Exchange Act, both as administered by the SEC, as well as the rules of Nasdaq that apply to companies with securities listed on the Nasdaq Capital Market.

Several of the more significant regulatory provisions applicable to BHCs and banks to which the Company are subject are discussed below, along with certain regulatory matters concerning the Parent Company and the Bank. To the extent that the following information describes statutory or regulatory provisions, such information is qualified in its entirety by reference to the particular statutes or regulations. Any change in applicable law or regulation may have a material effect on the business and prospects of the Parent Company and the Bank.

Financial and Bank Holding Company Activities

As a FHC, the Parent Company is permitted to engage, directly or through subsidiaries, in a wide variety of activities that are financial in nature or are incidental or complementary to a financial activity, in addition to all of the activities otherwise allowed.

As a FHC, the Parent Company is generally subject to the same regulation as other BHCs, including the reporting, examination, supervision and consolidated capital requirements of the FRB. To preserve its FHC status, the Parent Company must remain well-capitalized and well-managed and ensure that the Bank remains well-capitalized and well-managed for regulatory purposes and earns “satisfactory” or better ratings on its periodic Community Reinvestment Act examinations. An FHC ceasing to meet these standards is subject to a variety of restrictions, depending on the circumstances.

If the Parent Company or the Bank are either not well-capitalized or not well-managed, the Parent Company or the Bank must promptly notify the FRB. Until compliance is restored, the FRB has broad discretion to impose appropriate limitations on a FHC’s activities. If compliance is not restored within 180 days, the FRB may ultimately require the FHC to divest its depository institutions or in the alternative, to discontinue or divest any activities that are permitted only to non-FHC bank holding companies.

If the FRB determines that a FHC or its subsidiaries do not satisfy the CRA requirements, the potential restrictions are different. In that case, until all of the subsidiary institutions are restored to at least “satisfactory” CRA rating status, the FHC may not engage, directly or through a subsidiary, in any of the additional activities permissible under the BHC Act nor make additional acquisitions of companies engaged in such additional activities. However, completed acquisitions and additional activities and affiliations previously begun are left undisturbed, as the BHC Act does not require divestiture for this type of situation.

Federal Deposit Insurance

The FDIC's Deposit Insurance Fund provides insurance coverage for certain deposits, up to a standard maximum deposit insurance amount of $250 thousand per depositor and is funded through assessments on insured depository institutions, based on the risk each institution poses to the Deposit Insurance Fund. The Bank accepts client deposits that are insured by the Deposit Insurance Fund and, therefore, must pay insurance premiums. The FDIC may increase the Bank’s insurance premiums based on various factors, including the FDIC’s assessment of its risk profile. In October of 2022, the FDIC finalized a rule to increase the initial base deposit insurance assessment rate by two basis points beginning in the first quarter of 2023. The increase in the assessment rate for banks is intended to increase the Deposit Insurance Fund reserve ratio to 1.35%. For 2022, the FDIC insurance expense for the Bank was $1.1 million.

If the FDIC is appointed conservator or receiver of a bank upon that bank’s insolvency or the occurrence of other events, the FDIC may sell some, part, or all of a bank’s assets and liabilities to another bank or repudiate or disaffirm most types of contracts to which that bank was a party if the FDIC believes such contracts are burdensome. In resolving the estate of a failed bank, the FDIC as receiver will first satisfy its own administrative expenses, and the claims of holders of U.S. deposit liabilities also have priority over those of other general unsecured creditors.

Liability for Banking Subsidiaries

The Parent Company is required to serve as a source of financial and managerial strength to the Bank and, under appropriate conditions, to commit resources to support the Bank. This support may be required by the FRB at times when the Bank might otherwise determine not to provide it or when doing so is not otherwise in the interests of the Parent Company or its shareholders or creditors. The FRB may require a BHC to make capital injections into a troubled subsidiary bank and may charge the BHC with engaging in unsafe and unsound practices if the BHC fails to commit resources to such a subsidiary bank or if it undertakes actions that the FRB believes might jeopardize the BHC’s ability to commit resources to such subsidiary bank.

Under these requirements, the Parent Company may in the future be required to provide financial assistance to the Bank should it experience financial distress. Capital loans by the Parent Company to the Bank would be subordinate in right of payment to deposits and certain other debts of the Bank. In the event of the Parent Company's bankruptcy, any commitment by the Parent Company to a federal bank regulatory agency to maintain the capital of the Bank would be assumed by the bankruptcy trustee and entitled to a priority of payment.

Pennsylvania Banking Law

The Pennsylvania Banking Code contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, and employees, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Pennsylvania Banking Code delegates extensive rule-making power and administrative discretion to the Pennsylvania Department of Banking and Securities so that the supervision and regulation of state-chartered banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

The FDIA, however, prohibits state-chartered banks from making new investments, loans, or becoming involved in activities as principal and equity investments which are not permitted for national banks unless the FDIC determines the activity or investment does not pose a significant risk of loss to the Deposit Insurance Fund, and a bank meets all applicable capital requirements. Accordingly, additional operating authority provided to the Bank by the Pennsylvania Banking Code may be significantly restricted by the FDIA.

Dividend Restrictions

The Parent Company is a legal entity separate and distinct from its banking and non-banking subsidiaries. Since the Parent Company's consolidated net income consists largely of net income of its subsidiaries, its ability to make capital distributions, including paying dividends and repurchasing shares, depends upon its receipt of dividends from these subsidiaries. Under federal law, there are various limitations on the extent to which the Bank can declare and pay dividends to the Parent Company, including those related to regulatory capital requirements, general regulatory oversight to prevent unsafe or unsound practices, and federal banking law requirements concerning the payment of dividends out of net profits, surplus, and available earnings. The Bank must maintain the CET1 Capital Conservation Buffer requirement of 2.5% to avoid becoming subject to restrictions on capital distributions, including dividends. Certain contractual restrictions also may limit the ability of the Bank to pay dividends to the Parent Company. No assurances can be given that the Bank will, in any circumstances, pay dividends to the Parent Company.

The Parent Company's ability to declare and pay dividends to its shareholders is similarly limited by federal banking law and FRB regulations and policy.

FRB policy provides that a BHC should not pay dividends unless (1) the BHC’s net income over the last four quarters (net of dividends paid) is sufficient to fully fund the dividends, (2) the prospective rate of earnings retention appears consistent with the capital needs, asset quality, and overall financial condition of the BHC and its subsidiaries, and (3) the BHC will continue to meet minimum required capital adequacy ratios. Accordingly, a BHC should not pay cash dividends that can only be funded in ways that weaken the BHC’s financial health, such as by borrowing. The policy also provides that a BHC should inform the FRB reasonably in advance of declaring or paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in a material adverse change to the BHC’s capital structure. BHCs also are expected to consult with the FRB before increasing dividends or redeeming or repurchasing capital instruments. Additionally, the FRB could prohibit or limit the payment of dividends by a BHC if it determines that payment of the dividend would constitute an unsafe or unsound practice.

Transactions between a Bank and its Affiliates

Federal banking laws and regulations impose qualitative standards and quantitative limitations upon certain transactions between a bank and its affiliates, including between a bank and its holding company and companies that the BHC may be deemed to control for these purposes. Transactions covered by these provisions must be on arm’s-length terms and cannot exceed certain amounts which are determined with reference to that bank’s regulatory capital. Moreover, if the transaction is a loan or other extension of credit, it must be secured by collateral in an amount and quality expressly prescribed by statute, and if the affiliate is unable to pledge sufficient collateral, the BHC may be required to provide it. The Dodd-Frank Act expanded the coverage and scope of these restrictions and requirements, including by applying them to the credit exposure arising under derivative transactions, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions. Federal banking laws also place similar restrictions on loans and other extensions of credit by FDIC-insured banks, such as the Bank, and their subsidiaries to their directors, executive officers, and principal shareholders.

Regulatory Capital Requirements

Compliance with respect to capital requirements is incorporated by reference from Note 16, Shareholders' Equity and Regulatory Capital, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary

Data," and from the Capital Adequacy and Regulatory Matters section of Item 7, "Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations."

The Bank is subject to certain risk-based capital and leverage ratio requirements under the U.S. Basel III capital rules adopted by the FRB. These rules implement the Basel III international regulatory capital standards in the U.S., as well as certain provisions of the Dodd-Frank Act. These quantitative calculations are minimums, and the FRB may determine that a banking organization, based on its size, complexity, or risk profile, must maintain a higher level of capital in order to operate in a safe and sound manner. The FRB asset-sized reporting threshold for a BHC is $3.0 billion and a company with consolidated assets under that limit is generally not subject to the FRB consolidated capital rules. A company with consolidated assets under the limit may continue to file reports that include capital amounts and ratios. Orrstown has elected to continue to file those reports.

Under the U.S. Basel III capital rules, the Parent Company's and the Bank's assets, exposures, and certain off-balance sheet items are subject to risk weights used to determine the institutions' risk-weighted assets. These risk-weighted assets are used to calculate the following minimum capital ratios for the Parent Company and the Bank:

• CET1 Risk-Based Capital Ratio, equal to the ratio of CET1 capital to risk-weighted assets. CET1 capital primarily includes common shareholders' equity subject to certain regulatory adjustments and deductions, including goodwill, intangible assets, certain deferred tax assets, and AOCI. The Company has elected to opt out of including AOCI components.

• Tier 1 Risk-Based Capital Ratio, equal to the ratio of Tier 1 capital to risk-weighted assets. Tier 1 capital is primarily comprised of CET1 capital, perpetual preferred stock, and certain qualifying capital instruments.

• Total Risk-Based Capital Ratio, equal to the ratio of total capital, including CET1 capital, Tier 1 capital, and Tier 2 capital, to risk-weighted assets. Tier 2 capital primarily includes qualifying subordinated debt and qualifying ALL.

• Tier 1 Leverage Ratio, equal to the ratio of Tier 1 capital to quarterly average assets (net of goodwill, certain other intangible assets, and certain other deductions).

Failure to be well-capitalized or to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our operations or financial condition. Failure to be well-capitalized or to meet minimum capital requirements could also result in restrictions on the Bank's ability to pay dividends or otherwise distribute capital or to receive regulatory approval of applications.

In addition to meeting the minimum capital requirements, under the U.S. Basel III capital rules, the Bank must also maintain the required Capital Conservation Buffer to avoid becoming subject to restrictions on capital distributions and certain discretionary bonus payments to management. The Capital Conservation Buffer is calculated as a ratio of CET1 capital to risk-weighted assets, and it effectively increases the required minimum risk-based capital ratios. The Capital Conservation Buffer requirement is 2.5%. The Tier 1 Leverage Ratio is not impacted by the Capital Conservation Buffer, and a banking institution may be considered well-capitalized while remaining out of compliance with the Capital Conservation Buffer.

The Parent Company has the ability to provide additional capital to the Bank to maintain the Bank's risk-based capital ratios at levels which would be considered well-capitalized.

At December 31, 2022, the Parent Company's and the Bank's regulatory capital ratios were above applicable well-capitalized standards and met the Capital Conservation Buffer requirement.

Bank Acquisitions by Orrstown

BHCs must obtain prior approval of the Federal Reserve in connection with any acquisition that results in the BHC owning or controlling 5% or more of any class of voting securities of a bank or another BHC.

Acquisitions of Ownership of Orrstown

Acquisitions of Orrstown's voting stock above certain thresholds are subject to prior regulatory notice or approval under federal banking laws, including the BHC Act and the Change in Bank Control Act of 1978. Under the Change in Bank Control Act, a person or entity generally must provide prior notice to the FRB before acquiring the power to vote 10% or more of our outstanding common stock. Investors should be aware of these requirements when acquiring shares in the Company's stock.

Data Privacy

Federal and state law contains extensive consumer privacy protection provisions. The GLB Act requires financial institutions to periodically disclose their privacy policies and practices relating to sharing such information and enables retail clients to opt out of our ability to share information with unaffiliated third parties under certain circumstances. Other federal and state laws and regulations impact our ability to share certain information with affiliates and non-affiliates for marketing and/or non-marketing purposes, or to contact clients with marketing offers. These security and privacy policies and procedures for the protection of personal and confidential information are in effect across all businesses and geographic locations as applicable. Federal law also makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain client information of a financial nature by fraudulent or deceptive means. Data privacy and data protection are areas of increasing federal and state legislative focus.

Like other lenders, the Bank uses credit bureau data in its underwriting activities. Use of such data is regulated under the Fair Credit Reporting Act, which also regulates reporting information to credit bureaus, prescreening individuals for credit offers, sharing of information between affiliates, and using affiliate data for marketing purposes. Similar state laws may impose additional requirements on the Company.

Cybersecurity

The GLB Act requires financial institutions to implement a comprehensive information security program that includes administrative, technical, and physical safeguards to ensure the security and confidentiality of client records and information.

The Cybersecurity Information Sharing Act is intended to improve cybersecurity in the U.S. by enhanced sharing of information about security threats among the U.S. government and private sector entities, including financial institutions. The Cybersecurity Information Sharing Act also authorizes companies to monitor their own systems notwithstanding any other provision of law and allows companies to carry out defensive measures on their own systems from cyber-attacks. The law includes liability protections for companies that share cyber threat information with third parties so long as such sharing activity is conducted in accordance with Cybersecurity Information Sharing Act.

In October 2016, the federal bank regulatory agencies issued an Advanced Notice of Proposed Rulemaking regarding enhanced cyber risk management standards, which would apply to a wide range of large financial institutions and their third-party service providers. The proposed rules would expand existing cybersecurity regulations and guidance to focus on cyber risk management and governance, management of internal and external dependencies, and incident response, cyber resilience, and situational awareness. In addition, the proposal contemplated more stringent standards for institutions with systems that are critical to the financial sector. These enhanced standards would apply only to depository institutions and depository institution holding companies with total consolidated assets of $50 billion or more. The federal banking agencies have not yet taken further action on such proposed standards.

The United States federal bank regulatory agencies adopted a rule regarding notification requirements for banking organizations related to significant computer security incidents. Effective April 1, 2022, a bank holding company and a state member bank are required to notify the Federal Reserve within 36 hours of incidents that have materially disrupted or degraded, or are reasonably likely to materially disrupt or degrade, the banking organization’s ability to deliver services to a material portion of its client base, jeopardize the viability of key operations of the banking organization, or impact the stability of the financial sector. The Company's Computer Security Incident Response Plan includes procedures for timely and accurate notifications to regulators, law enforcement, and insurance companies. These procedures are tested comprehensively at least annually.

Community Reinvestment Act

The CRA is intended to encourage banks to help meet the credit needs of their service areas, including low- and moderate-income neighborhoods, consistent with safe and sound business practices. The relevant federal bank regulatory agency, the FRB in the Bank’s case, examines each bank and assigns it a public CRA rating. A bank’s record of fair lending compliance is part of the resulting CRA examination report. The CRA requires the relevant federal bank regulatory agency to consider a bank’s CRA assessment when considering that bank’s application to conduct certain mergers or acquisitions or to open or relocate a branch office. The FRB also must consider the CRA record of each subsidiary bank of a BHC in connection with any acquisition or merger application filed by the BHC. An unsatisfactory CRA record could substantially delay or result in the denial of an approval or application by the Parent Company or the Bank. The Bank received a CRA rating of “Satisfactory” in its most recent examination. Leaders of the federal banking agencies have indicated their support for modernizing the CRA regulatory framework to address changing delivery systems and consumer preferences. In May 2022, the United States federal bank regulatory agencies issued a joint proposal that would, among other things, expand access to credit, investment, and basic banking services in low- and moderate-income communities, adapt to changes in the banking industry, including the expanded role of mobile and online banking, and provide greater clarity, consistency, and transparency. Following the comment period, it is expected that a final ruling will be issued by the Agencies during 2023.

Anti-Money Laundering

The Bank Secrecy Act and the PATRIOT Act contain anti-money laundering and financial transparency provisions intended to detect and prevent the use of the U.S. financial system for money laundering and terrorist financing activities. The Bank Secrecy Act, as amended by the PATRIOT Act, requires depository institutions and their holding companies to undertake activities including maintaining an anti-money laundering program, verifying the identity of clients, verifying the identity of certain beneficial owners for legal entity clients, monitoring for and reporting suspicious transactions, reporting on cash transactions exceeding specified thresholds, and responding to requests for information by regulatory authorities and law enforcement agencies. The Bank is subject to the Bank Secrecy Act and, therefore, is required to provide its employees with anti-money laundering training, designate an anti-money laundering compliance officer, and undergo an annual, independent audit to assess the effectiveness of its anti-money laundering program. The Bank has implemented policies, procedures, and internal controls that are designed to comply with these anti-money laundering requirements. Bank regulators are focusing their examinations on anti-money laundering compliance, and we will continue to monitor and augment, where necessary, our anti-money laundering compliance programs. The federal banking agencies are required, when reviewing bank and BHC acquisition or merger applications, to consider the effectiveness of the anti-money laundering activities of the applicant.

The Anti-Money Laundering Act of 2020 ("AMLA"), which amends the BSA, was enacted in January 2021. The AMLA codifies a risk-based approach to anti-money laundering compliance for financial institutions; requires the Treasury to promulgate priorities for anti-money laundering and countering the financing of terrorism policy; requires the development of standards by the Treasury for testing technology and internal processes for BSA compliance; expands enforcement- and investigation-related authority, including a significant expansion in the available sanctions for certain BSA violations; and expands BSA whistleblower incentives and protections. Many of the statutory provisions in the AMLA will require additional rulemaking, reports and other measures, and the impact of the AMLA will depend on, among other things, rulemaking and implementation guidance. Of these statutory provisions, the final rule for the Corporate Transparency Act (the "CTA") will become effective January 1, 2024. The CTA authorizes FinCEN to collect uniform beneficial ownership information for certain types of corporations, limited liability companies or other similar entities and disclose the information to authorized Federal agencies engaged in national security, intelligence, or law enforcement activities; state, local, and Tribal law enforcement agencies with court authorization; financial institutions with client due diligence requirements and regulators supervising them for compliance with such requirements; foreign law enforcement agencies, prosecutors, judges, and other agencies that meet specific criteria; and Treasury officers and employees under certain circumstances in an attempt to help prevent criminal and terrorist activity.

Office of Foreign Assets Control Regulation

The Office of Foreign Assets Control is responsible for administering economic sanctions that affect transactions with designated foreign countries, nationals, and others, as defined by various Executive Orders and in various legislation. Office of Foreign Assets Control-administered sanctions take many different forms. For example, sanctions may include: (1) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on U.S. persons engaging in financial transactions relating to, making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (2) a blocking of assets in which the government or "specially designated nationals" of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction, including property in the possession or control of U.S. persons. The Office of Foreign Assets Control also publishes lists of persons, organizations, and countries suspected of aiding, harboring, or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. Blocked assets, such as property and bank deposits, cannot be paid out, withdrawn, set off, or transferred in any manner without a license from the Office of Foreign Assets Control. Failure to comply with these sanctions could have serious legal and reputational consequences.

Transaction Account Reserves

FRB regulations require depository institutions to maintain cash reserves against specified deposit liabilities. The dollar amount of a depository institution's reserve requirement is determined by applying the reserve ratios specified in Regulation D to an institution's transaction accounts (primarily NOW and regular checking accounts). The FRB issued a final rule, effective December 22, 2020, lowering the reserve requirement on transaction accounts to 0%. Effective January 1, 2023, the FRB will establish the new reserve requirement exemption amount and low reserve tranche for 2023, but will not elevate the current reserve percentage from zero for depository institutions.

Consumer Protection Regulation and Supervision

The Bank is subject to the regulations promulgated by the CFPB, as administered by the FRB, with respect to federal consumer protection laws. The Bank is also subject to certain state consumer protection laws and, under the Dodd-Frank Act, state attorneys general and other state officials are empowered to enforce certain federal consumer protection laws and regulations. State authorities have increased their focus on and enforcement of consumer protection rules. These federal and state consumer protection laws apply to a broad range of the Bank's activities and to various aspects of its business and include laws relating to interest rates, fair lending, disclosures of credit terms and estimated transaction costs to consumer borrowers, debt collection practices, the use and provision of information to consumer reporting agencies, and the prohibition of unfair, deceptive, or abusive acts or practices in connection with the offer, sale, or provision of consumer financial products and services.

The CFPB has promulgated many mortgage-related final rules since it was established under the Dodd-Frank Act, including rules related to the ability to repay, qualified mortgage standards, mortgage servicing standards, loan originator compensation standards, high-cost mortgage requirements, Home Mortgage Disclosure Act requirements, and appraisal and escrow standards for higher priced mortgages. The mortgage-related final rules issued by the CFPB have materially restructured the origination, servicing, and securitization of residential mortgages in the U.S. These rules have impacted, and will continue to impact, the business practices of residential mortgage lenders, including the Bank.

Nasdaq Capital Market

The Company's common stock is listed on the Nasdaq Capital Market under the trading symbol "ORRF" and is subject to Nasdaq's rules for listed companies.

Available Information

The Company is subject to the informational requirements of the Exchange Act and, in accordance with the Exchange Act, it files annual, quarterly, and current reports, proxy statements, and other information with the SEC. The SEC maintains an Internet web site that contains reports, proxy statements, and other information about issuers, like us, who file electronically with the SEC. The address of the site is www.sec.gov. The reports and other information, including any related amendments, filed by us with, or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, by the Company to, the SEC are also available free of charge at our Internet web site as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The address of the site is www.orrstown.com. Except as specifically incorporated by reference into this Annual Report on Form 10-K, information on those web sites is not part of this report.

ITEM 1A – RISK FACTORS

An investment in our common stock is subject to risks inherent in our business. The material risks and uncertainties that management believes affect us are described below. This report is qualified in its entirety by these risk factors.

Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report and our other filings with the SEC. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our business operations.

If any of the following risks actually materialize, our business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of our common stock could decline significantly, and you could lose all or part of your investment.

Risks Related to Credit

If our allowance for loan losses is not sufficient to cover actual losses, our earnings would decrease.

The allowance for loan losses is recorded as a reduction to loans and leases on the consolidated balance sheet, and the reserve for unfunded lending commitments is included in other liabilities on the consolidated balance sheet. While the Company believes that its allowance for loan losses as of December 31, 2022 was sufficient to cover incurred losses in the loan and lease portfolio on that date, the Company may need to increase its provision for credit losses in future periods due to changes in the risk characteristics of the loan and lease portfolio, thereby negatively impacting its results of operations.

We periodically make a determination of an allowance for loan losses based on available information, including, but not limited to, the quality of the loan and lease portfolio as indicated by trends in loan risk ratings, payment performance, economic conditions, the value of the underlying collateral and the level of non-accruing and criticized loans and leases. Management relies on its loan officers and credit quality reviews, its experience and its evaluation of economic conditions, among other factors, in determining the amount of provision required for the allowance for loan losses. Provisions to this allowance result in an expense for the period. If, as a result of general economic conditions, previously incorrect assumptions in the qualitative factors, or an increase in defaulted loans or leases, we determine that additional increases in the allowance for loan losses are necessary, additional expenses may be incurred.

Determining the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and trends, all of which may undergo material changes. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans and leases that are identified. We have in the past been, and in the future may be, required to increase our allowance for loan losses for any of several reasons. State and federal regulators, in reviewing our loan and lease portfolio as part of a regulatory examination, may request that we increase the allowance for loan losses. Changes in economic conditions or individual business or personal circumstances affecting borrowers, new information regarding existing loans and leases, identification of additional problem loans and leases and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. Any increases in the allowance for loan losses may result in a decrease in our net income and, possibly, our capital, and could have an adverse effect on our financial condition and results of operations.

As a result of the adoption of ASU 2016-13 effective January 1, 2023, the Company updated its critical accounting policy to the allowance for credit losses. The updates in this standard replace the incurred loss impairment methodology GAAP with the current expected credit losses ("CECL") methodology. The CECL methodology incorporates current condition, and "reasonable and supportable" forecasts, as well as prepayments, to estimate loan losses over the life of the loan. The Company expects to recognize a one-time cumulative-effect adjustment to the allowance for credit losses as of the date of adoption. The determination of the one-time cumulative-effect adjustment, and the determination of the allowance for credit losses in future periods, under the CECL model depend significantly upon the Company's assumptions and judgments with respect to a variety of factors. As under the existing incurred loss model, if the Company's assumptions and judgments regarding such matters prove to be inaccurate, its allowance for credit losses might not be sufficient, and additional provisions for credit losses might need to be made. Depending on the amount of such provisions for credit losses, the adverse impact on the Company's earnings could be material. For a more complete description of the potential impact ASU 2016-13 may have on our financial statements and allowance for credit losses, please refer to Note 1, Summary of Significant Accounting Policies, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data" appearing elsewhere in this Form 10-K.

Commercial real estate lending may expose us to a greater risk of loss and impact our earnings and profitability.

Our business strategy includes making loans secured by commercial real estate. These types of loans generally have higher risk-adjusted returns and shorter maturities than other loans. Loans secured by commercial real estate properties are generally for larger amounts and may involve a greater degree of risk than other loans. Payments on loans secured by these properties are often dependent on the income produced by the underlying properties which, in turn, depends on the successful operation and management of the properties. Accordingly, repayment of these loans is subject to conditions in the real estate market or the local economy. In challenging economic conditions, these loans represent higher risk and could result in internal risk rating downgrades and an increase in our total net charge-offs, requiring us to increase our allowance for loan losses, which could have a material adverse effect on our financial condition or results of operations. While we seek to minimize these risks in a variety of ways, there can be no assurance that these measures will protect against credit-related losses.

Our loan portfolio has a significant concentration in commercial real estate loans.

Our loan portfolio is made up largely of commercial real estate loans. The federal banking agencies have promulgated guidance governing banks with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development and other land represent 100% or more of total risk-based capital or (ii) total commercial real estate loans represent 300% or more of total risk-based capital and that bank’s commercial real estate loan portfolio has increased 50% or more during the prior thirty-six months. Owner-occupied commercial real estate loans are excluded from this second category. If a bank is deemed to have a concentration in commercial real estate loans, it will be required to employ heightened risk management practices that address board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing and maintenance of increased capital levels as needed to support the level of commercial real estate lending. At December 31, 2022, the Bank’s construction, land development and other land balances were 64% of total risk-based capital, commercial real estate loans were 319% of total risk-based capital and the Bank’s commercial real estate loan portfolio increased by 78% during the prior thirty-six months. The Bank believes it has taken the appropriate steps to implement appropriate risk management practices, which are subject to regulatory examination, including enhanced market analysis, stress testing and sensitivity analysis. If our regulators conclude that we have not implemented appropriate risk management practices, it could adversely affect our business, and could result in the requirement to maintain increased capital levels or restrict our ability to originate new loans secured by commercial real estate. We can provide no assurance that capital would be available, or available on terms favorable to the Company, at that time.

The credit risk related to commercial and industrial loans is greater than the risk related to residential loans.

Commercial and industrial loans generally carry larger loan balances and involve a greater degree of risk of nonpayment or late payment than home equity loans or residential mortgage loans. Commercial and industrial loans include advances to local and regional businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although commercial and industrial loans may be unsecured to our highest rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. Commercial and industrial loans are more susceptible to risk of loss during a downturn in the economy, as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline. We attempt to mitigate this risk through our underwriting standards, including evaluating the creditworthiness of the borrower, regular monitoring, and, to the extent available, credit ratings on the business. However, these procedures cannot entirely eliminate the risk of loss associated with commercial and industrial lending.

Environmental liability associated with our lending activities could result in losses.

In the course of business, we may acquire, through foreclosure, properties securing loans originated or purchased that are in default. Particularly in commercial real estate lending, there is a risk that material environmental violations could be discovered on these properties. In this event, we might be required to remedy these violations at the affected properties at our sole cost and expense. The cost of remedial action could substantially exceed the value of affected properties. We may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have an adverse effect on our financial condition and results of operations.

As a participating lender in the SBA PPP, we are subject to risks that the SBA may not fund some or all PPP loan guaranties and to additional risks of litigation from our clients or other parties regarding our processing of loans for the PPP.

The Company had $14.1 million in gross outstanding balance of SBA PPP loans at December 31, 2022. We also have credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which a loan was originated, funded, or serviced by us. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by us, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

We may be exposed to the risk of litigation regarding our process and procedures used in processing applications for the PPP and in connection with our processing of PPP loan forgiveness applications. If any such litigation is filed against us and is not resolved in a manner favorable to us, it may result in a material adverse impact on our business, financial condition and results of operations or adversely affect our reputation. In addition, litigation can be costly, regardless of outcome.

Risks Related to Interest Rates and Investments

Changes in interest rates could adversely impact the Company's financial condition and results of operations.

Our operations are subject to risks and uncertainties surrounding our exposure to changes in the interest rate environment. Operating income, net income and liquidity depend to a great extent on our net interest margin. Interest rates are highly sensitive to many factors beyond our control, including competition, general economic conditions, geopolitical tensions and monetary and fiscal policies of various governmental and regulatory authorities, including the FRB. Conditions such as inflation, deflation, recession, unemployment and other factors beyond our control may also affect interest rates. The nature and timing of any changes in interest rates or general economic conditions and their effect on us cannot be controlled and are difficult to predict. If the rate of interest we pay on our interest-bearing liabilities increases more than the rate of interest we receive on our interest-earning assets, our net interest income, and therefore our earnings and liquidity, could contract and be materially adversely affected. Our earnings and liquidity could also be materially adversely affected if the rates on interest-earning assets fall more quickly than those on our interest-bearing liabilities.

Changes in interest rates also can affect our ability to originate loans, our ability to obtain and retain deposits, and the value of interest-earning assets, and the ability to realize gains from the sale of such assets, which could all negatively impact shareholder's equity and regulatory capital. Since December 31, 2021, the FRB has raised the federal funds rate by 450 basis points and has indicated that additional interest rate increases are possible in 2023. Additional increases in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations, which could not only result in increased loan defaults, foreclosures and charge-offs, but could also necessitate further increases to our allowance for credit losses and reduce net income. A decrease in interest rates may trigger loan prepayments, which may serve to reduce net interest income if we are unable to lend these funds to other borrowers or invest the funds at the same or higher interest rates. In addition, based on our interest rate sensitivity analyses, an increase in the general level of interest rates will negatively affect the market value of the investment portfolio because of the relatively higher duration of certain securities included in the investment portfolio.

Our subordinated notes, issued in December 2018, have a 6.0% fixed interest rate through December 2023, after which the interest rate will convert to a variable rate, equivalent to the LIBOR fallback rate, or any replacement reference rate, plus 3.16% through maturity in December 2028. An increase in the interest rate on our subordinated debt could have a material adverse effect on our liquidity and results of operations.

Our securities portfolio performance in difficult market conditions could have adverse effects on our results of operations.

Unrealized losses on investment securities result from changes in market interest rates, credit spreads and liquidity in the marketplace, along with changes in the credit profile of individual securities issuers. Under GAAP, we are required to review our investment portfolio periodically for the presence of impairment of our securities, taking into consideration current and future market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, our ability and intent to hold investments until a recovery of fair value, as well as other factors. Adverse developments with respect to one or more of the foregoing factors may require us to deem particular securities to be impaired, with the credit-related portion of the reduction in the value recognized as a charge to our earnings through a valuation allowance. Subsequent valuations, in light of factors prevailing at that time, may result in significant changes in the values of these securities in future periods. Any of these factors could require us to recognize further impairments in the value of our securities portfolio, which may have an adverse effect on our regulatory capital, financial condition or results of operations in future periods. During 2022, the Company experienced a decline in the value of its AFS investment securities, as a result of the rising interest rate environment, which resulted in $55.2 million in unrealized losses reflected in AOCI and reduced total shareholders' equity. Additional increases in interest rates and credit spread changes could result in additional unrealized losses on AFS investment securities. The Company has determined that its unrealized losses on investment securities as of December 31, 2022 did not meet the definition of OTTI. The Company does not intend to sell any of its investment securities nor will be required to sell them before recovery of their amortized cost.

In addition, deterioration or defaults made by issuers of the underlying collateral of our investment securities may cause additional credit-related other-than-temporary impairment charges to our income statement. Our ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations.

Potential downgrades of U.S. government securities by one or more of the credit ratings agencies could have a material adverse effect on our operations, earnings and financial condition.

A possible future downgrade of the sovereign credit ratings of the U.S. government and a decline in the perceived creditworthiness of U.S. government-related obligations could impact our ability to obtain funding that is collateralized by affected instruments, as well as affect the pricing of that funding when it is available. A downgrade may also adversely affect the market value of such instruments. We cannot predict if, when or how any changes to the credit ratings or perceived creditworthiness of these organizations will affect economic conditions. Among other things, a downgrade in the U.S. government's credit rating could adversely impact the value of our securities portfolio and may trigger requirements that the Company post additional collateral for trades relative to these securities. A downgrade of the sovereign credit ratings of the U.S. government or the credit ratings of related institutions, agencies or instruments would significantly exacerbate the other risks to which we are subject and any related adverse effects on the business, financial condition and results of operations.

Uncertainty about the transition from LIBOR to other benchmark interest rate indexes may adversely affect our business.

LIBOR is used extensively in the United States as a benchmark for various consumer, commercial and financial contracts, including funding sources, adjustable-rate mortgages, corporate debt, interest rate swaps and other derivatives. LIBOR is set based on interest rate information reported by certain banks, which will stop reporting such information after June 30, 2023. Other benchmarks may perform differently than LIBOR or may have other consequences that cannot currently be anticipated. On March 15, 2022, Congress passed the Adjustable Interest Rate (LIBOR) Act to establish a replacement reference rate for contracts that (i) reference LIBOR, (ii) will not mature prior to June 30, 2023 or (iii) may lack fallback provisions for providing a clear replacement for LIBOR. On December 16, 2022, the Federal Reserve adopted the final rule which implemented the legislation that replaces references to LIBOR with Board-selected benchmark replacements based on SOFR. The Company has implemented alternative references rates in our financial instruments to replace LIBOR, including Term SOFR. The uncertainty regarding the transition from LIBOR to another benchmark rate or rates, such as the SOFR, could have adverse impacts on our funding costs or net interest margins, as well as any floating-rate obligations, loans, deposits, derivatives, and other financial instruments that currently use LIBOR as a benchmark rate and, ultimately, adversely affect our financial condition and results of operations.

Risks Related to Competition and to Our Business Strategy

Difficult economic and market conditions can adversely affect the financial services industry and may materially and adversely affect the Company.

Our operations are sensitive to general business and economic conditions in the U.S. If the growth of the U.S. economy slows, or if the economy worsens or enters a recession, our growth and profitability could be constrained. In addition, economic conditions in foreign countries can affect the stability of global financial markets, which could impact the U.S. economy and financial markets. Weak economic conditions, which could directly impact our operations, are characterized by inflation, fluctuations in debt and equity capital markets, including a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased loan delinquencies, real estate price declines and lower home sales and commercial activity, and increased problem assets and foreclosures. All of these factors are detrimental to our business. In addition, our business is significantly affected by monetary and related policies of the U.S. federal government, its agencies and government-sponsored entities. Changes in any of these policies could have a material adverse effect on our business, financial position, results of operations and cash flows.

Adverse developments affecting the financial services industry, such as actual events or concerns involving liquidity, defaults, or non-performance by financial institutions or transactional counterparties, could adversely affect our financial condition and results of operations.

Actual events involving limited liquidity, defaults, non-performance or other adverse developments that affect financial institutions, transactional counterparties or other companies in the financial services industry or the financial services industry generally, or concerns or rumors about any events of these kinds or other similar risks, have in the past and may in the future lead to market-wide liquidity problems. For example, on March 10, 2023, Silicon Valley Bank ("SVB") was closed by the California Department of Financial Protection and Innovation, which appointed the FDIC as receiver. Similarly, on March 12, 2023, Signature Bank was placed into receivership. A statement by the U.S. Department of the Treasury (the "Treasury"), the FRB and the FDIC indicated that all depositors of SVB would have access to all of their money after only one business day of closure, including funds held in uninsured deposit accounts.

Increases in bond interest rates have led to a significant decline in the fair value of investment securities. Although the Treasury, FDIC and FRB have announced a program to provide up to $25 billion of loans to financial institutions secured by certain of such government-backed agency securities held by financial institutions to mitigate the risk of potential losses on the sale of such instruments, widespread demands for customer withdrawals or other liquidity needs of financial institutions for immediate liquidity may exceed the capacity of such program. Additionally, there is no guarantee that the Treasury, FDIC and FRB will provide access to uninsured funds in the future in the event of the closure of other banks or financial institutions, or that they would do so in a timely fashion.

Because our business is concentrated in south central Pennsylvania, the greater Baltimore region, and Washington County, Maryland, our financial performance could be materially adversely affected by economic conditions and real estate values in these market areas.

Our operations and the properties securing our loans are primarily located in south central Pennsylvania, the greater Baltimore region, and Washington County, Maryland. Our operating results depend largely on economic conditions and real estate valuations in these and surrounding areas. A deterioration in economic conditions, increased unemployment, inflation, and a decline in real estate values in these market areas or other factors beyond our control could materially adversely affect our operations.

Inflationary pressures and rising prices may affect our results of operations and financial condition.

Inflation rose sharply at the end of 2021 and throughout 2022. Inflationary pressures are currently expected to remain elevated throughout 2023. Small to medium-sized businesses may be impacted more during periods of high inflation as they are not able to leverage economies of scale to mitigate cost pressures compared to larger businesses. Consequently, the ability of our clients to repay their loans may deteriorate, and in some cases this deterioration may occur quickly, which would adversely impact our results of operations and financial condition. Furthermore, a prolonged period of inflation could cause wages and other costs to increase, which could adversely affect our results of operations and financial condition.

We face significant competition in the financial services industry.

We face significant competition in originating loans, attracting deposits and providing other financial services from financial and non-financial services firms, including traditional banks and credit unions, online banks, mortgage banking companies, wealth management companies, financial technology companies and others. Some of our competitors enjoy advantages, including greater financial resources and higher lending limits, more expansive marketing campaigns, better brand recognition, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. Emerging technologies have the potential to intensify competition and accelerate disruption in the financial services industry. In recent years, non-financial services firms, such as financial technology companies, have been offering services traditionally provided by financial institutions. These firms use technology and mobile platforms to enhance the ability of companies and individuals to borrow money, save and invest. Our ability to compete successfully depends on a number of factors, including our ability to develop and execute strategic plans and initiatives; to develop competitive products and technologies; and to attract, retain and develop a highly skilled employee workforce. If we are not able to compete successfully, we could be placed at a competitive disadvantage, which could result in the loss of clients and market share, and our business, results of operations and financial condition could suffer.

Our business may be adversely affected if we fail to adapt our products and services to technological advances, evolving industry standards and consumer preferences.

The banking industry undergoes constant technological change with frequent introductions of new technology-driven products and services. The widespread adoption of new technologies, including internet services, cryptocurrencies and payment systems, could require substantial expenditures to modify or adapt our existing products and services as we grow and develop our internet banking and mobile banking channel strategies in addition to remote connectivity solutions. We might not be successful in developing or introducing new products and services, integrating new products or services into our existing offerings, responding or adapting to changes in consumer behavior, preferences, spending, investing and/or saving habits, achieving market acceptance of our products and services, reducing costs in response to pressures to deliver products and services at lower prices or sufficiently developing and maintaining loyal clients. Our future success may depend, in part, on our ability to address the needs of our current and prospective clients by using technology to provide products and services that will satisfy demands for convenience, as well as to create additional efficiencies in operations.

Development of new products and services may impose additional costs on us and may expose us to increased operational risk.

The introduction of new products and services can involve significant time and resources, including to obtain regulatory approvals. Substantial risks and uncertainties are associated with the introduction of new products and services, including technical and control requirements that may need to be developed and implemented, rapid technological change in the industry, our ability to access technical and other information from its clients, the significant and ongoing investments required to bring new products and services to market in a timely manner at competitive prices and the preparation of marketing, sales and other materials that fully and accurately describe the product or service and its underlying risks. Our failure to manage these risks and uncertainties would also expose us to enhanced risk of operational lapses which may result in the recognition of financial statement liabilities. Regulatory and internal control requirements, capital requirements, competitive alternatives, vendor relationships and shifting market preferences may also determine if such initiatives can be brought to market in a manner that is timely and attractive to our clients. Products and services relying on internet and mobile technologies may expose us to fraud and cybersecurity risks. Failure to successfully manage these risks in the development and implementation of new products or services could have a material adverse effect on our business and reputation, as well as on our consolidated results of operations and financial condition.

We may incur significant losses as a result of ineffective risk management processes and strategies.

We seek to monitor and control our risk exposure through a risk and control framework encompassing a variety of separate but complementary financial, credit, operational, compliance, and legal reporting systems; internal controls; management review processes; and other mechanisms. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application may not be effective and may not anticipate every economic and financial outcome in all market environments or the specifics and timing of such outcomes.

We face continuing and growing security risks to our information base, including the information we maintain relating to our clients.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our business and to store sensitive data, including financial information regarding clients. Our electronic communications and information systems infrastructure, as well as the systems infrastructures of the vendors we use to meet our data processing and communication needs, could be susceptible to cyber-attacks, such as denial of service attacks, hacking, terrorist activities or identity theft. Financial services institutions and companies engaged in data processing have reported breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disable or degrade service or sabotage systems, often through the introduction of computer viruses or malware, cyber-attacks and other means. Denial of service attacks have been launched against a number of large financial services institutions. Hacking and identity theft risks, in particular, could cause serious reputational harm. Cyber threats are rapidly evolving and we may not be able to anticipate or prevent all such attacks. Although to date we have not experienced any material losses relating to cyber-attacks or other information security breaches, there can be no assurance that we will not suffer such losses in the future. No matter how well designed or implemented our controls are, we will not be able to anticipate all security breaches of these types, and we may not be able to implement effective preventive measures against such security breaches in a timely manner. A failure or circumvention of our security systems could have a material adverse effect on our business operations and financial condition.

We regularly assess and test our security systems and disaster preparedness, including back-up systems, but the risks are substantially escalating. As a result, cyber-security and the continued enhancement of our controls and processes to protect our systems, data and networks from attacks, unauthorized access or significant damage remain a priority. Accordingly, we may be required to expend additional resources to enhance our protective measures or to investigate and remediate any information security vulnerabilities or exposures. Any breach of our system security could result in disruption of our operations, unauthorized access to confidential client information, significant regulatory costs, litigation exposure and other possible damages, loss or liability. Such costs or losses could exceed the amount of available insurance coverage, if any, and would adversely affect our earnings. Also, any failure to prevent a security breach, or to quickly and effectively deal with such a breach, could negatively impact client confidence, damaging our reputation and undermining our ability to attract and keep clients.

We may not be able to successfully implement future information technology system enhancements, which could adversely affect our business operations and profitability.

We invest significant resources in information technology system enhancements in order to provide functionality and security at an appropriate level. We may not be able to successfully implement and integrate future system enhancements, which could adversely impact the ability to provide timely and accurate financial information in compliance with legal and regulatory requirements, which could negatively impact the Company's growth, revenue and profit and could result in regulatory scrutiny. In addition, future system enhancements could have higher than expected costs and/or result in operating inefficiencies, which could increase the costs associated with the implementation as well as ongoing operations.

Failure to properly utilize system enhancements that are implemented in the future could result in significant costs to remediate or replace the defective components, which would adversely impact our financial condition and results of operations. In addition, we may incur significant training, licensing, maintenance, consulting and amortization expenses during and after systems implementations, and any such costs may continue for an extended period of time.

We may become subject to claims and litigation pertaining to fiduciary responsibility.

We provide fiduciary services through OFA. From time to time, clients may make claims and take legal action with regard to the performance of our fiduciary responsibilities. Whether such claims and legal actions are founded or unfounded, if such claims or legal actions are not resolved in a manner favorable to us, the claims or related actions may result in significant financial expense and liability to us and/or adversely affect our reputation in the marketplace, as well as adversely impact client demand for our products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Climate change may adversely affect our business and results of operations.

Current and anticipated effects of climate change could negatively impact the Company and its clients. Weather-related events, such as severe storms, hurricanes, flooding and droughts, can present risks to the Company and its clients, including property damage, change in the value of properties securing our loans, changes in client behavior and preferences, and disruption of business operations, all which can increase credit risk and result in loss of revenue and additional expenses. These concerns over the impacts of climate change have gained political and social attention resulting in many legislative and regulatory initiatives to lessen the effects of climate change, which also may result in heightened supervisory expectations on banks’ risk management practices. Ongoing legislative and regulatory uncertainties and expanded requirements for climate risk management practices may result in increases to compliance and operating costs, which could have a negative impact on our financial condition and results of operations.

Risks Related to Mergers and Acquisitions

Growing by acquisition involves risks.

We intend to pursue a growth plan consistent with our business strategy, including growth by acquisition, as well as leveraging our existing branch network. To the extent that we acquire other companies in the future, our business may be negatively impacted by certain risks inherent with such acquisitions. Some of these risks include the following:

- we may incur substantial expenses in pursuing potential acquisitions;
- management may divert its attention from other aspects of our business;
- we may assume potential and unknown liabilities of the acquired company;
- the acquired business may not perform in accordance with management's expectations, including potentially losing key clients of the acquired business;
- difficulties may arise in connection with the integration of the operations of the acquired business with our businesses; and
- we may lose key employees of the combined business.

Our ability to manage growth successfully will depend on our ability to attract qualified personnel and maintain cost controls and asset quality while attracting additional loans and deposits on favorable terms, as well as on factors beyond our control, such as economic conditions and competition. If we grow too quickly and are not able to attract qualified personnel, control costs and maintain asset quality, this continued rapid growth could materially adversely affect our financial performance.

Goodwill generated in acquisitions may negatively affect our financial condition.

To the extent that merger consideration, consisting of cash and shares of our common stock, exceeds the fair value of the net assets acquired, including identifiable intangibles, that amount will be reported as goodwill by us. In accordance with current accounting guidance, goodwill will not be amortized but will be evaluated for impairment annually or more frequently as warranted by specific events or circumstances. A failure to realize the expected benefits of a merger could adversely impact the carrying value of the goodwill recognized in the merger and, in turn, negatively affect our financial results.

We may be unable to successfully integrate the operations of acquired entities over time.

Acquisitions involve the integration with companies that previously operated independently. The potential difficulties of combining the operations of the acquired companies with Orrstown include integrating personnel with diverse business backgrounds, integrating departments, systems operating procedures and information technologies, combining different corporate cultures, attracting new clients and retaining existing clients and key employees.

The process of integrating operations could cause an interruption of, or loss of momentum in, the activities of the combined company and the loss of key personnel. The diversion of management’s attention and any delays or difficulties encountered in connection with the merger and the integration process could have a material adverse effect on the business and results of operations of the combined company.

The success of an acquisition depends, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses acquired with the Company. If we are unable to successfully execute on integration, the anticipated earnings and cost savings expected to be derived from an acquisition may not be realized fully or may take longer to realize than anticipated.

The market price of our common stock after acquisitions may be affected by factors different from those affecting our shares currently.

The businesses of the Company and acquired entities may differ and, accordingly, the results of operations of the combined company and the market price of the shares of common stock of the combined company may be affected by factors different from those currently affecting the independent results of operations and market prices of common stock of each separate entity. The market value of our common stock fluctuates based upon various factors, including changes in our business, operations or prospects, market assessments of the merger, regulatory considerations, market and economic considerations, and other factors. Further, the market price of our common stock after an acquisition may be affected by factors different from those currently affecting our common stock. Additionally, future business acquisitions may result in the issuance and payment of additional shares of stock, which would dilute current shareholders’ ownership interests, and may involve the payment of a premium over book and market values. Therefore, dilution of our tangible book value and net income per common share could occur in connection with any future transaction.

Risks Related to Regulatory Compliance and Legal Matters

We operate in a highly regulated industry, and laws and regulations, or changes in them, could limit or restrict our activities and could have a material adverse effect on our operations.

We and our subsidiaries are subject to extensive state and federal regulation and supervision. Federal and state laws and regulations govern numerous matters affecting us, including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. The FRB and the state banking regulators have the power to issue cease and desist orders to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the FRB possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we and our subsidiaries may conduct business and obtain financing.

The laws, rules, regulations, and supervisory guidance and policies applicable to us are subject to regular modification and change. Such changes could, among other things, subject us to additional costs, including costs of compliance; limit the types of financial services and products we may offer; and/or increase the ability of non-banks to offer competing financial services and products. Failure to comply with laws, regulations, policies, or supervisory guidance could result in enforcement and other legal actions by federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties, and/or reputational damage, which could have a material adverse effect on our business, financial condition, and results of operations. See the "Supervision and Regulation" section of Item 1, "Business."

Altering our overdraft fee practices could materially adversely affect the Company's fee income and results of operations.

Overdraft fee practices of banks have recently come under increased regulatory scrutiny and been the subject of litigation. This increased scrutiny and litigation have prompted many larger banks to reform their overdraft fee practices or cease charging overdraft fees altogether. Reforming, reducing or eliminating overdraft fees could materially adversely affect our fee income and results of operations. Pending or future legal proceedings, regarding our overdraft fee practices, against us may result in judgments, settlements, fines, penalties, defense costs, or other results adverse to us, which could materially adversely affect our business, financial condition or results of operations, or cause serious reputational harm to us.

Increases in FDIC insurance premiums may have a material adverse effect on our results of operations.

We are generally unable to control the amount of premiums that are required to be paid for FDIC insurance. In October of 2022, the FDIC finalized a rule to increase the assessment rate by two basis points beginning in the first quarter of 2023. The increase in the assessment rate for banks is intended to increase the Deposit Insurance Fund reserve ratio to 1.35%. On March 10, 2023, the FDIC was appointed receiver of SVB, and on March 12, 2023, the FDIC was appointed receiver of Signature Bank, in each case due primarily to liquidity concerns at those institutions. Promptly following such bank failures, the federal banking regulators announced that the FDIC will use funds from the Deposit Insurance Fund to ensure that all depositors of SVB and Signature Bank are made whole, at no cost to taxpayers. We anticipate that the FDIC will impose special assessments on all banks in order to replenish the Deposit Insurance Fund. As a result of these or bank or financial institution failures, the Company may be required to pay significantly higher premiums than the levels currently imposed, as well as additional special assessments or taxes, which could adversely affect earnings. Any future increases or required prepayments in FDIC insurance premiums may materially adversely affect our results of operations.

Legislative, regulatory and legal developments involving income and other taxes could materially adversely affect the Company's results of operations and cash flows.

The Company is subject to U.S. federal and U.S. state income, payroll, property, sales and use, and other types of taxes, including the Pennsylvania Bank Shares Tax. Significant judgment is required in determining the Company's provisions for income taxes. Changes in tax rates, enactments of new tax laws, revisions of tax regulations, and claims or litigation with taxing authorities could result in substantially higher taxes, and therefore, could have a significant adverse effect on the Company's results of operations, financial condition and liquidity. Increases in the assessment rate for the Pennsylvania Bank Shares Tax, which is calculated on the outstanding equity of the Bank, may also materially adversely affect results of operations.

The Company is required to use judgment in applying accounting policies and different estimates and assumptions in the application of these policies could result in a decrease in capital and/or other material changes to the reports of financial condition and results of operations.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the fair value of certain financial instruments, particularly securities, and goodwill and purchase accounting. While we have identified those accounting policies that we consider critical and have procedures in place to facilitate the associated judgments, different assumptions in the application of these policies could have a material adverse effect on our financial condition and results of operations.

Changes in our accounting policies or in accounting standards could materially affect how we report our financial results and condition.

From time to time, the FASB, SEC and other regulatory bodies change the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can be operationally complex to implement and can materially impact how we record and report our financial condition and results of operations.

We are subject to stringent capital requirements which may adversely impact return on equity, require additional capital raises, or limit the ability to pay dividends or repurchase shares.

Federal regulations establish minimum capital requirements for insured depository institutions, including minimum risk-based capital and leverage ratios, and define "capital" for calculating these ratios. The minimum capital requirements are: (i) a common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The regulations also establish a "capital conservation buffer" of 2.5%, which if complied with will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The application of these capital requirements could, among other things, require us to maintain higher capital, resulting in lower returns on equity, and we may be required to obtain additional capital or be subject to adverse regulatory actions, including limitations on our ability to pay dividends or repurchase shares, if we are unable to comply with such requirements.

The FRB may require us to commit capital resources to support the Bank.

Federal law requires that a holding company act as a source of financial and managerial strength to its subsidiary bank and to commit resources to support such subsidiary bank. Under the "source of strength" doctrine, the FRB may require a holding company to make capital injections into a troubled subsidiary bank and may charge the holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the holding company may not have the resources to provide it and therefore may require the holding company to borrow the funds or raise capital on terms considered unfavorable to shareholders. Any loans by a holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by us to make a required capital injection becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act, and other fair lending laws and regulations impose community investment and nondiscriminatory lending requirements on financial institutions. The CFPB, the FRB, the Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act or other fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

We may become subject to enforcement actions even though noncompliance was inadvertent or unintentional.

The financial services industry is subject to intense scrutiny from bank supervisors in the examination process and aggressive enforcement of federal and state regulations, particularly with respect to mortgage-related practices and other consumer compliance matters, and compliance with anti-money laundering, Bank Secrecy Act and Office of Foreign Assets Control regulations, and economic sanctions against certain foreign countries and nationals. Enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. We maintain systems and procedures designed to ensure that we comply with applicable laws and regulations; however, some legal/regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though systems and procedures designed to ensure compliance were in place at the time. Failure to comply with these and other regulations, and supervisory expectations related thereto, may result in fines, penalties, lawsuits, regulatory sanctions, reputation damage, or restrictions on our business.

We face significant legal risks, both from regulatory investigations and proceedings and from private actions brought against us.

As a participant in the financial services industry, many aspects of our business involve substantial risk of legal liability. From time to time we are named as a defendant or are otherwise involved in various legal proceedings, including regulatory enforcement actions, class actions and other litigation or disputes with third parties. Litigation pending against us is described in Note 22, Contingencies, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statement and Supplementary Data," of this Annual Report on Form 10-K. There is no assurance that regulatory enforcement actions or litigation with private parties will not increase in the future. Pending or future legal proceedings against us may result in judgments, settlements, fines, penalties, indemnification costs, defense costs, or other results adverse to us, which could materially adversely affect our business, financial condition or results of operations, or cause serious reputational harm to us.

Risks Related to Liquidity

We are subject to liquidity risk, which could negatively affect our funding levels.

Market conditions or other events could negatively affect our access to or the cost of funding, affecting our ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, or fund asset growth and new business initiatives at a reasonable cost, in a timely manner and without adverse consequences. Although we maintain a liquid asset portfolio and have implemented strategies to maintain sufficient and diverse sources of funding to accommodate planned, as well as unanticipated, changes in assets, liabilities, and off-balance sheet commitments under various economic conditions, a substantial, unexpected, or prolonged change in the level or cost of liquidity could have a material adverse effect on us. If the cost effectiveness or the availability of supply in these credit markets is reduced for a prolonged period of time, our funding needs may require us to access funding and manage liquidity by other means. These alternatives may include generating client deposits, securitizing or selling loans, extending the maturity of wholesale borrowings, borrowing under certain secured borrowing arrangements, using relationships developed with a variety of fixed income investors, and further managing loan growth and investment opportunities. These alternative means of funding may result in an increase to the overall cost of funds and may not be available under stressed conditions, which would cause us to liquidate a portion of our liquid asset portfolio to meet any funding needs. In the event additional liquidity is needed, we have access to liquidity from the FHLB, the FRB discount window and other sources. At December 31, 2022, we have combined borrowing capacity from the FHLB and FRB of over $1.0 billion. Accessing these sources of liquidity would impose additional borrowing costs on the Company.

Loss of deposits or a change in deposit mix could increase our cost of funding.

Deposits are a stable source of funding for which costs are typically lower than other financing options. We compete with banks and other financial institutions for deposits, as well as institutions offering uninsured investment alternatives, including money market funds and Treasury Bill alternatives. Our competitors may offer higher interest rates than we do, which could decrease the deposits that we attract or require us to increase our rates to retain existing deposits or obtain new deposits. Recent bank failures could negatively impact depositor confidence in us or the banking industry and cause our deposits to decline. Funding costs may increase if we lose deposits and are forced to replace them with more expensive sources of funding, if clients shift their deposits into higher cost products or if we need to raise interest rates to avoid losing deposits. Higher funding costs reduce our net interest margin, net interest income and net income. Increased deposit competition could materially adversely affect our ability to fund lending operations. As a result, we may need to seek other sources of funds that could increase our cost of funds.

Wholesale funding sources may prove insufficient to replace deposits at maturity and support our operations and future growth.

The Company must maintain sufficient funds to respond to the needs of depositors and borrowers. To manage liquidity, we draw upon a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. These sources may include Federal Home Loan Bank advances, proceeds from the sale of investments and loans, and liquidity resources at the holding company. Our ability to manage liquidity will be severely constrained if we are unable to maintain access to funding or if adequate financing is not available to accommodate future growth at acceptable costs. In addition, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, operating margins and profitability would be adversely affected. Turbulence in the capital and credit markets may adversely affect our liquidity and financial condition and the willingness of certain counterparties and clients to do business with us.

The Parent Company is a holding company dependent on liquidity through payments, including dividends, from its bank subsidiary, which is subject to restrictions.

The Parent Company is a holding company, separate from the Bank, and must provide for its own liquidity. The Parent Company depends on dividends, distributions and other payments from the Bank to fund dividend payments and stock repurchases, if permitted, and to fund all payments on obligations. The FRB requires a BHC to act as a source of financial and managerial strength for its subsidiary banks. The FRB could require us to commit resources to the Bank when doing so is not otherwise in the interests of our shareholders or creditors. The Bank is subject to laws that restrict dividend payments or authorize regulatory bodies to prohibit or reduce the flow of funds from it to us. If the Bank is unable to pay dividends to us, we may not be able to service our debt, pay dividends on our common stock or engage in stock repurchases. A reduction or elimination of dividends could adversely affect the market price of our common stock and would adversely affect our business, financial condition, results of operations and prospects. In addition, our right to participate in a distribution of assets upon the Bank’s liquidation or reorganization is subject to the prior claims of the Bank’s creditors, including its depositors. Restrictions on the Bank’s ability to dividend funds to the Company are included in Note 16, Shareholders' Equity and Regulatory Capital, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

The soundness of other financial institutions could adversely affect the Company.

Our ability to engage in routine funding and other transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have historically led to market-wide liquidity problems, losses of depositor, creditor and counterparty confidence and could lead to losses or defaults by us or by other institutions. While we did not have any direct exposure to SVB or Signature Bank as of March 14, 2023, the failures of those institutions led to extreme volatility in the prices of securities issued by financial institutions. Bank failures could negatively impact depositor and investor confidence in us, which could negatively impact our stock price or liquidity. We could experience increases in deposits and assets as a result of other banks’ difficulties or failure, which would increase the capital we are required to maintain to support such growth.

Risks Related to Owning Our Stock

If the Company wants, or is compelled, to raise additional capital in the future, that capital may not be available when it is needed or on terms favorable to current shareholders.

Federal banking regulators require us to maintain adequate levels of capital to support our operations. These capital levels are determined and dictated by law, regulation and banking regulatory agencies. In addition, capital levels are also determined by our management and board of directors based on capital levels that they believe are necessary to support our business operations. Changes in our financial condition or results of operations, applicable accounting standards, laws and regulations and other factors could make it necessary or advisable for the Company to raise additional capital. Under such circumstances, the Company’s ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we cannot provide assurance of our ability to raise additional capital on terms and time frames acceptable to us or to raise additional capital at all. Additionally, the inability to raise capital in sufficient amounts may adversely affect our operations, financial condition and results of operations. Our ability to borrow could also be impaired by factors that are nonspecific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole. If we raise capital through the issuance of additional shares of our common stock or other securities, we would likely dilute the ownership interests of current investors by diluting earnings per share of our common stock and potentially diluting book value per share, depending on the issuance price. The price at which we issue additional shares of stock could be less than the current market price of our common stock. Furthermore, a capital raise through the issuance of additional shares may have an adverse impact on our stock price. In addition, a capital raise involving the issuance of debt securities could negatively impact our earnings and liquidity.

The market price of our common stock is subject to volatility.

The market price of the Company’s common stock has been subject to fluctuations in response to numerous factors, many of which are beyond our control. These factors include actual or anticipated variations in our operational results and cash flows, changes in financial estimates by securities analysts, trading volume, large purchases or sales of our common stock, market conditions within the banking industry, the general state of the securities markets and the market for stocks of financial institutions, as well as general economic conditions. The impact of the recent failures of SVB and Signature Bank on the price of securities issued by financial institutions, generally, is one example of a situation in which factors outside of our control can negatively impact the market price of our securities. In addition, if the Company’s common stock ceases to be included in the Russell 2000 index, which is reconstituted in June of each year, this could result in decreased liquidity in, and demand for, our common stock, which could cause the market price of our common stock to decline.

A reduction in our credit rating could adversely affect our access to capital and could increase our cost of funds.

A credit rating agency regularly evaluates the Parent Company and the Bank, and credit ratings are based on a number of factors, including our financial strength and ability to generate earnings, as well as factors not entirely within our control, including conditions affecting the financial services industry, the economy, and changes in rating methodologies. There can be no assurance that we will maintain our current credit ratings. A downgrade of the credit ratings of the Parent Company or the Bank could adversely affect our access to liquidity and capital, and could significantly increase our cost of funds, trigger additional collateral or funding requirements, and decrease the number of investors and counterparties willing to lend to us or purchase our securities. This could affect our growth, profitability, and financial condition, including liquidity.

General Risk Factors

The Company may not be able to attract and retain skilled people.

Competition for the best people in most activities engaged in by us can be intense, and we may not be able to attract and hire sufficiently skilled people to fill open and newly created positions or to retain current or future employees. This competition for talented, skilled and diverse employees has been intensified by the increase in remote and flexible work arrangements, wage pressures and opportunities in the labor market. An inability to attract and retain individuals with the necessary skills to fill open positions, or the unexpected loss of services of one or more of our key personnel, could have a material adverse impact on our business due to the loss of their skills, knowledge of our markets, years of industry experience or the difficulty of promptly finding qualified replacement personnel.

We believe that our continued growth and future success will depend in large part on the skills of our management team and our ability to motivate and retain these individuals and other key personnel. The loss of service of one or more of our executive officers or key personnel could delay or reduce our ability to successfully implement our long-term business strategy, our business could suffer, and the value of our stock could be materially adversely affected. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. We believe our management team possesses valuable knowledge about the banking industry and that their knowledge and relationships could be very difficult to replicate. Our success also depends on the experience of our branch managers and lending officers and on their relationships with the clients and communities they serve. The loss of these key personnel could negatively impact our banking operations. The loss of key personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition, or operating results.

We could be adversely affected by a failure in our internal controls.

We rely on our employees to design, manage, and operate our systems and controls to assure that we properly enter into, record and manage processes, transactions and other relationships with clients, suppliers and other parties with whom we do business. In some cases, we rely on employees of third parties to perform these tasks. We also depend on employees and the systems and controls for which they are responsible to assure that we identify and mitigate the risks that are inherent in our relationships and activities. When we change processes or procedures, introduce new products or services, or implement new technologies, we may fail to adequately identify or manage operational risks resulting from such changes.

As a result of our necessary reliance on employees, whether ours or those of third parties, we are subject to human vulnerabilities. These range from innocent human error to misconduct or malfeasance, potentially leading to operational breakdowns or other failures. Our controls may not be adequate to prevent problems resulting from human involvement in our business, including risks associated with the design, operation and monitoring of automated systems. Errors by our employees or others responsible for systems and controls on which we depend and any resulting failures of those systems and controls could result in significant harm to us. This could include client remediation costs, regulatory fines or penalties, litigation or enforcement actions, or limitations on our business activities. We could also suffer damage to our reputation, impacting our ability to attract and retain clients and employees.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well-designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Negative public opinion could damage our reputation and adversely affect our earnings.

Reputational risk, or the risk to the Company's earnings and capital from negative public opinion, is inherent in our business. Negative public opinion can result from the actual or perceived manner in which we conduct our business activities, including banking operations and trust and investment operations, our management of actual or potential conflicts of interest and ethical issues, and our protection of confidential client information. Negative public opinion can also result from events occurring in the banking industry, such as bank failures, which are outside of the Company's control. Negative public opinion can adversely affect the Company's ability to keep and attract clients and can expose the Company to litigation and regulatory action. Although we take steps to minimize reputation risk in the way we conduct our business activities and deal with our clients, communities and vendors, these steps may not be effective. The proliferation of social media websites utilized by us and other third parties, as well as the personal use of social media by our employees and others, including personal blogs and social network profiles, also may increase the risk that negative, inappropriate or unauthorized information may be posted or released publicly that could harm our reputation or have other negative consequences, including as a result of our employees interacting with our clients in an unauthorized manner in various social media outlets. Any damage to our reputation could affect our ability to retain and develop the business relationships necessary to conduct business, which in turn could negatively impact our financial condition, results of operations, and the market price of our common stock.

Acts of terrorism, natural disasters, global climate change, pandemics and global conflicts may have a negative impact on our business and operations.

Acts of terrorism, natural disasters, global climate change, pandemics, global conflicts or other similar events could disrupt our operations, result in damage to our properties, reduce or destroy the value of the collateral for our loans and otherwise have a negative impact on our business and operations. While we have in place business continuity plans, such events could still damage our facilities, disrupt or delay the normal operations of our business (including communications and technology), result in harm to, or cause travel limitations on, our employees, and have a similar impact on our clients, suppliers, third-party vendors and counterparties. These events also could impact us negatively to the extent that they result in reduced capital markets activity, lower asset price levels, or disruptions in general economic activity in the U.S. or abroad, or in financial market settlement functions. In addition, these or similar events may impact economic growth negatively, which could have an adverse effect on our business and operations, and may have other adverse effects on us in ways that we are unable to predict.

Anti-takeover provisions could negatively impact our shareholders.

Provisions of Pennsylvania law and provisions of our articles of incorporation and bylaws could make it more difficult for a third party to acquire control of us or have the effect of discouraging a third party from attempting to acquire control of us, even if a merger might be in the best interest of our shareholders. Our articles of incorporation authorize our Board of Directors to issue preferred stock without shareholder approval and such preferred stock could be issued as a defensive measure in response to a takeover proposal. These and other provisions could make it more difficult for a third party to acquire us.

ITEM 1B – UNRESOLVED STAFF COMMENTS

None.

ITEM 2 – PROPERTIES

Our principal executive offices are located at 77 East King Street, Shippensburg, Pennsylvania, with additional executive and administrative offices at 4750 Lindle Road, Harrisburg, Pennsylvania. These facilities are owned by the Bank, which also maintains its principal and additional executive and administrative offices at those locations.

We own or lease other premises for use in conducting our business activities, including bank branches, an operations center, and offices in Cumberland, Dauphin, Franklin, Lancaster, and Perry Counties, Pennsylvania and Anne Arundel, Baltimore, Howard, and Washington Counties, Maryland. We believe that the properties currently owned and leased are adequate for present levels of operation. We are constantly evaluating the best and most efficient mix of branch locations to service our clients due to evolving trends in our industry and increased client engagement through digital channels.

During the third quarter of 2022, the Company announced that five Pennsylvania branches would be closing and staffing model adjustments would be made to drive long-term growth and improve operating efficiencies in 2023 and forward. As a result of these initiatives, the Company recorded a pre-tax restructuring charge of $3.2 million, which included building and fixed asset write-downs of $1.9 million. On December 23, 2022, the Bank announced that it had entered into a Purchase and Assumption Agreement providing for the sale of its Path Valley branch, one of the five branches scheduled to be closed, and the associated deposit liabilities. The transaction is expected to close in the second quarter of 2023. In the first quarter of 2021, the Company consolidated an additional six branch locations, discontinued three loan production offices, and reduced its back-office real estate, which reduced approximately 27,000 square feet. In January 2020, Orrstown consolidated five Pennsylvania branches in Franklin and Perry Counties that averaged less than $20.0 million in deposits per location into other, larger Bank branches and sold an operation's center facility in the second quarter of 2020. These efforts improved the profitability of the remaining branch locations and eliminated close to 50,000 square feet of excess back-office space.

ITEM 3 – LEGAL PROCEEDINGS

Information regarding legal proceedings is included in Note 22, Contingencies, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statement and Supplementary Data."

ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Market Information

Our common stock is traded on the NASDAQ Capital Market under the symbol "ORRF." At the close of business on March 9, 2023, there were 2,852 shareholders of record.

The Board declared cash dividends of $0.76 and $0.74 per common share in 2022 and 2021, respectively. Although the Company cannot guarantee the amount of future dividend payments, the Board understands the importance of the dividend to our shareholders and is committed to paying regular cash dividends; however, there can be no assurance as to future dividends because they are dependent on our future earnings, capital requirements and financial condition. Restrictions on the payment of dividends are discussed in Note 16, Shareholders' Equity and Regulatory Capital, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data." On January 24, 2023, the Board declared a cash dividend of $0.20 per common share, which was paid on February 14, 2023, to shareholders of record as of February 7, 2023.

Securities Authorized for Issuance under Equity Compensation Plans

Information regarding the Company's equity compensation plans is included in Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

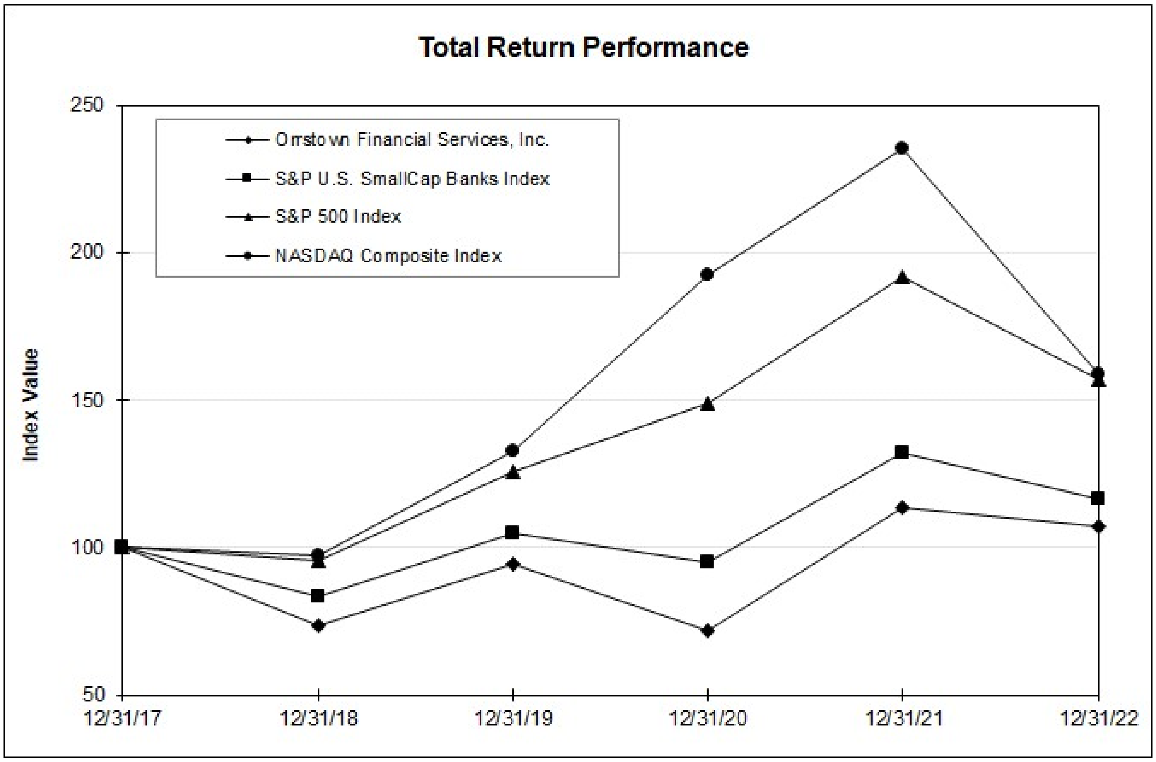
Issuer Purchases of Equity Securities

Period	(a) Total number of shares (or units) purchased	(b) Average price paid per share (or unit)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
October 1, 2022 to October 31, 2022	4,785	$ 24.26	4,785	159,059
November 1, 2022 to November 30, 2022	—	—	—	159,059
December 1, 2022 to December 31, 2022	—	—	—	159,059
Total	4,785	$ 24.26	4,785	

In September 2015, the Board of Directors of the Company authorized a share repurchase program pursuant to which the Company could repurchase up to 416,000 shares of the Company's outstanding shares of common stock in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Exchange Act. On April 19, 2021, the Board of Directors authorized the additional future repurchase of up to 562,000 shares of its outstanding common stock for a total of 978,000 shares. When and if appropriate, repurchases may be made in open market or privately negotiated transactions, depending on market conditions, regulatory requirements and other corporate considerations, as determined by management. Share repurchases may not occur and may be discontinued at any time. For the three months and year ended December 31, 2022, the Company repurchased 4,785 and 584,771 shares of its common stock at an average price of $24.26 per share and $24.25, respectively. At December 31, 2022, 818,941 shares had been repurchased under the program at a total cost of $18.7 million, or $22.78 per share. Common stock available for future repurchase totals approximately 159,059 shares, or 1% of the Company's outstanding common stock at December 31, 2022.

PERFORMANCE GRAPH

The performance graph below compares the cumulative total shareholder return on our common stock with other indexes: the S&P U.S. SmallCap Banks index of banks with assets between $1.0 billion and $5.0 billion, the S&P 500 Index, and the NASDAQ Composite index. The graph assumes an investment of $100 on December 31, 2017 and reinvestment of dividends on the date of payment without commissions. Shareholder returns on our common stock are based on trades on the NASDAQ Stock Market. The performance graph represents past performance and should not be considered to be an indication of future performance.



	Period Ending					
Index	**12/31/17**	**12/31/18**	**12/31/19**	**12/31/20**	**12/31/21**	**12/31/22**
Orrstown Financial Services, Inc.	100.00	73.66	94.18	71.97	113.34	107.39
S&P U.S. SmallCap Bank Index	100.00	83.44	104.69	95.08	132.36	116.69
S&P 500 Index	100.00	95.62	125.72	148.85	191.58	156.88
NASDAQ Composite Index	100.00	97.16	132.81	192.47	235.15	158.65

Source: S&P Global Market Intelligence © 2023

In accordance with the rules of the SEC, this section captioned “Performance Graph” shall not be incorporated by reference into any of our future filings made under the Exchange Act or the Securities Act. The Performance Graph and its accompanying table are not deemed to be soliciting material or to be considered filed under the Exchange Act or the Securities Act.

Recent Sales of Unregistered Securities

The Company has not, within the past three years, sold any equity securities, which were not registered under the Securities Act.

ITEM 6 – [RESERVED]

ITEM 7 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to assist readers in understanding the consolidated financial condition and results of operations of the Company and should be read in conjunction with our Consolidated Financial Statements and notes thereto included in this Annual Report on Form 10-K. Certain prior period amounts presented in this discussion and analysis have been reclassified to conform to current period classifications.

Overview

The Company, headquartered in Shippensburg, Pennsylvania, is a one-bank holding company that has elected status as a financial holding company. The consolidated financial information presented herein reflects the Company and its wholly-owned subsidiary, the Bank. At December 31, 2022, the Company had total assets of $2.9 billion, total liabilities of $2.7 billion and total shareholders' equity of $228.9 million as reported in the consolidated balance sheets.

The Company's primary source of income is net interest income, which is the difference between interest earned on its interest earning assets, such as loans and investment securities, and interest paid on its interest-bearing liabilities that includes deposits and borrowings. Our results of operations are impacted by economic conditions and market interest rates. Our profitability for the years ended December 31, 2022, 2021 and 2020 was influenced by our continued organic growth and ongoing expansion into targeted markets, the rising interest rates in 2022, and a continued focus on maintaining strong asset quality.

During 2022, the Company agreed to settle a litigation matter, which resulted in a provision for legal settlement ("legal settlement") of $13.0 million, before the tax effect, and the Company announced that five branch locations in Pennsylvania would be closing and staffing model adjustments would be made to drive long-term growth and improve operating efficiencies in 2023 and forward. As a result of these initiatives, the Company recorded a pre-tax restructuring charge of $3.2 million. Both the legal settlement and the restructuring charge were included in non-interest expenses in the consolidated statements of income under Part II, Item 8, "Financial Statements and Supplemental Data."

During the year ended December 31, 2020, the Company recognized charges associated with the consolidation of six branch locations, the discontinuance of three loan production offices, a reduction in back-office real estate and staffing reductions. These actions were initiated due to evolving client preferences for the digital delivery of products and services. The cost reductions resulting from these actions and the consolidation of five branches earlier in 2020, enabled the Company to invest in technology and people to facilitate its continued growth. A charge of $1.6 million was recorded in the year ended December 31, 2020, which included $1.3 million related to branch and loan production office consolidations.

Critical Accounting Estimates

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the financial services industry. The most significant accounting policies followed by the Company are presented in Note 1, Summary of Significant Accounting Policies, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data." In applying those accounting policies, the Company's management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. Certain of the critical accounting estimates are more dependent on such judgment and, in some cases, may contribute to volatility in our reported financial performance should the assumptions and estimates used change over time due to changes in circumstances. Some of the more significant areas in which the Company's management applies critical assumptions and estimates include the following:

Accounting for loan losses — The loan portfolio is the largest asset on the Company's balance sheet. The allowance for loan losses represents the amount that, in management's judgment, appropriately reflects credit losses inherent in the loan portfolio at the balance sheet date. A provision for loan losses is recorded to adjust the level of the ALL as deemed necessary by management. In estimating losses inherent in the loan portfolio, assumptions and judgment are applied to measure amounts and timing of expected future cash flows, collateral values and other factors used to determine the borrowers' abilities to repay its obligations. Historical loss trends are also considered, as are economic conditions, industry trends, portfolio trends and borrower-specific financial data. Loans acquired at a discount, that is, in part, attributable to credit quality, are initially recorded at fair value with no carry-over of an acquired entity's previously established ALL. Cash flows expected at acquisition, in excess of estimated fair value, are recognized as interest income over the remaining lives of the loans. Subsequent decreases in the expected principal cash flows require the Company to evaluate the need for additions to the ALL. Subsequent improvements in expected cash flows result, first, in the recovery of any applicable ALL and, then, in the recognition of additional interest income over the remaining lives of the loans. Changes in the circumstances considered when determining management's estimates and assumptions could result in changes to those estimates and assumptions and also in adjustment of the ALL, or, in the case of loans acquired at a discount, increases in interest income in future periods. The Company has delayed the implementation of *ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The implementation deadline of ASU 2016-13 was extended for smaller reporting and other companies until the fiscal year and interim periods beginning after December 15, 2022. The Company will implement ASU 2016-13 effective January 1, 2023. We expect to recognize a one-time cumulative-effect adjustment that results in an increase to the allowance for credit losses as of the date of adoption of the new standard. See Notes 1, Summary of Significant Accounting Policies, and Note 3, Loans and Allowance for Loan Losses, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplemental Data," to the consolidated financial statements for details on our allowance for loan losses estimate.

Accounting for OTTI — The Company determines whether unrealized losses are temporary in nature in accordance with *FASB ASC 320-10, Investments - Overall, ("FASB ASC 320-10")* and *FASB ASC 325-40, Investments – Beneficial Interests in Securitized Financial Assets*, when applicable. The evaluation is based upon factors such as the creditworthiness of the underlying borrowers, performance of the underlying collateral, if applicable, and the level of credit support in the security structure. Management also evaluates other factors and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost and near-term prospects of the issuer.

FASB ASC 320-10 requires the Company to assess if an OTTI exists by considering whether the Company has the intent to sell the security or it is more likely than not that it will be required to sell the security before recovery. If either of these situations applies, the guidance requires the Company to record an OTTI charge to earnings on debt securities for the difference between the amortized cost basis of the security and the fair value of the security. If neither of these situations applies, the Company is required to assess whether it is expected to recover the entire amortized cost basis of the security. If the Company is not expected to recover the entire amortized cost basis of the security, the guidance requires the Company to bifurcate the identified OTTI into a credit loss component and a component representing loss related to other factors. A discount rate is applied which equals the effective yield of the security. The difference between the present value of the expected flows and the amortized book value is considered a credit loss, which would be recorded through earnings as an OTTI charge. When a market price is not readily available, the market value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from the open market and other sources as appropriate for the security. The difference between the market value and the present value of cash flows expected to be collected is recognized in AOCI on the unaudited condensed consolidated statements of financial condition. See Note 2, Investment Securities, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplemental Data," to the consolidated financial statements for details on our investment securities and OTTI evaluation.

Accounting for income taxes — The Company is subject to federal and state income taxes in the jurisdictions in which it operates. Due to the complexity of the tax laws, management may make judgments in computing income tax expense, which are subject to varying interpretations by management and the taxing authorities, and could result in changes upon final determination. Income tax expense is based upon income before taxes, adjusted for the effect of certain tax-exempt income, non-deductible expenses and credits. Temporary differences may occur as a result of certain income and expense items being reported in different periods for financial reporting and tax purposes. Deferred taxes are calculated, using the applicable enacted marginal tax rate, based on the differences between the tax basis and carrying value of the asset or liability on the financial statement. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of income. Under *FASB ASC 740*, *Income Taxes*, the Company must apply a more likely than not probability threshold on its tax positions before a financial statement benefit is recognized. A valuation allowance would be recognized if any deferred tax assets were determined to be more likely than not unrecoverable. See Note 7, Income Taxes, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplemental Data," to the consolidated financial statements for details on our income tax expense and deferred tax assets and liabilities.

Readers of the Company's consolidated financial statements should be aware that the estimates and assumptions used may need to be updated in future financial presentations for changes in circumstances, business or economic conditions, in order to fairly represent the condition of the Company at that time.

Economic Climate, Inflation and Interest Rates

Preliminary real GDP for the fourth quarter of 2022 reflected an annualized increase of 2.7%, which declined from the annualized increase of 3.2% during the third quarter of 2022 and 7.0% during the fourth quarter of 2021. The fourth quarter of 2022 reflected increases in private inventory investments, which included manufacturing and utilities, consumer spending, primarily healthcare and personal care services, and federal government spending due to non-defense spending and compensation. The decrease in real GDP from the third quarter of 2022 is due to slowing of nonresidential fixed investment and consumer spending. During the fourth quarter of 2021, restrictions and disruptions were still occurring due to COVID-19 cases; however, there was a strong economic recovery from the pandemic, which the economy experienced increases in multiple industries, including private inventory investment and exports including travel, personal spending within healthcare, recreation and transportation. Residential fixed investment remained down during 2022 from 2021 due to a decrease in new single-family construction and the impact from inflation and supply chain issues.

The personal consumption expenditures ("PCE") price index increased 3.2% in the fourth quarter of 2022, compared to an increase of 4.3% and 7.0% for the final estimates in the third quarter of 2022 and fourth quarter of 2021, respectively. Excluding food and energy prices, the PCE increased 3.2% in the fourth quarter of 2022 compared to 4.7% in the third quarter of 2022 and 5.2% in the fourth quarter.

The national unemployment rate remained unchanged at 3.5% in December 2022 compared to September 2022, but did improve from 3.9% in December 2021. Within the Company's geographic footprint, the unemployment rate has decreased in Pennsylvania by 0.9% from 4.4% at December 2021 to 3.5% at December 2022, and decreased in Maryland by 1.5% from 4.7% at December 2021 to 3.2% in December 2022. These decreases in unemployment rates are consistent with the counties in which the Company operates branches and other corporate offices. There continued to be notable job gains in healthcare, leisure and hospitality and professional services during the second half of 2022. Although there was a strong economic recovery in 2021 from the pandemic, the fluctuations in real GDP during 2022 are indicative of inflation, supply chain challenges, geopolitical tensions and labor shortages.

At December 31, 2022, the 10-year Treasury bond reached 3.88%, an increase of 0.05% from 3.83% at September 30, 2022, and a significant increase from 1.51% at December 31, 2021, as it continued to rise due to inflationary pressures. In an attempt to combat the impact of inflation, the rising consumer price index, supply chain disruptions, the state of the labor market and geopolitical tensions, the Federal Reserve Open Markets Committee ("FOMC") approved increases to the Fed Funds rate totaling 450 basis points since March 2022:

- 25 basis points on March 17, 2022;
- 50 basis points on May 5, 2022;
- 75 basis points on June 16, 2022;
- 75 basis points on July 27, 2022;
- 75 basis points on September 21, 2022;
- 75 basis points on November 2, 2022;
- 50 basis points on December 15, 2022; and
- 25 basis points on February 2, 2023.

The majority of the assets and liabilities of a financial institution are monetary in nature and, therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation does have an impact on the Company, particularly with respect to the growth of total assets and noninterest expenses, which tend to rise during periods of general inflation. Risks also exist due to supply and demand imbalances, employment shortages, the interest rate environment, and geopolitical tensions. It is reasonably foreseeable that estimates made in the financial statements could be materially and adversely impacted in the near term as a result of these conditions, including expected credit losses on loans and the fair value of financial instruments that are carried at fair value.

As the Company’s balance sheet consists primarily of financial instruments, interest income and interest expense are greatly influenced by the level of interest rates and the slope of the yield curve, as well as the mix of assets and funding. The Company has been able to grow its net interest income by $12.7 million from 2021 to 2022 due to organic commercial loan growth and rising interest rates, despite the decrease of $10.7 million in SBA PPP interest income from the prior year. Competition for quality lending opportunities and deposits remains intense, which, together with an inverted yield curve, will continue to challenge the Company's ability to grow its net interest margin and to manage its overhead expenses.

Results of Operations

Summary

Earnings in 2022 reflected an increase in net interest income primarily from the deployment of cash into higher yielding commercial loans and investment securities and the impact from rising interest rates, partially offset by the increase in costs of funds, increases in provision for loan losses and non-interest expenses, including salaries and employee benefits expense and the impact of the legal settlement and restructuring charge.

The Company recorded net income of $22.0 million, $32.9 million and $26.5 million for 2022, 2021 and 2020, respectively. Diluted earnings per share totaled $2.06, $2.96 and $2.40 for 2022, 2021 and 2020, respectively. Excluding the legal settlement and the restructuring charge, for the year ended December 31, 2022, net income totaled $34.8 million and diluted earnings per share totaled $3.25. See "Supplemental Reporting of Non-GAAP Measures."

Net interest income totaled $99.6 million, $87.0 million and $83.6 million for 2022, 2021 and 2020, respectively, reflecting the deployment of cash into higher yielding commercial loans and investment securities and the impact of the rising interest rates during 2022. Interest rates increased during 2019, but decreased throughout 2020 and remained low during 2021, contributing to reductions in yields on loans and investment securities and the cost of interest-bearing liabilities during 2021 and 2020. During 2021 and 2020, net interest income benefited from the Company's expanded geographic footprint, organic growth in commercial loans from an expanded sales force as the Company continued to take advantage of market opportunities, and SBA PPP interest income. For 2022, 2021 and 2020, interest income recognized on SBA PPP loans totaled $6.1 million, $16.8 million and $10.9 million, respectively.

Asset quality trends continued to exhibit low levels of charge-offs and non-performing loans, except for one commercial construction loan with an outstanding balance of $15.4 million that the Bank downgraded to substandard and placed into non-accrual status during the fourth quarter of 2022. The provision for loan losses totaled $4.2 million, $1.1 million and $5.3 million in 2022, 2021 and 2020, respectively. During 2022, qualitative factors were unchanged from December 31, 2021, except for a reduction in the *National and Local Economic Conditions* factor. This factor had been increased previously for economic concerns in the commercial real estate portfolio associated with the COVID-19 pandemic. The additional allocation was removed during 2022 as these concerns had subsided. In 2021, improvement in borrowers' performances and the economic recovery resulted in a reduction in certain qualitative factors, including the COVID-19 qualitative factor. This factor was previously implemented to specifically address the downgrades of loans resulting from granted deferrals or forbearances based upon identified hardships caused by the economic shutdown during the pandemic. The provision for loan losses recorded in 2020 was primarily a result of increased uncertainty related to the COVID-19 pandemic.

Noninterest income totaled $27.0 million, $29.2 million and $28.3 million for 2022, 2021 and 2020, respectively. The decrease of $2.2 million from 2021 to 2022 was primarily due to a decrease in mortgage banking activities of $5.5 million. This was partially offset by increases in swap fee income of $2.3 million and other income, primarily due to realized gains on the investment in a non-housing limited partnership of $1.1 million. The increase from 2020 to 2021 included increases of $1.7 million in wealth management income, $706 thousand in interchange income, $635 thousand in mortgage banking activities, and investment securities gains of $654 thousand due to the sales of $148.4 million of investments securities during 2021. These increases in 2021 were partially offset by gains on the sale of portfolio loans of $2.8 million recorded in 2020. There were no sales of portfolio loans in 2022 and 2021.

Noninterest expenses totaled $95.8 million, $74.1 million and $74.1 million for 2022, 2021 and 2020, respectively. Salaries and employee benefits expense increased $4.0 million from 2021 to 2022 due to incentive compensation and merit-based increases, the filling of several vacancies, and higher healthcare costs. In 2022, the Company incurred additional non-interest expenses due to a legal settlement of $13.0 million and a restructuring charge, which included planned branch closures, of $3.2 million. Salaries and employee benefits expense increased by $652 thousand from 2020 to 2021 due to an increase in incentive compensation, partially offset by a decrease in healthcare costs. In 2020, the Company incurred $1.3 million in restructuring expenses, which included branch and loan production office consolidations. During 2020, the Company recorded a loss of $736 thousand associated with the sale of an operations facility, and recorded a recovery from settlement on a cybersecurity insurance claim of $486 thousand.

Income tax expense totaled $4.6 million, $8.0 million and $6.0 million for 2022, 2021 and 2020, or an effective tax rate of 17.2%, 19.6% and 18.6% respectively. The Company's effective tax rate is less than the 21% federal statutory rate due to tax-exempt income, including interest earned on tax-exempt loans and investment securities, income from life insurance policies and tax credits. The difference in the effective tax rate in 2022 from prior years was primarily due to a decrease in taxable income resulting from the legal settlement and restructuring charge, an increase in tax-exempt interest income on loans and investment securities due to the rising interest rate environment, and additional tax credits.

Net Interest Income

Net interest income is the primary component of the Company's net income. Interest-earning assets include loans, investment securities and interest-bearing bank balances. Interest-bearing liabilities include primarily deposits and borrowed funds.

Net interest income is affected by changes in interest rates, the volume of interest-earning assets and interest-bearing liabilities, and the composition of those assets and liabilities. “Net interest spread” and “net interest margin” are two common statistics related to changes in net interest income. Net interest spread represents the difference between the yields earned on interest-earning assets and the rates paid for interest-bearing liabilities. Net interest margin is the ratio of net interest income to average earning asset balances.

The FRB influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company's loan portfolio is affected by changes in the prime interest rate. In March 2020, the prime rate was reduced by 150 basis points and ended 2020 at 3.25%. The prime rate remained at that level throughout 2021 until the FOMC increased the fed fund rate by 425 basis points during 2022 as an attempt to combat the impact of inflation, the rising consumer price index, supply chain disruptions, the state of the labor market and geopolitical tensions.

Core deposits are deposits that are stable, lower cost and generally reprice more slowly than other deposits when interest rates change. Core deposits, which exclude certificates of deposit, are typically funds of local clients who also have a borrowing or other relationship with the Bank. The Company is primarily funded by core deposits, with noninterest-bearing demand deposits historically being a significant source of funds. During 2022, this lower-cost funding base had a positive impact on the Bank's net interest income and net interest margin in the rising interest rate environment. However, the competition for deposits increased in the latter part of 2022 with clients utilizing their funds at a higher frequency and additional liquidity needed to meet the credit demands of clients. Therefore, funding costs are expected to continue to increase into 2023 and could result in margin compression.

The following table presents net interest income, net interest spread and net interest margin on a taxable-equivalent basis for 2022, 2021 and 2020. Taxable-equivalent adjustments are the result of increasing income from tax-exempt loans and investment securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 21% federal corporate tax rate for 2022, 2021 and 2020, reflecting our statutory tax rates for those years.

	2022			2021			2020		
	Average Balance	Taxable-Equivalent Interest	Taxable-Equivalent Rate	Average Balance	Taxable-Equivalent Interest	Taxable-Equivalent Rate	Average Balance	Taxable-Equivalent Interest	Taxable-Equivalent Rate
Assets									
Federal funds sold and interest-bearing bank balances	**$ 98,793**	**$ 774**	**0.78 %**	$ 258,834	$ 353	0.14 %	$ 32,519	$ 115	0.35 %
Taxable securities	**368,479**	**10,237**	**2.78**	372,461	6,622	1.78	438,565	10,458	2.38
Tax-exempt securities [1]	**141,161**	**5,209**	**3.69**	89,574	3,157	3.52	55,807	1,982	3.55
Total investment securities	**509,640**	**15,446**	**3.03**	462,035	9,779	2.12	494,372	12,440	2.52
Loans [1][2][3]	**2,042,422**	**93,799**	**4.59**	1,985,350	84,453	4.25	1,928,486	87,900	4.56
Total interest-earning assets	**2,650,855**	**110,019**	**4.15**	2,706,219	94,585	3.50	2,455,377	100,455	4.09
Cash and due from banks	**28,534**			30,231			26,954		
Bank premises and equipment	**32,673**			34,545			36,627		
Other assets	**155,428**			143,479			143,919		
Allowance for loan losses	**(22,690)**			(19,659)			(17,030)		
Total assets	**$ 2,844,800**			$ 2,894,815			$ 2,645,847		
Liabilities and Shareholders' Equity									
Interest-bearing demand deposits	**$ 1,414,177**	**$ 4,308**	**0.30 %**	$ 1,392,996	$ 1,287	0.09 %	$ 1,156,292	$ 4,755	0.41 %
Savings deposits	**232,660**	**341**	**0.15**	202,371	203	0.10	163,133	246	0.15
Time deposits	**273,276**	**1,688**	**0.62**	360,264	2,709	0.75	452,298	7,008	1.55
Total interest-bearing deposits	**1,920,113**	**6,337**	**0.33**	1,955,631	4,199	0.21	1,771,723	12,009	0.68
Securities sold under agreements to repurchase	**22,305**	**44**	**0.20**	22,888	32	0.14	18,064	86	0.48
FHLB advances and other	**15,678**	**630**	**4.01**	40,589	482	1.19	179,457	1,923	1.07
Subordinated notes	**31,993**	**2,013**	**6.29**	31,931	2,009	6.29	31,874	2,006	6.29
Total interest-bearing liabilities	**1,990,089**	**9,024**	**0.45**	2,051,039	6,722	0.33	2,001,118	16,024	0.80
Noninterest-bearing demand deposits	**557,142**			542,952			381,869		
Other liabilities	**53,288**			38,665			35,960		
Total liabilities	**2,600,519**			2,632,656			2,418,947		
Shareholders' equity	**244,281**			262,159			226,900		
Total liabilities and shareholders' equity	**$ 2,844,800**			$ 2,894,815			$ 2,645,847		
Taxable-equivalent net interest income / net interest spread		**100,995**	**3.70 %**		87,863	3.17 %		84,431	3.29 %
Taxable-equivalent net interest margin			**3.81 %**			3.25 %			3.44 %
Taxable-equivalent adjustment		**(1,365)**			(889)			(824)	
Net interest income		**$ 99,630**			$ 86,974			$ 83,607	
Ratio of average interest-earning assets to average interest-bearing liabilities			**133 %**			132 %			123 %

NOTES TO ANALYSIS OF NET INTEREST INCOME:

(1) Yields and interest income on tax-exempt assets have been computed on a taxable-equivalent basis assuming a 21% tax rate.

(2) Average balances include nonaccrual loans.

(3) Interest income on loans includes prepayment and late fees.

The following table presents changes in net interest income on a taxable-equivalent basis for 2022, 2021 and 2020 by rate and volume components.

	2022 Versus 2021 Increase (Decrease) Due to Change in			2021 Versus 2020 Increase (Decrease) Due to Change in		
	Average Volume	Average Rate	Total	Average Volume	Average Rate	Total
Interest Income						
Federal funds sold and interest-bearing bank balances	**$ (218)**	**$ 639**	**$ 421**	$ 800	$ (562)	$ 238
Taxable securities	**(71)**	**3,686**	**3,615**	(1,576)	(2,260)	(3,836)
Tax-exempt securities	**1,818**	**234**	**2,052**	1,199	(24)	1,175
Loans	**2,428**	**6,918**	**9,346**	2,592	(6,039)	(3,447)
Total interest income	**3,957**	**11,477**	**15,434**	3,015	(8,885)	(5,870)
Interest Expense						
Interest-bearing demand deposits	**20**	**3,001**	**3,021**	973	(4,441)	(3,468)
Savings deposits	**30**	**108**	**138**	59	(102)	(43)
Time deposits	**(654)**	**(367)**	**(1,021)**	(1,426)	(2,873)	(4,299)
Securities sold under agreements to repurchase	**(1)**	**13**	**12**	23	(77)	(54)
FHLB advances and other	**(296)**	**444**	**148**	(1,488)	47	(1,441)
Subordinated notes	**4**	**—**	**4**	4	(1)	3
Total interest expense	**(897)**	**3,199**	**2,302**	(1,855)	(7,447)	(9,302)
Taxable-Equivalent Net Interest Income	**$ 4,854**	**$ 8,278**	**$ 13,132**	$ 4,870	$ (1,438)	$ 3,432

Note: The change attributed to volume is calculated by multiplying the average change in average balance by the prior year's average rate. The remainder is attributable to rate.

2022 versus 2021

Net interest income increased by $12.6 million, or 15%, from $87.0 million in 2021 to $99.6 million in 2022. Net interest income for 2022 on a taxable-equivalent basis increased by $13.1 million, or 15%, compared with 2021. The Company’s net interest spread increased by 53 basis points from 3.17% in 2021 to 3.70% in 2022.

Interest income on loans increased by $9.3 million, from $84.2 million in 2021 to $93.5 million in 2022, and interest income on investment securities increased by $5.3 million, from $9.1 million in 2021 to $14.4 million in 2022. Total interest expense increased by $2.3 million from $6.7 million in 2021 to $9.0 million in 2022.

Taxable-equivalent net interest margin increased by 56 basis points to 3.81% in 2022 from 3.25% in 2021.The taxable-equivalent yield on interest-earning assets increased by 65 basis points to 4.15% in 2022 from 3.50% in 2021, which reflects the deployment of cash into higher yielding loans and investment securities, as well as the rising interest rates on the loans and investment securities portfolios, which were partially offset by the increase of 12 basis points in the cost of interest-bearing liabilities from 2021 to 2022. The cost of interest-bearing liabilities increased from 0.33% in 2021 to 0.45% in 2022 reflecting an increase to deposit rates due to the rising rate environment, partially offset by the runoff in higher cost time deposit balances. In 2021, the Company repaid its overnight borrowings, resulting in a decrease in interest expense.

Average loans increased by $57.1 million, and remained at $2.0 billion during 2022 and 2021, due to commercial and home equity loan growth, but was partially offset by the impact of SBA PPP loan forgiveness. Average investment securities increased by $47.6 million from $462.0 million in 2021 to $509.6 million during 2022 due to investment purchases. Average interest-bearing liabilities decreased by $61.0 million from $2.1 billion in 2021 to $2.0 billion during 2022 due primarily to a decrease in average balances in time deposits and overnight borrowings.

The yield on loans increased by 34 basis points to 4.59% in 2022 from 4.25% in 2021. Taxable-equivalent interest income earned on loans increased by $9.3 million, or 11%, year-over-year, primarily due to an increase in the average balances of commercial and home equity loans, excluding SBA PPP loans, and the impact of the rising rate environment. The increase in interest income from loan growth and higher rates was partially offset by a decrease in interest income from SBA PPP loans due to reduced fee income as a lower amount of SBA PPP loans were forgiven during 2022 compared to 2021.

The average balance of commercial loans, excluding SBA PPP loans, increased by $352.1 million from $1.2 billion during 2021 to $1.6 billion during 2022. SBA PPP loans, net of deferred fees and costs, averaged $67.1 million during 2022, a decrease of $299.7 million from an average of $366.8 million in 2021. This decrease was due to the forgiveness of SBA PPP loans since 2021. Average home equity loans increased by $19.1 million from $156.4 million for 2021 to $175.5 million for 2022. Average installment and other consumer loans decreased by $12.9 million from $39.2 million for 2021 to $26.3 million for 2022.

For 2022, interest income on loans included $6.1 million of interest and net deferred fee income associated with the SBA PPP loans compared to $16.8 million for 2021. Accretion of purchase accounting adjustments included in interest income was $1.1 million during 2022 compared to $1.7 million in 2021. The decrease in accretion was partially due to a decline from the prior year in accelerated accretion from acquired loan payoffs or significant payments. During 2022, accelerated accretion was $724 thousand compared to $1.1 million in 2021. Prepayment income on commercial loans increased slightly by $109 thousand to $1.0 million during 2022 from $926 thousand in 2021.

Interest income on investment securities on a tax-equivalent basis increased by $5.6 million to $15.4 million for 2022 from $9.8 million for 2021, with the taxable equivalent yield increasing by 91 basis points from 2.12% for 2021 to 3.03% for 2022. The increase reflects the impact from higher interest rates in 2022 and investment security purchases at higher yields. The purchases of $181.5 million were partially offset by investment security sales totaling $31.3 million and unrealized losses of $55.2 million during 2022.

The average balance of federal funds sold and interest-bearing bank balances decreased by $160.0 million from $258.8 million for 2021 to $98.8 million for 2022, due primarily to the deployment of cash into loans and investment securities. The related interest income increased by $421 thousand to $774 thousand for 2022 from $353 thousand for 2021. This increase was caused by the increase in the interest rate at the FRB as a result of multiple Fed Funds rate increases by the FOMC during 2022.

Interest expense on interest-bearing liabilities increased by $2.3 million year-over-year due to the increase in the cost of interest-bearing liabilities by 12 basis points from 0.33% for 2021 to 0.45% for 2022. This increase is due to deposit rate increases made in 2022, partially offset by the impact of a decrease in the average balance of interest-bearing deposits of $61.0 million that resulted from continued runoff of certificates of deposit and the zero balance in overnight borrowings for the majority of 2022 following repayment of overnight borrowings in the third quarter of 2021.

The average balance of interest-bearing deposits decreased by $35.5 million from $2.0 billion in 2021 to $1.9 billion 2022; however, the cost of funds increased by 12 basis points from 0.21% in 2021 to 0.33% in 2022. Average time deposits decreased $87.0 million, or 24%, in 2022, which decrease in volume reduced interest expense on time deposits by $654 thousand. The cost of time deposits declined by 13 basis points from 0.75% in 2021 to 0.62% in 2022 as higher yielding time deposits matured. Average interest-bearing demand deposits increased by $21.2 million in 2022. Interest expense for interest-bearing demand deposits increased by $3.0 million, with the cost of funds increasing from 0.09% in 2021 to 0.30% in 2022 as a result of deposit rate increases during 2022.

Interest expense on borrowings increased by $164 thousand in 2022 from 2021, despite the decrease of $24.9 million in the average balance of FHLB advances from $40.6 million in 2021 to $15.7 million in 2022. This was due primarily to the increase in interest rates on overnight borrowings during the fourth quarter of 2022.

2021 versus 2020

In 2021, net interest income increased by $3.4 million, or 4%, compared with 2020. Net interest income for 2021 on a taxable-equivalent basis increased by $3.4 million, or 4%, compared with 2020. The Company’s net interest spread decreased by twelve basis points to 3.17% for 2021 compared with 2020.

The taxable-equivalent yield on interest-earning assets and cost of interest-bearing liabilities both decreased from 2020 to 2021, reflecting a decreasing interest rate environment. Average commercial loans increased in 2021 due to SBA PPP loans and commercial loan production. Average balances in taxable investment securities declined as a result of sales and paydowns. Average interest-bearing liabilities declined due to decreased average balances in time deposits and overnight borrowings.

Taxable-equivalent interest income on loans decreased by $3.4 million, or 4%, from 2020 to 2021. The decline resulted from a decrease of 31 basis points in loan yield from 4.56% in 2020 to 4.25% in 2021 due to a decreasing interest rate environment. The impact of the reduced yield was partially offset by the increase in average loans of $56.9 million, or 3%, which was driven by SBA PPP and commercial loan production. Accretion of purchase accounting adjustments included in interest income was $2.3 million, $2.3 million, and $3.8 million in 2021, 2020 and 2019, respectively.

Taxable-equivalent interest income earned on investment securities decreased by $2.7 million, or 21%, from 2020 to 2021, with decreases in both average volume and yield. Average investment securities decreased by $32.3 million, or 7%, and the taxable-equivalent yield decreased by 40 basis points from 2.52% in 2020 to 2.12% in 2021. Sales of taxable securities of $148.4 million between the first and third quarters of 2021 contributed to the decrease in average investment securities. The Company purchased investment securities of $195.0 million during 2021; however, the timing and size of the purchases for the year led to a decrease in the average balance.

Interest expense on deposits and borrowings decreased by $9.3 million from 2020 to 2021, despite an increase in the average balance of interest-bearing liabilities of $49.9 million, or 2%. The cost of interest-bearing liabilities declined by 47 basis points from 0.80% in 2020 to 0.33% in 2021 due to deposit rate reductions in the first and third quarters of 2021, combined with the continued maturity of higher yielding certificates of deposit and the repayment and maturities of overnight borrowings.

The average balance of interest-bearing deposits increased by $183.9 million, or 10%, from 2020 to 2021. Average interest-bearing demand deposits increased by $236.7 million, or 20%, in 2021. Interest expense for interest-bearing demand deposits decreased by $3.5 million, with the cost of funds decreasing from 0.41% in 2020 to 0.09% in 2021 as a result of deposit rate reductions during 2021, which resulted in a decrease in interest expense of $4.4 million. Average time deposits decreased $92.0 million, or 20%, in 2021, which reduced interest expense on time deposits by $1.4 million. The cost of time deposits declined by 80 basis points from 1.55% in 2020 to 0.75% in 2021 due to rate reductions.

Interest expense on all borrowings decreased by $1.5 million in 2021 from 2020 due primarily to reduced balances. The average balance of FHLB advances decreased by $138.9 million from 2020 to 2021 due to maturities and repayments, while the average balance of short-term borrowings increased by $4.8 million.

Provision for Loan Losses

The Company recorded a provision for loan losses of $4.2 million, $1.1 million and $5.3 million in 2022, 2021 and 2020, respectively. In calculating the provision for loan losses, both quantitative and qualitative factors, including the Company's historical net charge-off data and economic and market conditions, were considered.

In 2022, 2021 and 2020, the provision for loan losses was driven primarily by loan growth. During 2022, qualitative factors were unchanged, except for a reduction in the *National and Local Economic Conditions* factor, that reduced the provision by $726 thousand. The provision for loan losses during 2020 and 2021 was impacted by the effect of COVID-19 on the Company's loan portfolio as a new qualitative factor was created to address the potential associated risk. In 2020, the Company established a COVID-19 qualitative reserve of $2.7 million. This reserve was fully reversed in 2021 based on the sustained performance of the impacted borrowers resulting in a decline in the provision for loan losses in 2021 compared to 2020.

See further discussion in the “Asset Quality” and “Credit Risk Management” sections of this Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Noninterest Income

The following table compares noninterest income for 2022, 2021 and 2020.

	2022	2021	2020	$ Change 2022-2021	$ Change 2021-2020	% Change 2022-2021	% Change 2021-2020
Service charges on deposit accounts	**$ 3,826**	$ 3,047	$ 2,874	**$ 779**	$ 173	**25.6 %**	6.0 %
Interchange income	**4,055**	4,129	3,423	**(74)**	706	**(1.8)**	20.6
Other service charges, commissions and fees	**788**	646	683	**142**	(37)	**22.0**	(5.4)
Swap fee income	**2,632**	293	847	**2,339**	(554)	**798.3**	(65.4)
Trust and investment management income	**7,631**	7,896	6,912	**(265)**	984	**(3.4)**	14.2
Brokerage income	**3,620**	3,571	2,821	**49**	750	**1.4**	26.6
Mortgage banking activities	**407**	5,909	5,274	**(5,502)**	635	**(93.1)**	12.0
Gains on sale of portfolio loans	**—**	—	2,803	**—**	(2,803)	**—**	(100.0)
Income from life insurance	**2,339**	2,273	2,261	**66**	12	**2.9**	0.5
Other income	**1,814**	750	427	**1,064**	323	**141.9**	75.6
Subtotal before securities (losses) gains	**27,112**	28,514	28,325	**(1,402)**	189	**(4.9)**	0.7
Investment securities (losses) gains	**(160)**	638	(16)	**(798)**	654	**(125.1)**	4,087.5
Total noninterest income	**$ 26,952**	$ 29,152	$ 28,309	**$ (2,200)**	$ 843	**(7.5)%**	3.0 %

2022 versus 2021

Noninterest income decreased by $2.2 million from 2021 to 2022. The following were significant factors in that net decrease:

- Service charges on deposit accounts increased by $779 thousand, or 26%, due to higher customer transaction activity as the economy continued to recover from the COVID-19 pandemic during 2022 and changes to the deposit fee structure that took effect in April 2022.
- Swap fee income increased by $2.3 million, or 798%, which fluctuates based on market conditions and client demand.
- Mortgage banking income decreased by $5.5 million, or 93%, from 2021 to 2022 due to a significant decline in the gains on sale and fair value of the held-for-sale mortgages caused by market conditions, which included rapidly rising interest rates and lower housing inventory during 2022. In addition, the difficult mortgage market caused a slowdown in residential mortgage loan production, thereby causing corresponding reductions in the residential mortgage loan pipeline and secondary market sales year-over-year. The fair value on the held-for-sale mortgages, principally construction-to-permanent loans, decreased by $1.3 million from a gain of $181 thousand in 2021 to a loss of $1.2 million in 2022. Mortgage loans sold totaled $76.2 million in 2022 compared to $200.8 million in 2021. In addition, the Company recorded an MSR valuation reserve reversal of $79 thousand during 2022 compared to a reversal of $987 thousand in 2021, which were due to increases in market rates.
- Other income increased by $1.1 million, or 142%, from 2021 to 2022 primarily due to distributions of $964 thousand from investments in non-housing limited partnerships and an increase in gains on sale of SBA loans of $283 thousand, partially offset by a decrease of $128 thousand in tax credits recognized from the Bank's investment in solar renewable energy partnerships.
- Investment securities losses totaled $160 thousand in 2022 compared to investment securities gains of $638 thousand in 2021. During 2022, the Company recorded a loss of $171 thousand on one non-agency CMO security which was called at a price below par. This realized loss was partially offset by the sale of $31.3 million of municipal securities, which resulted in a gain of $32 thousand. During 2021, the Company sold $148.4 million of commercial mortgage-backed securities and asset-backed securities for a net gain of $609 thousand.

2021 versus 2020

Noninterest income increased by $843 thousand from 2020 to 2021. The Company continues to focus on growth in relationship fee-based revenue for commercial and retail clients. The following were significant factors in that net increase:

- Service charges on deposit accounts increased by $173 thousand due to the lifting of fee waivers implemented in 2020 due to the COVID-19 pandemic and increased deposit account activity associated with the re-opening of the economy in the second quarter of 2021.
- Interchange income increased by $706 thousand due to increased consumer spending upon the re-opening of the economy, expanded distribution of debit cards by the Bank and increased usage by consumers.
- Swap fee income decreased by $554 thousand due to reduced demand from potential clients in a low interest rate environment.
- Wealth management income, which includes both trust and investment management income and brokerage income, grew to $11.5 million, an increase of $1.7 million, from 2020 to 2021. Strong market conditions and the addition of new clients continue to drive growth in the wealth management business. Assets under management increased by $149.1 million to $1.9 billion at December 31, 2021 from $1.7 billion at December 31, 2020.
- Mortgage banking income increased by $635 thousand from 2020 to 2021 due primarily to mortgage servicing right valuation allowance reversals in 2021, partially offset by reduced gains on sale in 2021. There was higher refinancing activity during 2020 and into the first half of 2021. Due to market conditions, the margins and production declined, which resulted in a reduced pipeline at December 31, 2021. Mortgage loans sold totaled $200.8 million in 2021 compared with $205.2 million in 2020, and as of December 31, 2021, the Bank serviced $502.5 million of residential mortgage loans, which was up by $61.4 million from December 31, 2020.
- Gains on sale of portfolio loans decreased by $2.8 million from 2020 to 2021. During 2020, the Bank recorded $2.8 million in gains due to the sale of $10.9 million of classified loans for a net gain of $2.5 million and the sale of an $11.0 million portfolio of recreational vehicle loans for a gain of $314 thousand.
- Other income increased by $323 thousand from 2020 to 2021, primarily due to gains recorded on the sales of two shuttered properties in 2021.
- Investment securities gains increased by $654 thousand from 2020 to 2021. During 2021, the Company recorded net investment securities gains of $638 thousand from the sales of $148.4 million of commercial mortgage-backed securities and asset-backed securities. There were no sales of debt securities during 2020.

Noninterest Expenses

The following table compares noninterest expenses for 2022, 2021 and 2020.

	2022	2021	2020	$ Change 2022-2021	$ Change 2021-2020	% Change 2022-2021	% Change 2021-2020
Salaries and employee benefits	**$ 48,004**	$ 44,002	$ 43,350	**$ 4,002**	$ 652	**9.1 %**	1.5 %
Occupancy	**4,729**	4,731	4,760	**(2)**	(29)	**—**	(0.6)
Furniture and equipment	**5,083**	5,115	4,756	**(32)**	359	**(0.6)**	7.5
Data processing	**4,560**	4,061	3,574	**499**	487	**12.3**	13.6
Automated teller machine and interchange fees	**1,287**	1,202	1,057	**85**	145	**7.1**	13.7
Advertising and bank promotions	**2,264**	2,178	1,660	**86**	518	**3.9**	31.2
FDIC insurance	**1,083**	816	686	**267**	130	**32.7**	19.0
Other professional services	**3,254**	2,555	3,120	**699**	(565)	**27.4**	(18.1)
Directors' compensation	**938**	865	921	**73**	(56)	**8.4**	(6.1)
Taxes other than income	**1,391**	1,321	1,144	**70**	177	**5.3**	15.5
Intangible asset amortization	**1,105**	1,275	1,569	**(170)**	(294)	**(13.3)**	(18.7)
Provision for legal settlement	**13,000**	—	—	**13,000**	—	**100.0**	—
Restructuring expenses	**3,155**	—	1,310	**3,155**	(1,310)	**100.0**	(100.0)
Insurance claim (recovery) receivable write off	**—**	—	(486)	**—**	486	**—**	(100.0)
Other operating expenses	**5,953**	6,020	6,659	**(67)**	(639)	**(1.1)**	(9.6)
Total noninterest expenses	**$ 95,806**	$ 74,141	$ 74,080	**$ 21,665**	$ 61	**29.2 %**	0.1 %

2022 versus 2021

Noninterest expenses increased by $21.7 million from 2021 to 2022. The following were significant factors within that net increase:

- Salaries and employee benefit expense increased by $4.0 million, or 9%, due primarily to merit-based and incentive compensation increases, the filling of several vacancies in key positions and higher healthcare costs.
- Data processing expense increased by $499 thousand, or 12%, due primarily to an increase in core system costs and investments in new technology as the Company focuses on the evolving needs of its clients.
- FDIC insurance expense increased by $267 thousand, or 33%, due primarily to an increase in the assessment rate driven by commercial loan growth and a lower deduction from SBA PPP loans due to loan forgiveness.
- Professional services increased by $699 thousand, or 27%, due primarily to an increase in compliance and technology consulting services resulting from vacancies in compliance and technology staff and higher legal expenses partially associated with outstanding litigation.
- Intangible asset amortization decreased by $170 thousand, or 13%, due to amortization of the core deposit intangible assets on an accelerated basis.
- During 2022, the Company agreed to settle a litigation matter, which resulted in a provision for legal settlement of $13.0 million. There were no similar charges in 2021.
- During 2022, the Company announced that five branch locations would be closing and staffing model adjustments would be made to drive long-term growth and improve operating efficiencies in 2023 and forward. As a result of these initiatives, the Company recorded a pre-tax restructuring charge of $3.2 million. There were no similar charges in 2021.

2021 versus 2020

Noninterest expenses increased by $61 thousand from 2020 to 2021. The following were significant factors within that net increase:

- Salaries and employee benefit expense increased by $652 thousand due primarily to performance-based incentive compensation earned from strong individual production, the Company exceeding targets and other employee incentives. There were also additions to staff in 2021. The impact of these items was partially offset by a decrease in employee medical benefits that resulted from favorable claims history.
- Data processing expense increased by $487 thousand due primarily to increased core system costs, investments in new technology and trust data processing activity.
- Advertising and bank promotions increased by $518 thousand due to increased marketing efforts to promote our commitment to the new round of SBA PPP funding in early 2021, followed by increased advertising and promotions in the post-pandemic environment.
- FDIC insurance expense increased by $130 thousand due to increases in the FDIC assessment base driven by the rise in the Bank's average total assets in 2021, an increase in the assessment rate due to commercial loan growth and credits received in 2020 that did not recur in 2021.
- Professional services decreased by $565 thousand due to higher legal costs incurred in 2020 in connection with the reimbursement of the Company's underwriters in connection with the SEPTA litigation.
- Taxes other than income increased by $177 thousand due to an increase in the Pennsylvania Bank Shares Tax expense that was impacted by an increase in the Bank's total equity balance.
- Intangible asset amortization decreased by $294 thousand principally due to the elimination of a customer intangible associated with the discontinuance of Wheatland on July 31, 2020 and full amortization of a covenant not to compete in 2020.
- Restructuring expenses were $1.3 million in 2020 related to the branch and loan production office consolidations. There were no similar charges in 2021.
- In 2020, the Company recorded $486 thousand of refunds received from an insurance company related to a 2018 cyber security incident. There were no such refunds in 2021.
- Other operating expenses decreased by $639 thousand from 2020 to 2021. The reserve for unfunded commitments was reduced by $454 thousand in 2021 due to reductions in qualitative factors, which were previously elevated due to the COVID-19 pandemic. Also in 2021, certain loss rate assumptions were reduced following a review of historical loss and line utilization experience. In 2020, there was a write-down of $544 thousand in the carrying value of a property held for sale and an impairment charge of $152 thousand on a customer list intangible asset due to the discontinuance of Wheatland. These did not recur in 2021. Partially offsetting these expense reductions was a loss of $514 thousand in 2021 as compared to a gain of $226 thousand in 2020 from the termination of cash flow hedge derivatives. Other normal fluctuations are in the ordinary course of business.

Income Taxes

Income tax expense totaled $4.6 million, $8.0 million and $6.0 million for 2022, 2021 and 2020, respectively. The effective tax rate for 2022 was 17.2% compared with 19.6% for 2021 and 18.6% for 2020. Generally, the Company’s effective tax rate is less than the 21% federal statutory rate due to tax-exempt income, including interest earned on tax-exempt loans and investment securities, income from life insurance policies and tax credits. The difference in the effective tax rate in 2022 from prior years was primarily due to a decrease in taxable income resulting from the legal settlement and restructuring charge, an increase in tax-exempt interest income on loans and investment securities due to the rising interest rate environment, and additional tax credits.

Note 7, Income Taxes, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data," includes a reconciliation of our federal statutory tax rate to the Company's effective tax rate, which is a meaningful comparison between years and measures income tax expense as a percentage of pretax income.

Financial Condition

Management devotes substantial time to overseeing the investment and cost of funds in loans, investment securities and deposits and the formulation of policies directed toward the profitability and management of the risks associated with these investments.

Investment Securities

The Company utilizes available-for-sale securities to manage interest rate risk, to enhance income through interest and dividend income, to provide liquidity and to collateralize certain deposits and borrowings.

The Company has established investment policies and an asset management policy to assist in administering its investment portfolio. Decisions to purchase or sell these securities are based on economic conditions and management's strategy to respond to changes in interest rates, liquidity, pledges to secure deposits and repurchase agreements and other factors while trying to maximize return on the investments. The Company may segregate its investment portfolio into three categories: "securities held-to-maturity," "trading securities" and "securities available-for-sale." At December 31, 2022 and 2021, management has classified the entire investment securities portfolio as available-for-sale, which is accounted for at current market value with unrealized gains and losses excluded from earnings and reported in OCI, net of income taxes.

The Company's investment securities portfolio includes debt investments that are subject to varying degrees of credit and market risks, which arise from general market conditions, and factors impacting specific industries, as well as news that may impact specific issues. Management monitors its debt securities, using various indicators in determining whether a debt security is other-than-temporarily impaired, including the amount of time the security has been in an unrealized loss position, and the cause and extent of the unrealized loss. In addition, management assesses whether it is likely we will have to sell the security prior to recovery, or if we are able to hold the security until the price recovers. For those debt securities in which management concludes the security is other-than-temporarily impaired, it recognizes the credit component of an OTTI impairment in earnings and the remaining portion in OCI. The Company did not have any cumulative OTTI expense in 2022, 2021 or 2020.

The following table summarizes the fair value of available-for-sale securities at December 31, 2022, 2021 and 2020.

	2022	2021	2020
U.S. Treasury	**$ 17,291**	$ 19,702	$ —
U.S. Government Agencies	**5,135**	—	—
States and political subdivisions	**197,414**	193,370	112,670
GSE residential MBS	**59,402**	40,726	4,293
GSE residential CMOs	**68,378**	65,922	58,011
Non-agency CMOs	**39,758**	29,698	16,918
Private label commercial CMOs	**—**	—	62,236
Asset-backed	**125,973**	122,621	211,966
Other	**377**	399	371
Total investment securities	**$ 513,728**	$ 472,438	$ 466,465

The Company increased its investment portfolio in 2022 with the average balance of the investment securities increasing from $462.0 million for the year ended December 31, 2021 to $509.6 million for the year ended December 31, 2022.

During 2022, the Company purchased investment securities totaling $181.5 million, which included mortgage-backed securities of $75.3 million, municipal securities of $73.7 million, asset-backed securities of $27.6 million, and a U.S. government agency security of $4.9 million, and sold $31.3 million of municipal securities, which were replaced by the purchases of higher yielding securities. At December 31, 2022, the Company recognized a loss of $171 thousand on the call of a non-agency CMO security at a price below its par value of $14.7 million. The realized loss was included in securities gains and losses in noninterest income in the consolidated statements of income. The balance of investment securities included net unrealized losses of $49.6 million compared to net unrealized gains of $5.6 million at December 31, 2021. This change was due to significant market interest rate increases in 2022.

In 2021, the Company sold $148.4 million of commercial MBS and asset-backed securities, which were offset by purchases of GSE residential MBS, non-agency CMOs, municipal securities and United States Treasury notes of $195.0 million. Due to improvements in the capital markets, the Company strategically exited its private label commercial CMO portfolio. The external environment, with tightening credit spreads, presented an opportunity to execute these sales in March 2021. Proceeds from the sales were deployed into agency-backed securities and taxable municipal bonds given the elevated level of liquidity. In September 2021, the Company sold certain asset-backed securities to reduce the risk profile of the investment portfolio and improve yields based on the market conditions and interest rate environment.

The following table shows the maturities of investment securities at book value at December 31, 2022, and weighted average yields of such investment securities. Yields are shown on a tax equivalent basis, assuming a 21% federal income tax rate.

	Within 1 year	After 1 year but within 5 years	After 5 years but within 10 years	After 10 years	Total
U.S. Treasury securities					
Book value	$ —	$ —	$ 20,070	$ —	$ 20,070
Yield	— %	— %	1.05 %	— %	1.05 %
Average maturity (years)	—	—	5.3	—	5.3
U. S. Government Agencies					
Book value	$ —	$ —	$ 4,907	$ —	$ 4,907
Yield	— %	— %	6.03 %	— %	6.03 %
Average maturity (years)	—	—	9.0	—	9.0
States and political subdivisions					
Book value	$ —	$ 6,403	$ 58,371	$ 161,051	$ 225,825
Yield	— %	3.57 %	2.87 %	2.72 %	2.79 %
Average maturity (years)	—	4.6	8.3	20.4	16.8
GSE residential mortgage-backed securities					
Book value	$ —	$ —	$ —	$ 63,778	$ 63,778
Yield	— %	— %	— %	3.87 %	3.87 %
Average maturity (years)	—	—	—	42.4	42.4
GSE residential CMOs					
Book value	$ —	$ —	$ —	$ 75,446	$ 75,446
Yield	— %	— %	— %	3.01 %	3.01 %
Average maturity (years)	—	—	—	26.9	26.9
Non-agency CMOs					
Book value	$ —	$ 14,171	$ —	$ 28,127	$ 42,298
Yield	— %	6.12 %	— %	4.28 %	4.90 %
Average maturity (years)	—	3.2	—	34.3	23.9
Asset-backed					
Book value	$ —	$ —	$ —	$ 130,577	$ 130,577
Yield	— %	— %	— %	5.12 %	5.12 %
Average maturity (years)	—	—	—	21.8	21.8
Other					
Book value	$ 249	$ —	$ —	$ 128	$ 377
Yield	2.45 %	— %	— %	— %	1.62 %
Average maturity (years)	0.4	—	—	—	0.3
Total					
Book value	$ 249	$ 20,574	$ 83,348	$ 459,107	$ 563,278
Yield	2.45 %	5.33 %	2.62 %	3.71 %	3.60 %
Average maturity (years)	0.4	3.6	7.6	25.8	22.7

The average maturity is based on the contractual terms of the debt or mortgage-backed securities, and does not factor in required repayments or anticipated prepayments. At December 31, 2022, the weighted average estimated life is 34 years for mortgage-backed and CMO securities, and 22 years for asset-backed securities, based on current interest rates and anticipated prepayment speeds.

The following table summarizes the credit ratings and collateral associated with the Company's available-for-sale investment securities portfolio, excluding equity securities, at December 31, 2022:

Sector	Portfolio Mix	Amortized Book	Fair Value	Credit Enhancement	AAA	AA	A	BBB	NR	Collateral / Guarantee Type
Unsecured ABS	1 %	$ 4,899	$ 4,319	30 %	— %	— %	— %	— %	100 %	Unsecured Consumer Debt
Student Loan ABS	1	6,900	6,658	26	—	—	—	—	100	Seasoned Student Loans
Federal Family Education Loan ABS	20	114,685	110,723	8	89	11	—	—	—	Federal Family Education Loan [1]
PACE Loan ABS	—	2,685	2,467	6	100	—	—	—	—	PACE Loans [4]
Non-Agency RMBS	3	16,948	14,926	14	100	—	—	—	—	Reverse Mortgages [2]
Non-Agency CMBS	4	21,226	21,267	18	—	—	—	—	100	Commercial Real Estate
Municipal - General Obligation	19	105,055	92,961		4	90	6	—	—	
Municipal - Revenue	21	120,770	104,453		—	82	12	—	6	
SBA ReRemic [5]	1	5,532	5,371		—	100	—	—	—	SBA Guarantee [3]
Small Business Administration	1	4,907	5,135		—	100	—	—	—	SBA Guarantee [3]
Agency MBS	25	139,224	127,780		—	100	—	—	—	Residential Mortgages [3]
U.S. Treasury securities	4	20,070	17,291		—	100	—	—	—	U.S. Government Guarantee [3]
Bank CDs	—	249	249		—	—	—	—	100	FDIC Insured CD
	100 %	$ 563,150	$ 513,600		23 %	67 %	3 %	— %	7 %	

(1) 97% guaranteed by U.S. government

(2) Non-agency reverse mortgages with current structural credit enhancements

(3) Guaranteed by U.S. government or U.S government agencies

(4) PACE acronym represents Property Assessed Clean Energy loans

(5) SBA ReRemic acronym represents Re-Securitization of Real Estate Mortgage Investment Conduits

Note: Ratings in table are the lowest of the six rating agencies (Standard & Poor's, Moody's, Morningstar, DBRS, KBRA and Fitch). Standard & Poor's rates U.S. government obligations at AA+

Loan Portfolio

The Company offers a variety of products to meet the credit needs of its borrowers, principally commercial real estate loans, commercial and industrial loans, retail loans secured by residential properties, and to a lesser extent, installment loans. No loans are extended to non-domestic borrowers or governments.

Generally, the Bank is permitted under applicable law to make loans to single borrowers (including certain related persons and entities) in aggregate amounts of up to 15% of the sum of total capital and excess ALL not included in Tier 2 capital. The Company's policy has established an internal lending limit to one borrower of $25.0 million, an amount that is below its regulatory lending limit of $43.3 million at December 31, 2022. No borrower had an outstanding exposure exceeding the legal lending limit at year-end.

The risks associated with lending activities differ among loan classes and are subject to the impact of changes in interest rates, market conditions of collateral securing the loans and general economic conditions. Any of these factors may adversely impact a borrower's ability to repay loans, and also impact the associated collateral. A further discussion on the classes of loans the Company makes and related risks is included in Note 1, Summary of Significant Accounting Policies, and Note 3, Loans and Allowance for Loan Losses, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

The following table presents the loan portfolio, excluding residential LHFS, by segments and classes at December 31 of each of the years set forth below.

	2022	2021	2020	2019	2018
Commercial real estate:					
Owner-occupied	**$ 315,770**	$ 238,668	$ 174,908	$ 170,884	$ 129,650
Non-owner occupied	**608,043**	551,783	409,567	361,050	252,794
Multi-family	**138,832**	93,255	113,635	106,893	78,933
Non-owner occupied residential	**104,604**	106,112	114,505	120,038	100,367
Acquisition and development:					
1-4 family residential construction	**25,068**	12,279	9,486	15,865	7,385
Commercial and land development	**158,308**	93,925	51,826	41,538	42,051
Commercial and industrial (1)	**357,774**	485,728	647,368	214,554	160,964
Municipal	**12,173**	14,989	20,523	47,057	50,982
Residential mortgage:					
First lien	**229,849**	198,831	244,321	336,372	235,296
Home equity – term	**5,505**	6,081	10,169	14,030	12,208
Home equity – lines of credit	**183,241**	160,705	157,021	165,314	143,616
Installment and other loans	**12,065**	17,630	26,361	50,735	33,411
Total loans	**$ 2,151,232**	$ 1,979,986	$ 1,979,690	$ 1,644,330	$ 1,247,657

(1) Includes $13.8 million, $189.9 million and $403.3 million of SBA PPP loans, net of deferred fees and costs, as of December 31, 2022, 2021 and 2020, respectively.

The loan portfolio at December 31, 2022 increased by $171.2 million from December 31, 2021 due primarily to commercial loan and residential mortgage production, which was offset by SBA PPP loan forgiveness of $176.1 million and reductions in installment and other loans in 2022. Overall loan growth, excluding SBA PPP loans, was $349.0 million or 20% for the year ended December 31, 2022 compared to 2021.

The loan portfolio at December 31, 2021 increased by $296 thousand from December 31, 2020 due primarily to commercial loan production, which was offset by SBA PPP loan forgiveness of $442.8 million and reductions in mortgage loans and installment and other loans of $54.6 million in 2021. Overall loan growth, excluding SBA PPP loans, was $213.7 million, or 14% in 2021.

From 2019 to 2020, the increase in total loans was due primarily to the origination of SBA PPP loans, which was partially offset by a reduction in mortgage loans resulting from significant refinancing activity in the low interest rate environment. The increase in the loan portfolio from 2018 to 2019 was approximately 75% attributable to loans acquired in the Hamilton transaction. The Mercersburg acquisition in 2018 and Hamilton acquisition in 2019 increased the loan portfolio, principally in the residential mortgage - first lien and commercial real estate - owner and non-owner occupied classes.

The Company's organic growth has occurred principally in commercial real estate, commercial and industrial loans and home equity lines of credit, excluding SBA PPP loans, as we focused on increasing diversification in the portfolio. The growth in installment and other loans in 2019 was principally attributable to purchased automobile financing loans at higher returns than comparable cash flows in the investment securities portfolio.

In addition to monitoring the loan portfolio by loan class as noted above, the Company also monitors concentrations by segment. The Bank's lending policy reports segment concentrations that exceed 20% of the Bank's total risk-based capital ("RBC"). The following segments met this criterion at December 31, 2022.

	Balance	% of Total Loans	% of Total RBC
Office Space	$ 241,126	11.2%	82.3%
1-4 Family Rentals	104,604	4.9	35.7
Hotels & Motels (including B&B)	62,493	2.9	21.3
Loans outside of market area	178,429	8.3	60.9
Multi-Family CRE	149,683	7.0	51.1
Purchased Participation	111,141	5.2	37.9
Senior Housing and Care	126,399	5.9	43.1
Strip centers (retail)	122,688	5.7	41.9
Warehouse	104,442	4.9	35.7

The following table presents expected maturities of loan classes by fixed rate or adjustable-rate categories at December 31, 2022.

	Due In					
	One Year or Less	One Year Through Five Years	Five Years Through 15 Years	After 15 Years	Total	% of Total
Commercial real estate:						
Owner occupied						
Fixed rate	$ 6,184	$ 29,781	$ 83,618	$ 8,531	$ 128,114	41 %
Adjustable and floating rate	8,130	47,166	125,756	6,606	187,657	59 %
	14,314	76,946	209,373	15,137	315,770	100 %
Non-owner occupied						
Fixed rate	5,965	71,559	95,250	—	172,774	28 %
Adjustable and floating rate	14,944	53,576	356,418	10,331	435,269	72 %
	20,909	125,135	451,668	10,331	608,043	100 %
Multi-family						
Fixed rate	7,088	36,255	10,187	65	53,595	39 %
Adjustable and floating rate	113	35,479	45,745	3,901	85,237	61 %
	7,201	71,733	55,932	3,966	138,832	100 %
Non-owner occupied residential						
Fixed rate	975	10,865	9,223	1,748	22,812	22 %
Adjustable and floating rate	2,131	13,306	63,224	3,130	81,792	78 %
	3,106	24,171	72,447	4,879	104,604	100 %
Acquisition and development:						
1-4 family residential construction						
Fixed rate	—	544	5,948	2,213	8,706	35 %
Adjustable and floating rate	12,296	2,375	150	1,541	16,362	65 %
	12,296	2,919	6,098	3,754	25,068	100 %

	Due In					
	One Year or Less	One Year Through Five Years	Five Years Through 15 Years	After 15 Years	Total	% of Total
Commercial and land development						
Fixed rate	257	463	10,933	117	11,770	7 %
Adjustable and floating rate	34,706	48,929	37,135	25,768	146,538	93 %
	34,963	49,392	48,068	25,885	158,308	100 %
Commercial and industrial						
Fixed rate	3,557	117,751	44,283	977	166,568	47 %
Adjustable and floating rate	82,965	46,804	57,815	3,621	191,206	53 %
	86,522	164,555	102,098	4,598	357,774	100 %
Municipal						
Fixed rate	365	2,954	2,770	—	6,089	50 %
Adjustable and floating rate	—	0	4,139	1,945	6,084	50 %
	365	2,954	6,909	1,945	12,173	100 %
Residential mortgage:						
First lien						
Fixed rate	130	2,015	34,380	120,919	157,444	68 %
Adjustable and floating rate	287	319	9,154	62,645	72,405	32 %
	417	2,334	43,534	183,564	229,849	100 %
Home equity - term						
Fixed rate	47	680	3,495	815	5,037	92 %
Adjustable and floating rate	3	56	63	346	468	8 %
	50	736	3,558	1,161	5,505	100 %
Home equity - lines of credit						
Fixed rate	51	9,009	45,620	13,954	68,634	37 %
Adjustable and floating rate	18,056	188	1,300	95,063	114,607	63 %
	18,107	9,197	46,920	109,017	183,241	100 %
Installment and other loans						
Fixed rate	766	4,936	329	10	6,041	50 %
Adjustable and floating rate	3,842	—	2,158	24	6,024	50 %
	4,608	4,936	2,487	34	12,065	100 %
	$ 202,857	$ 535,010	$ 1,049,093	$ 364,272	$ 2,151,232	

The final maturity is used in the determination of maturity of acquisition and development loans that convert from construction to permanent status. Variable rate loans shown above include semi-fixed loans that contractually will adjust with prime or another variable rate index after the interest lock period, which may be up to 10 years. At December 31, 2022, these semi-fixed loans totaled $529.8 million.

Asset Quality

Risk Elements

The Company’s loan portfolio is subject to varying degrees of credit risk. Credit risk is managed through the Company's underwriting standards, on-going credit reviews, and monitoring of asset quality measures. Additionally, loan portfolio diversification, which limits exposure to a single industry or borrower, and collateral requirements also mitigate the Company's risk of credit loss.

The following table presents the Company's risk elements and relevant asset quality ratios at December 31 of each of the years set forth below.

	2022	2021	2020	2019	2018
Nonaccrual loans	**$ 20,583**	$ 6,449	$ 10,310	$ 10,657	$ 5,165
OREO	**—**	—	—	197	130
Total nonperforming assets	**20,583**	6,449	10,310	10,854	5,295
Restructured loans still accruing	**682**	804	934	979	1,132
Loans past due 90 days or more and still accruing [1]	**439**	1,201	554	2,232	57
Total nonperforming and other risk assets	**$ 21,704**	$ 8,454	$ 11,798	$ 14,065	$ 6,484
Loans 30-89 days past due	**$ 7,311**	$ 5,925	$ 10,291	$ 17,527	$ 5,186
Asset quality ratios:					
Total nonperforming loans to total loans	**0.96 %**	0.33 %	0.52 %	0.65 %	0.41 %
Total nonperforming assets to total assets	**0.70 %**	0.23 %	0.37 %	0.46 %	0.27 %
Total nonperforming assets to total loans and OREO	**0.96 %**	0.33 %	0.52 %	0.66 %	0.42 %
Total risk assets to total loans and OREO	**1.01 %**	0.43 %	0.60 %	0.86 %	0.52 %
Total risk assets to total assets	**0.74 %**	0.30 %	0.43 %	0.59 %	0.34 %
Allowance for loan losses to total loans	**1.17 %**	1.07 %	1.02 %	0.89 %	1.12 %
Allowance for loan losses to nonperforming loans	**122.32 %**	328.42 %	195.45 %	137.52 %	271.33 %
Allowance for loan losses to nonperforming loans and restructured loans still accruing	**118.40 %**	292.02 %	179.22 %	125.95 %	222.55 %

[1] Includes $307 thousand, $214 thousand, $456 thousand, $2.0 million and zero, respectively, of purchased credit impaired loans at December 31, 2022, 2021, 2020, 2019 and 2018. As of December 31, 2021, there was one loan for $891 thousand, which was in the process of collection and guaranteed by the SBA, and was subsequently collected during the first quarter of 2022.

The following table provides detail of impaired loans at December 31, 2022 and 2021.

	2022			2021		
	Nonaccrual Loans	Restructured Loans Still Accruing	Total	Nonaccrual Loans	Restructured Loans Still Accruing	Total
Commercial real estate:						
Owner occupied	**$ 2,767**	**$ —**	**$ 2,767**	$ 3,763	$ —	$ 3,763
Non-owner occupied residential	**81**	**—**	**81**	122	—	122
Acquisition and development						
Commercial and land development	**15,426**	**—**	**15,426**	—	—	—
Commercial and industrial	**31**	**—**	**31**	250	—	250
Residential mortgage:						
First lien	**1,838**	**682**	**2,520**	1,831	804	2,635
Home equity – term	**5**	**—**	**5**	7	—	7
Home equity – lines of credit	**395**	**—**	**395**	436	—	436
Installment and other loans	**40**	**—**	**40**	40	—	40
	$ 20,583	**$ 682**	**$ 21,265**	$ 6,449	$ 804	$ 7,253

Nonperforming assets include nonaccrual loans and foreclosed real estate. Risk assets, which include nonperforming assets and restructured and loans past due 90 days or more and still accruing, totaled $21.7 million at December 31, 2022, an increase of $13.3 million or 157%, from $8.5 million at December 31, 2021. Nonaccrual loans totaled $20.6 million at December 31, 2022, an increase of $14.1 million from $6.4 million at December 31, 2021 due primarily to additions in loans placed on non-accrual status of $16.4 million, partially offset by loans returning to accrual status and payment activity of $724 thousand and $1.5 million, respectively. The additions in loans placed on non-accrual status was primarily due to one commercial construction loan with an outstanding balance of $15.4 million that was downgraded to substandard. The loan was not past due at December 31, 2022; however, management determined that it was appropriate to place the loan on non-accrual status due to other relevant factors. At this time, management deems the value of underlying collateral sufficient to cover any potential losses on this loan. Management does not believe that this credit is indicative of overall stress in the loan portfolio. The increase in nonaccrual loan amounts also impacted other asset quality ratios detailed above.

The ALL totaled $25.2 million at December 31, 2022, a $4.0 million increase from $21.2 million at December 31, 2021, resulting from a provision for loan losses of $4.2 million and net charge-offs of $162 thousand for 2022. At December 31, 2022, the ALL is higher as a percentage of the total loan portfolio at 1.17% compared to 1.07% in 2021 and 1.02% in 2020.

The ALL increased primarily as a result of commercial loan growth, which receives a higher reserve allocation compared to consumer loans, for the year ended December 31, 2022. During 2022, qualitative factors were unchanged, except for a reduction in the *National and Local Economic Conditions* factor, that reduced the reserve by $726 thousand. This factor had been increased previously for economic concerns in the commercial real estate portfolio associated with the COVID-19 pandemic. The additional allocation was removed during 2022 as these concerns had subsided. The increase in provision for loan losses from 2020 to 2021 was due primarily to the impact of COVID-19 on the Company's loan portfolio as a new qualitative factor was created to address the potential associated risk. The COVID-19 qualitative reserve of $2.7 million was fully reversed in 2021 based on the sustained performance of the impacted borrowers. In addition, qualitative factors were reduced during 2021 in the *Classified Loans Trends* and *National and Local Economic Conditions* categories, due in part to improved conditions from the pandemic, which were partly offset by an increase in the qualitative factor for Concentrations of Credit caused by significant growth in commercial real estate loans.

From December 31, 2021 to December 31, 2022, special mention loans decreased by $16.2 million and substandard loans increased by $14.0 million. The decrease in special mention loans was due to continued improvements in economic conditions following the COVID-19 pandemic. The increase in substandard loans is due primarily to the aforementioned commercial construction loan with an outstanding balance of $15.4 million that was placed on non-accrual status.

For the years ended December 31, 2022, 2021 and 2020, gross recoveries of $248 thousand, $1.1 million and $1.2 million, respectively, were credited to the ALL. These recoveries on previously charged-off relationships are the result of successful loan monitoring and workout solutions. Recoveries are difficult to predict, and any additional recoveries that the Company receives will be used to replenish the ALL. Recoveries favorably impact historical charge-off factors, and contribute to changes in the quantitative and qualitative factors used in our allowance adequacy analysis. However, as the loan portfolio continues to grow, future provisions for loan losses may result.

The Company takes partial charge-offs on collateral-dependent loans when carrying value exceeds estimated fair value, as determined by the most recent appraisal adjusted for current (within the quarter) conditions, less costs to dispose. Impairment reserves remain in place if updated appraisals are pending, and represent management’s estimate of potential loss.

Management believes its coverage ratios are adequate for the risk profile of the loan portfolio given ongoing monitoring of the portfolio and its quantitative and qualitative analysis performed at December 31, 2022. As new information is learned about borrowers or updated appraisals on real estate with lower fair values are obtained, the Company may experience an increase in impaired loans. Despite generally favorable delinquency and nonperforming loan data, excluding the one commercial construction loan placed on non-accrual status during the fourth quarter of 2022, the impact of current economic conditions may result in the need for additional provisions for loan losses in future quarters.

The following table presents exposure to relationships with an impaired loan balance, which excludes accruing PCI loans, and the partial charge-offs taken to date and specific reserves established on those relationships at December 31, 2022 and 2021.

	# of Relationships	Recorded Investment	Partial Charge-offs to Date	Specific Reserves
December 31, 2022				
Relationships greater than $1 million	**2**	**$ 17,774**	**$ —**	**$ —**
Relationships greater than $500 thousand but less than $1 million	—	—	—	—
Relationships greater than $250 thousand but less than $500 thousand	**1**	**260**	—	—
Relationships less than $250 thousand	**60**	**3,231**	**320**	**28**
	63	**$ 21,265**	**$ 320**	**$ 28**
December 31, 2021				
Relationships greater than $1 million	1	$ 2,535	$ —	$ —
Relationships greater than $500 thousand but less than $1 million	1	602	17	—
Relationships greater than $250 thousand but less than $500 thousand	2	601	—	—
Relationships less than $250 thousand	63	3,515	303	28
	67	$ 7,253	$ 320	$ 28

Internal loan reviews are completed annually on all commercial relationships with a committed loan balance in excess of $1.0 million, which includes confirmation of risk rating by an independent credit officer. In addition, all commercial relationships greater than $500 thousand rated Substandard, Doubtful or Loss are reviewed and corresponding risk ratings are reaffirmed by the Bank's Problem Loan Committee, with subsequent reporting to the Management ERM Committee.

In its individual loan impairment analysis, the Company determines the extent of any full or partial charge-offs that may be required, or any reserves that may be needed. The determination of the Company’s charge-offs or impairment reserve include an evaluation of the outstanding loan balance and the related collateral securing the credit. Through a combination of collateral securing the loans and partial charge-offs taken to date, the Company believes that it has adequately provided for the potential losses that it may incur on these relationships at December 31, 2022. However, over time, additional information may result in increased reserve allocations or, alternatively, it may be deemed that the reserve allocations exceed those that are needed.

The Company’s foreclosed real estate balance at both December 31, 2022 and 2021 was zero for both residential and commercial properties. During 2022, no expense was recorded for the write-down of other real estate owned properties.

In an effort to assist clients, who were negatively impacted by the COVID-19 pandemic, the Bank offered various mitigation options, including a loan payment deferral program. Under this program, most commercial deferrals were for a 90-day period, while most consumer deferrals were for a 180-day period. The Company had a consumer loan under this deferral program of $56 thousand for which the deferral period subsequently expired in 2022. There were no loans under this deferral program as of December 31, 2022.

Credit Risk Management

Allowance for Loan Losses

The Company maintains the ALL at a level deemed adequate by management for probable incurred credit losses. The ALL is established and maintained through a provision for loan losses which is charged to earnings. On a quarterly basis, management assesses the adequacy of the ALL utilizing a defined methodology which considers specific credit evaluation of impaired loans, historical loss experience and qualitative factors. Management addresses the requirements for loans individually identified as impaired, loans collectively evaluated for impairment, and other bank regulatory guidance in its assessment.

The ALL is evaluated based on a review of the collectability of loans in light of historical experience; the nature and volume of the loan portfolio; adverse situations that may affect a borrower’s ability to repay; estimated value of any underlying collateral; and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. A description of the methodology for establishing the allowance and provision for loan losses and related procedures in establishing the appropriate level of reserve is included in Note 3, Loans and Allowance for Loan Losses, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

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The following table summarizes the Company’s internal risk ratings at December 31, 2022 and 2021.

	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	PCI Loans	Total
December 31, 2022							
Commercial real estate:							
Owner-occupied	**$ 305,159**	**$ 2,109**	**$ 3,532**	**$ 2,767**	**$ —**	**$ 2,203**	**$ 315,770**
Non-owner occupied	**601,244**	**4,243**	**2,273**	**—**	**—**	**283**	**608,043**
Multi-family	**130,851**	**7,739**	**242**	**—**	**—**	**—**	**138,832**
Non-owner occupied residential	**102,674**	**810**	**482**	**81**	**—**	**557**	**104,604**
Acquisition and development:							
1-4 family residential construction	**25,068**	**—**	**—**	**—**	**—**	**—**	**25,068**
Commercial and land development	**142,424**	**458**	**—**	**15,426**	**—**	**—**	**158,308**
Commercial and industrial	**331,103**	**17,579**	**7,013**	**31**	**—**	**2,048**	**357,774**
Municipal	**12,173**	**—**	**—**	**—**	**—**	**—**	**12,173**
Residential mortgage:							
First lien	**222,849**	**—**	**215**	**2,520**	**—**	**4,265**	**229,849**
Home equity – term	**5,485**	**—**	**—**	**5**	**—**	**15**	**5,505**
Home equity – lines of credit	**182,801**	**—**	**45**	**395**	**—**	**—**	**183,241**
Installment and other loans	**12,017**	**—**	**—**	**40**	**—**	**8**	**12,065**
	$ 2,073,848	**$ 32,938**	**$ 13,802**	**$ 21,265**	**$ —**	**$ 9,379**	**$ 2,151,232**

	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	PCI Loans	Total
December 31, 2021							
Commercial real estate:							
Owner-occupied	$ 219,250	$ 7,239	$ 6,087	$ 3,763	$ —	$ 2,329	$ 238,668
Non-owner occupied	528,010	23,297	166	—	—	310	551,783
Multi-family	84,414	8,238	603	—	—	—	93,255
Non-owner occupied residential	102,588	1,065	1,153	122	—	1,184	106,112
Acquisition and development:							
1-4 family residential construction	12,279	—	—	—	—	—	12,279
Commercial and land development	92,049	1,385	491	—	—	—	93,925
Commercial and industrial	470,579	7,917	4,720	250	—	2,262	485,728
Municipal	14,989	—	—	—	—	—	14,989
Residential mortgage:							
First lien	191,386	—	225	2,635	—	4,585	198,831
Home equity – term	6,058	—	—	7	—	16	6,081
Home equity – lines of credit	160,203	20	46	436	—	—	160,705
Installment and other loans	17,584	—	—	40	—	6	17,630
	$ 1,899,389	$ 49,161	$ 13,491	$ 7,253	$ —	$ 10,692	$ 1,979,986

Non-impaired substandard loans are performing loans, which have characteristics that cause management concern over the ability of the borrower to perform under present loan repayment terms and which may result in the reporting of these loans as nonperforming, or impaired, loans in the future. Generally, management feels that substandard loans that are currently performing and not considered impaired result in some doubt as to the borrower's ability to continue to perform under the terms of the loan, and represent potential problem loans. Non-impaired substandard loans totaled $13.8 million at December 31, 2022, an increase of $311 thousand compared to $13.5 million at December 31, 2021.

Additionally, the Special Mention classification is intended to be a temporary classification reflective of loans that have potential weaknesses that may, if not monitored or corrected, weaken the asset or inadequately protect the Company's position at some future date. Special mention loans represent an elevated risk, but their weakness does not yet justify a more severe, or classified, rating. These loans require inquiry by lenders on the cause of the potential weakness and, once analyzed, the loan classification may be downgraded to Substandard or, alternatively, could be upgraded to Pass. From December 31, 2021 to December 31, 2022, special mention loans decreased by $16.2 million and substandard loans increased by $14.0 million. The increase in substandard loans is due primarily to the aforementioned commercial construction loan with an outstanding balance of $15.4 million that was placed on non-accrual status. These risk rating downgrades were partially offset by continued improvements in economic conditions resulting in upgrades to other commercial loans. Any loans with second modifications that are COVID-19 related are classified as special mention.

The following tables, which excludes accruing PCI loans, summarize the average recorded investment in impaired loans and interest income recognized, on a cash basis, and interest income earned but not recognized for years ended December 31, 2022, 2021, 2020, 2019 and 2018.

	Average Impaired Balance	Interest Income Recognized	Interest Earned But Not Recognized
December 31, 2022			
Commercial real estate:			
Owner-occupied	**$ 3,050**	**$ —**	**$ 94**
Non-owner occupied residential	**96**	**—**	**8**
Acquisition and development:			
Commercial and land development	**1,187**	**—**	**9**
Commercial and industrial	**109**	**—**	**4**
Residential mortgage:			
First lien	**2,389**	**33**	**48**
Home equity – term	**6**	**—**	**—**
Home equity – lines of credit	**405**	**—**	**19**
Installment and other loans	**44**	**—**	**—**
	$ 7,286	**$ 33**	**$ 182**
December 31, 2021			
Commercial real estate:			
Owner-occupied	$ 3,825	$ 1	$ 1
Non-owner occupied	—	—	20
Non-owner occupied residential	225	—	24
Acquisition and development:			
Commercial and land development	187	—	—
Commercial and industrial	3,030	—	36
Residential mortgage:			
First lien	2,539	43	73
Home equity – term	11	—	—
Home equity – lines of credit	521	—	—
Installment and other loans	25	—	—
	$ 10,363	$ 44	$ 154

	Average Impaired Balance	Interest Income Recognized	Interest Earned But Not Recognized
December 31, 2020			
Commercial real estate:			
Owner-occupied	$ 4,636	$ 1	$ 172
Non-owner occupied	83	—	—
Multi-family	205	—	—
Non-owner occupied residential	388	—	21
Acquisition and development:			
Commercial and land development	641	—	23
Commercial and industrial	1,196	—	20
Residential mortgage:			
First lien	2,995	48	92
Home equity – term	11	—	1
Home equity – lines of credit	692	1	36
Installment and other loans	25	—	1
	$ 10,872	$ 50	$ 366
December 31, 2019			
Commercial real estate:			
Owner-occupied	$ 2,455	$ 2	$ 387
Non-owner occupied	46	—	—
Multi-family	152	—	24
Non-owner occupied residential	217	—	21
Acquisition and development:			
Commercial and land development	21	—	—
Commercial and industrial	683	—	130
Residential mortgage:			
First lien	2,582	50	91
Home equity – term	13	—	1
Home equity – lines of credit	750	2	64
Installment and other loans	13	—	2
	$ 6,932	$ 54	$ 720
December 31, 2018			
Commercial real estate:			
Owner-occupied	$ 1,495	$ 2	$ 156
Non-owner occupied	1,842	—	236
Multi-family	148	—	20
Non-owner occupied residential	346	—	36
Acquisition and development:			
1-4 family residential construction	181	—	—
Commercial and land development	1	—	1
Commercial and industrial	322	—	29
Residential mortgage:			
First lien	3,234	59	130
Home equity – term	19	—	2
Home equity – lines of credit	657	2	52
Installment and other loans	4	—	5
	$ 8,249	$ 63	$ 667

The following table summarizes activity in the ALL for years ended December 31, 2022, 2021, 2020, 2019 and 2018.

	Commercial					Consumer				
	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
December 31, 2022										
Balance, beginning of year	**$ 12,037**	**$ 2,062**	**$ 3,814**	**$ 30**	**$ 17,943**	**$ 2,785**	**$ 215**	**$ 3,000**	**$ 237**	**$ 21,180**
Provision for loan losses	**1,489**	**1,142**	**640**	**(6)**	**3,265**	**669**	**218**	**887**	**8**	**4,160**
Charge-offs	**—**	**—**	**—**	**—**	**—**	**(50)**	**(360)**	**(410)**	**—**	**(410)**
Recoveries	**32**	**10**	**51**	**—**	**93**	**40**	**115**	**155**	**—**	**248**
Balance, end of year	**$ 13,558**	**$ 3,214**	**$ 4,505**	**$ 24**	**$ 21,301**	**$ 3,444**	**$ 188**	**$ 3,632**	**$ 245**	**$ 25,178**
December 31, 2021										
Balance, beginning of year	$ 11,151	$ 1,114	$ 3,942	$ 40	$ 16,247	$ 3,362	$ 324	$ 3,686	$ 218	$ 20,151
Provision for loan losses	710	938	23	(10)	1,661	(517)	(73)	(590)	19	1,090
Charge-offs	(293)	—	(663)	—	(956)	(92)	(70)	(162)	—	(1,118)
Recoveries	469	10	512	—	991	32	34	66	—	1,057
Balance, end of year	$ 12,037	$ 2,062	$ 3,814	$ 30	$ 17,943	$ 2,785	$ 215	$ 3,000	$ 237	$ 21,180
December 31, 2020										
Balance, beginning of year	$ 7,634	$ 959	$ 2,356	$ 100	$ 11,049	$ 3,147	$ 319	$ 3,466	$ 140	$ 14,655
Provision for loan losses	2,745	146	2,096	(60)	4,927	203	117	320	78	5,325
Charge-offs	(3)	—	(748)	—	(751)	(114)	(146)	(260)	—	(1,011)
Recoveries	775	9	238	—	1,022	126	34	160	—	1,182
Balance, end of year	$ 11,151	$ 1,114	$ 3,942	$ 40	$ 16,247	$ 3,362	$ 324	$ 3,686	$ 218	$ 20,151
December 31, 2019										
Balance, beginning of year	$ 6,876	$ 817	$ 1,656	$ 98	$ 9,447	$ 3,753	$ 244	$ 3,997	$ 570	$ 14,014
Provision for loan losses	515	139	841	2	1,497	(347)	180	(167)	(430)	900
Charge-offs	(25)	—	(299)	—	(324)	(386)	(155)	(541)	—	(865)
Recoveries	268	3	158	—	429	127	50	177	—	606
Balance, end of year	$ 7,634	$ 959	$ 2,356	$ 100	$ 11,049	$ 3,147	$ 319	$ 3,466	$ 140	$ 14,655
December 31, 2018										
Balance, beginning of year	$ 6,763	$ 417	$ 1,446	$ 84	$ 8,710	$ 3,400	$ 211	$ 3,611	$ 475	$ 12,796
Provision for loan losses	(442)	396	209	14	177	363	165	528	95	800
Charge-offs	(17)	(7)	—	—	(24)	(148)	(292)	(440)	—	(464)
Recoveries	572	11	1	—	584	138	160	298	—	882
Balance, end of year	$ 6,876	$ 817	$ 1,656	$ 98	$ 9,447	$ 3,753	$ 244	$ 3,997	$ 570	$ 14,014

The following table summarizes asset quality ratios for years ended December 31, 2022, 2021, 2020, 2019 and 2018.

	2022	2021	2020	2019	2018
Provision for loan losses to net charge-offs (recoveries)	**2,568 %**	1,787 %	(3,114)%	347 %	(191)%
Ratio of ALL to total loans outstanding at December 31	**1.17 %**	1.07 %	1.02 %	0.89 %	1.12 %

The following table details net charge-offs (recoveries) to average loans outstanding by loan category for the years ended December 31, 2022 and 2021.

	2022	2021
Commercial real estate:		
Net recoveries	**$ (32)**	$ (176)
Average loans for the year	**$ 1,069,392**	$ 880,458
Net recoveries/average loans	**— %**	(0.02)%
Acquisition and development:		
Net recoveries	**(10)**	(10)
Average loans for the year	**147,364**	74,786
Net recoveries/average loans	**(0.01)%**	(0.01)%
Commercial and industrial:		
Net (recoveries) charge-offs	**(51)**	151
Average loans for the year	**408,995**	604,651
Net (recoveries) charge-offs/average loans	**(0.01)%**	0.02 %
Municipal:		
Net charge-offs (recoveries)	**—**	—
Average loans for the year	**13,486**	16,566
Net charge-offs (recoveries)/average loans	**— %**	— %
Residential mortgage:		
Net charge-offs	**10**	60
Average loans for the year	**389,048**	379,802
Net charge-offs /average loans	**— %**	0.02 %
Installment and other loans:		
Net charge-offs	**245**	36
Average loans for the year	**14,732**	21,706
Net charge-offs/average loans	**1.66 %**	0.17 %
Total loans:		
Net charge-offs	**$ 162**	$ 61
Average loans for the year	**$ 2,043,017**	$ 1,977,969
Net charge-offs/average loans	**0.01 %**	— %

[(1)] Average loans exclude loans held for sale.

The Company recorded a provision for loan losses of $4.2 million, $1.1 million, $5.3 million, $900 thousand and $800 thousand for 2022, 2021, 2020, 2019 and 2018, respectively. In addition, in certain cases, loans were successfully worked out with smaller charge-offs than the reserve established on them. During 2022, the increase in the provision for loan losses was due primarily to commercial loan growth, partially offset by a reduction in the *National and Local Economic Conditions* qualitative factor that reduced the reserve by $726 thousand. In 2021, the provision for loan loss was caused by commercial loan growth and an associated increase in the qualitative factor for *Concentrations of Credit* due to significant growth in commercial real estate loans, offset by reductions totaling $2.9 million in the *Classified Loans Trends, National and Local Economic Conditions* and *COVID-19* categories due in part to improved conditions from the pandemic. In 2020, the severe economic impact of COVID-19 on the loan portfolio drove an increase in qualitative assumptions, which were reversed in 2021 as sustained performance was demonstrated after the impacted loans were removed from deferral status or the forbearance period ended. In 2018 and 2019, our continued organic loan portfolio growth was a key factor in the quantitative and qualitative considerations used by management in the determination of the provision expense required to maintain an adequate allowance for loan losses. These variations resulted in the fluctuations in the ratios presented in the tables above.

See further discussion in the "Provision for Loan Losses" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations. Also, see Note 3, Loans and Allowance for Loan Losses, in the Notes to Consolidated Financial Statements for additional information.

The following table shows the allocation of the ALL by loan class, as well as the percent of each loan class in relation to the total loan balance at December 31, 2022, 2021, 2020, 2019 and 2018.

	2022		2021		2020		2019		2018	
	ALL Amount by Loan Class	**% of Loan Type to Total Loans**	**ALL Amount by Loan Class**	**% of Loan Type to Total Loans**	**ALL Amount by Loan Class**	**% of Loan Type to Total Loans**	**ALL Amount by Loan Class**	**% of Loan Type to Total Loans**	**ALL Amount by Loan Class**	**% of Loan Type to Total Loans**
Commercial real estate:										
Owner-occupied	**$ 3,618**	**15 %**	$ 2,752	12 %	$ 2,072	9 %	$ 1,539	10 %	$ 1,491	10 %
Non-owner occupied	**7,473**	**28 %**	7,244	28 %	6,049	21 %	3,965	22 %	3,683	20 %
Multi-family	**1,355**	**6 %**	870	5 %	1,846	6 %	974	7 %	792	6 %
Non-owner occupied residential	**1,112**	**5 %**	1,171	5 %	1,184	6 %	1,156	7 %	910	8 %
Acquisition and development:										
1-4 family residential construction	**376**	**1 %**	188	1 %	144	— %	239	1 %	104	1 %
Commercial and land development	**2,838**	**7 %**	1,874	5 %	970	3 %	720	3 %	713	3 %
Commercial and industrial	**4,505**	**17 %**	3,814	24 %	3,942	32 %	2,356	13 %	1,656	13 %
Municipal	**24**	**1 %**	30	1 %	40	1 %	100	3 %	98	4 %
Residential mortgage:										
First lien	**1,600**	**11 %**	1,188	10 %	1,627	12 %	1,635	20 %	2,002	19 %
Home equity - term	**32**	**— %**	31	— %	63	1 %	59	1 %	109	1 %
Home equity - lines of credit	**1,812**	**8 %**	1,566	8 %	1,672	8 %	1,453	10 %	1,642	12 %
Installment and other loans	**188**	**1 %**	215	1 %	324	1 %	319	3 %	244	3 %
Unallocated	**245**		237		218		140		570	
	$ 25,178	**100 %**	$ 21,180	100 %	$ 20,151	100 %	$ 14,655	100 %	$ 14,014	100 %

The following table summarizes the ending loan balance individually or collectively evaluated for impairment by loan class and the ALL allocation for each at December 31, 2022 and 2021.

	Commercial					Consumer				
	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
December 31, 2022										
Loans allocated by:										
Individually evaluated for impairment	$ 2,848	$ 15,426	$ 31	$ —	$ 18,305	$ 2,920	$ 40	$ 2,960	$ —	$ 21,265
Collectively evaluated for impairment	1,164,401	167,950	357,743	12,173	1,702,267	415,675	12,025	427,700	—	2,129,967
	$ 1,167,249	$ 183,376	$ 357,774	$ 12,173	$ 1,720,572	$ 418,595	$ 12,065	$ 430,660	$ —	$ 2,151,232
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ 28	$ —	$ 28	$ —	$ 28
Collectively evaluated for impairment	13,558	3,214	4,505	24	21,301	3,416	188	3,604	245	25,150
	$ 13,558	$ 3,214	$ 4,505	$ 24	$ 21,301	$ 3,444	$ 188	$ 3,632	$ 245	$ 25,178
December 31, 2021										
Loans allocated by:										
Individually evaluated for impairment	$ 3,885	$ —	$ 250	$ —	$ 4,135	$ 3,078	$ 40	$ 3,118	$ —	$ 7,253
Collectively evaluated for impairment	985,933	106,204	485,478	14,989	1,592,604	362,539	17,590	380,129	—	1,972,733
	$ 989,818	$ 106,204	$ 485,728	$ 14,989	$ 1,596,739	$ 365,617	$ 17,630	$ 383,247	$ —	$ 1,979,986
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ 28	$ —	$ 28	$ —	$ 28
Collectively evaluated for impairment	12,037	2,062	3,814	30	17,943	2,757	215	2,972	237	21,152
	$ 12,037	$ 2,062	$ 3,814	$ 30	$ 17,943	$ 2,785	$ 215	$ 3,000	$ 237	$ 21,180

In addition to the reserve allocations on impaired loans noted above, nine loans, with aggregate outstanding principal balances of $370 thousand, have had cumulative partial charge-offs to the ALL totaling $320 thousand at December 31, 2022. As updated appraisals were received on collateral-dependent loans, partial charge-offs were taken to the extent the loans' principal balance exceeded their fair value.

Management believes the allocation of the ALL between the various loan classes adequately reflects the probable incurred credit losses in each portfolio and is based on the methodology outlined in Note 3, Loans and Allowance for Loan Losses, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data." Management re-evaluates and makes certain enhancements to its methodology used to establish a reserve to better reflect the risks inherent in the different segments of the portfolio, particularly in light of increased charge-offs, with noticeable differences between the different loan classes. Management believes these enhancements to the ALL methodology improve the accuracy of quantifying probable incurred credit losses inherent in the portfolio. Management charges actual loan losses to the reserve and bases the provision for loan losses on its overall analysis.

The largest component of the ALL for the years presented has been allocated to the commercial real estate segment, particularly the non-owner occupied loan class. The higher allocations in this segment as compared with the other segments is consistent with the inherent risk associated with these loans, as well as generally higher levels of impaired and criticized loans for the periods presented. There has generally been a decrease in the ALL, as the level of classified assets decline, and historical loss rates have improved as a result of improving economic and market conditions; however, the significant increase in commercial loan production had the effect of increasing provision expense in 2022 and 2021. These increases were partially offset in 2022 and 2021 by adjustments to certain qualitative factors, which reduced the reserve by $726 thousand and $2.9 million, respectively, in these periods.

The unallocated portion of the ALL reflects estimated inherent losses within the portfolio that have not been detected, as well as the risk of error in the specific and general reserve allocation, other potential exposure in the loan portfolio, variances in management's assessment of national and local economic conditions and other factors management believes appropriate at the time. The unallocated portion of the allowance increased from $237 thousand, or 1.1% of the ALL, at December 31, 2021 to

$245 thousand, or 1.0% of the ALL, at December 31, 2022. The Company monitors the unallocated portion of the ALL, and by policy, has determined it should not exceed 3% of the total reserve. Future negative provisions for loan losses may result if the unallocated portion was to increase, and management determined the reserves were not required for the anticipated risk in the portfolio.

Management believes the Company's ALL is adequate based on information currently available. Future adjustments to the ALL and enhancements to the methodology may be necessary due to changes in economic conditions, regulatory guidance, or management's assumptions as to future delinquencies or loss rates.

Deposits

Total deposits grew by $11.3 million, or less than 1%, and remained consistent with a balance of $2.5 billion at both December 31, 2022 and 2021. The increase of $108.0 million, or 5%, from 2020 to 2021 was primarily due to deposits generated through the SBA PPP originations combined with clients continuing to maintain deposit balances in excess of historical norms. Similarly in 2020, the increase in deposits was due to deposits generated through the SBA PPP and government stimulus.

During the fourth quarter of 2022, the Bank announced that it had entered into a Purchase and Assumption Agreement providing for the sale of its Path Valley branch and associated deposit liabilities. At December 31, 2022, deposits of approximately $31.3 million are expected to be conveyed in the branch sale, are reported within total deposits at cost and are comprised of $23.5 million in interest-bearing deposits and $7.8 million in non-interest bearing deposits. The transaction is expected to close in the second quarter of 2023.

The following table presents average deposits for years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Demand deposits	**$ 557,142**	$ 542,952	$ 381,869
Interest-bearing demand deposits	**1,414,177**	1,392,996	1,156,292
Savings deposits	**232,660**	202,371	163,133
Time deposits	**273,276**	360,264	452,298
Total deposits	**$ 2,477,255**	$ 2,498,583	$ 2,153,592

Average total deposits decreased by $21.3 million, or 1%, primarily due to a decrease in average time deposits of $87.0 million, or 24%, from 2021 to 2022, partially offset by increases in all other deposit types. The decrease in average time deposits is due to maturities.

Management evaluates its utilization of brokered deposits, taking into consideration the interest rate curve and regulatory views on non-core funding sources, and balances this funding source with its funding needs based on growth initiatives. The Company anticipates that loan growth will be funded through deposit generation by offering competitive rates, as well as reliance on FHLB borrowings. The Bank's brokered deposit balances, including the average balance, remained at zero at December 31, 2022 and 2021.

The Company had time deposits that meet or exceed the FDIC insurance limit of $250,000 of $36.5 million and $44.0 million at December 31, 2022 and 2021, respectively. Time deposits held for conveyance in the pending branch sale totaled $2.2 million at December 31, 2022. At December 31, 2022, the scheduled maturities of time deposits that meet or exceed the FDIC insurance limit or otherwise uninsured were as follows:

Three months or less	**$ 14,027**
Over three months through six months	**4,662**
Over six months through one year	**11,638**
Over one year	**6,190**
Total	**$ 36,517**

Borrowings

In addition to deposit products, the Company uses short-term borrowing sources to meet liquidity needs and for temporary funding. Sources of short-term borrowings include the FHLB of Pittsburgh, federal funds purchased, and to a lesser extent, the FRB discount window. Short-term borrowings also include securities sold under agreements to repurchase with deposit clients, in which a client sweeps a portion of a deposit balance into a repurchase agreement, which is a secured borrowing with a pool of securities pledged against the balance.

The Company also utilizes long-term debt, consisting principally of FHLB fixed and amortizing advances, to fund its balance sheet with original maturities greater than one year. The Company evaluates its funding needs, interest rate movements, the cost of options, and the availability of attractive structures when considering the timing and extent of when it enters into long-term borrowings.

FHLB advances and other borrowings increased by $104.2 million to $106.1 million at December 31, 2022 compared to $1.9 million at December 31, 2021. Due to the utilization of excess liquidity by individuals and businesses, increased competition for deposits and seasonal deposit declines, the Bank's deposit balances started to decline slightly during the fourth quarter of 2022. The Bank opted to borrow funds to provide additional liquidity to meet the credit needs of its clients.

In December 2018, the Company issued unsecured subordinated notes payable totaling $32.5 million, which mature on December 30, 2028, and the proceeds of which were designated for general corporate use, including funding of cash consideration for mergers and acquisitions. The subordinated notes have a fixed interest rate of 6.0% through December 30, 2023, which then converts to a variable rate, equivalent to the LIBOR fallback rate, or any replacement reference rate, plus 3.16% through maturity.

For additional information about borrowings, refer to Note 12, Short-Term Borrowings, Note 13, Long-Term Debt, and Note 14, Subordinated Notes, to the Consolidated Financial Statements appearing in Part II, Item 8, "Financial Statements and Supplementary Data."

Shareholders' Equity

Shareholders’ equity totaled $228.9 million at December 31, 2022, a decrease of $42.8 million, or 16%, from $271.7 million at December 31, 2021. The decrease in 2022 was primarily attributable to other comprehensive losses of $44.4 million due to an increase in unrealized losses on AFS securities and interest rate swaps designated as cash flow hedges, caused by a substantial increase in market interest rates, as well as dividends paid of $8.3 million and share-based compensation costs of $12.2 million, partially offset by net income of $22.0 million.

For the year ended December 31, 2022, total comprehensive loss was $22.3 million, a decrease of $56.3 million, from total comprehensive income of $34.0 million for the same period in 2021. This decrease was primarily due to an increase in unrealized losses on AFS securities, net of taxes, of $43.7 million and a decrease in net income of $10.8 million, due partially to the provision for legal settlement of $10.3 million and a restructuring charge of $2.5 million, both on an after-tax basis, compared to the same period in 2021. The unrealized losses included in the consolidated statements of comprehensive (loss) income are the result of the significant increase in market interest rates.

In September 2015, the Board of Directors authorized a stock repurchase program, which is more fully described in Item 5 under Issuer Purchases of Equity Securities. Subsequently on April 19, 2021, the Board of Directors authorized the additional future repurchase of up to 562,000 shares of its outstanding common stock. The maximum number of shares that may yet be purchased under the plan is 159,059 shares at December 31, 2022.

The following table includes additional information for shareholders’ equity for years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Average shareholders’ equity	**$ 244,281**	$ 262,159	$ 226,900
Net income	**22,037**	32,881	26,463
Cash dividends paid	**8,264**	8,280	7,610
Average equity to average assets ratio	**8.59 %**	9.06 %	8.58 %
Dividend payout ratio	**36.39 %**	24.68 %	28.12 %
Return on average equity	**9.02 %**	12.54 %	11.66 %

Capital Adequacy and Regulatory Matters

Capital management in a regulated financial services industry must properly balance return on equity to its shareholders while maintaining sufficient levels of capital and related risk-based regulatory capital ratios to satisfy statutory and regulatory requirements. The Company’s capital management strategies have been developed to provide attractive rates of returns to its shareholders, while maintaining a “well capitalized” position of regulatory strength.

Effective with the third quarter of 2018, the FRB raised the consolidated asset limit on small bank holding companies from $1 billion to $3 billion, and a company with assets under the revised limits is not subject to the FRB consolidated capital rules. A company with consolidated assets under the revised limit may continue to file reports that include capital amounts and ratios. The Parent Company has elected to continue to file those reports.

The Parent Company and the Bank both have met all capital adequacy requirements to which they are subject at December 31, 2022 and 2021. At December 31, 2022 and 2021, the Bank was considered well capitalized under applicable banking regulations.

Tables presenting the Parent Company’s and the Bank’s capital amounts and ratios at December 31, 2022 and 2021 are included in Note 16, Shareholders' Equity and Regulatory Capital, to the Consolidated Financial Statements appearing in Part II, Item 8, "Financial Statements and Supplementary Data."

The Company routinely evaluates its capital levels in light of its risk profile to assess its capital needs. In addition to the minimum capital ratio requirement and minimum capital ratio to be well capitalized presented in the tables in Note 16, we must maintain a capital conservation buffer as noted in Item 1 - Business under the topic Basel III Capital Rules. At December 31, 2022, the Parent Company's and the Bank's capital conservation buffer, based on the most restrictive capital ratio, was 4.3% and 4.3%, respectively, which are above the regulatory requirement of 2.50% at December 31, 2022.

Liquidity and Rate Sensitivity

Liquidity. The primary function of asset/liability management is to ensure adequate liquidity and manage the Company’s sensitivity to changing interest rates. Liquidity management involves the ability to meet the cash flow requirements of clients who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The Company's primary sources of funds consist of deposit inflows, loan repayments, borrowings from the FHLB of Pittsburgh and maturities and prepayments of investment securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company's maximum borrowing capacity from the FHLB is $1.0 billion at December 31, 2022.

The Company regularly adjusts its investments in liquid assets based upon its assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and securities and the objectives of its asset/liability management policy.

At December 31, 2022, outstanding loan commitments totaled $863.8 million, which included $206.1 million in undisbursed loans, $296.2 million in unused home equity lines of credit, $338.3 million in commercial lines of credit, and $23.2 million in performance standby letters of credit. Time deposits due within one year after December 31, 2022 totaled $179.0 million, or 71% of time deposits, which includes both clients with longer-term time deposits nearing maturity and the more recent time deposit offerings with terms of 18 months or less. If these maturing deposits do not remain with the Company, it may be required to seek other sources of funds, including other time deposits and lines of credit. Due to current market conditions, the Company has paid higher rates on such deposits during 2022 than it paid in 2021. The Company has the ability to attract and retain deposits by adjusting the interest rates it offers.

The Company's most liquid assets are cash and cash equivalents. The levels of these assets depend on the Company's operating, financing, lending and investing activities during any given period. At December 31, 2022, cash and cash equivalents totaled $60.8 million, compared with $208.7 million at December 31, 2021, which the decrease is due to the deployment of cash into higher yielding loans and investment securities. Available-for-sale securities, net of securities pledged to maintain liquidity facilities at the FHLB, provide additional sources of liquidity, and totaled $116.9 million at December 31, 2022. Also, at December 31, 2022, the Company had the ability to borrow up to a total of $1.0 billion from the FHLB of Pittsburgh, of which $108.3 million in advances and letters of credit were outstanding. The Company's ability to borrow from the FHLB is dependent on having sufficient qualifying collateral, which generally consists of mortgage loans. In addition, the Company had $30.0 million in available unsecured lines of credit with other banks at December 31, 2022.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and interest on its borrowings. The Company also has repurchased shares of its common stock. The Company's primary source of income is dividends received from the Bank. Restrictions on the Bank's ability to dividend funds to the Company are described in Note 16, Shareholders' Equity and Regulatory Capital, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

Interest Rate Sensitivity. Interest rate sensitivity management requires the maintenance of an appropriate balance between interest sensitive assets and liabilities. Management, through its asset/liability management process, attempts to manage the level of repricing and maturity mismatch so that fluctuations in net interest income are maintained within policy limits in current and expected market conditions. For further discussion, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Contractual Obligations

The Company enters into contractual obligations in the normal course of business to fund loan growth, for asset/liability management purposes, to meet required capital needs and for other corporate purposes. The following table presents significant fixed and determinable contractual obligations of principal by payment date at December 31, 2022. In addition, at December 31, 2022, deposits of approximately $31.3 million are expected to be conveyed in connection with the Purchase and Assumption Agreement providing for the sale of the Bank's Path Valley branch. The transaction is expected to close in the second quarter of 2023.

Further discussion of the nature of each obligation is in the referenced Note to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data" referenced in the following table.

		Payments Due				
	Note Reference	Less than 1 year	2-3 years	4-5 years	More than 5 years	Total
Time deposits	10	$ 179,009	$ 63,298	$ 7,231	$ 1,463	$ 251,001
Short-term borrowings	12	121,935	—	—	—	121,935
Long-term debt	13	462	993	—	—	1,455
Subordinated notes	14	—	—	—	32,500	32,500
Operating lease obligations	5	1,153	2,380	2,500	8,187	14,220
Total		$ 302,559	$ 66,671	$ 9,731	$ 42,150	$ 421,111

The contractual obligations table above does not include off-balance sheet commitments to extend credit that are detailed in the following section. These commitments generally have fixed expiration dates and many will expire without being drawn upon, therefore the total commitment does not necessarily represent future cash requirements and is excluded from the contractual obligations table.

Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit and standby letters of credit.

The following table details significant commitments at December 31, 2022.

	Contract or Notional Amount
Commitments to fund:	
Home equity lines of credit	$ **296,213**
1-4 family residential construction loans	**49,538**
Commercial real estate, construction and land development loans	**156,560**
Commercial, industrial and other loans	**338,286**
Standby letters of credit	**23,229**

A discussion of the nature, business purpose, and guarantees that result from the Company’s off-balance sheet arrangements is included in Note 18, Financial Instruments with Off-Balance Sheet Risk, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

Recently Adopted and Recently Issued Accounting Standards

Recently adopted and recently issued accounting standards are described in Note 1, Summary of Significant Accounting Policies, to the Consolidated Financial Statements under Part II, Item 8, "Financial Statements and Supplementary Data."

Supplemental Reporting of Non-GAAP Measures

As a result of prior acquisitions, the Company had intangible assets consisting of goodwill and core deposit and other intangible assets totaling $21.8 million and $22.9 million at December 31, 2022 and 2021, respectively. Additionally, the Company incurred $3.2 million and $13.0 million in restructuring charges and a provision for legal settlement, respectively, during the year ended December 31, 2022.

Management believes providing certain “non-GAAP” information will assist investors in their understanding of the effect on recent financial results from non-recurring charges.

Tangible book value per common share and the impact of the restructuring charge and legal settlement on net income and associated ratios, as used by the Company in this supplemental reporting presentation, are determined by methods other than in accordance with GAAP. While the Company's management believes this information is a useful supplement to the GAAP-based measures reported in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, readers are cautioned that this non-GAAP disclosure has limitations as an analytical tool, should not be viewed as a substitute for financial measures determined in accordance with GAAP, and should not be considered in isolation or as a substitute for analysis of our results and financial condition as reported under GAAP, nor are such measures necessarily comparable to non-GAAP performance measures that may be presented by other companies. This supplemental presentation should not be construed as an inference that our future results will be unaffected by similar adjustments to be determined in accordance with GAAP. The decrease in tangible book value per share was primarily caused by the total comprehensive losses of $44.4 million during 2022 compared to total comprehensive income of $1.1 million during 2021. This decrease was primarily due to an increase in unrealized losses on AFS securities caused by the significant increase in market interest rates.

The following tables present the computation of each non-GAAP based measure shown together with its most directly comparable GAAP-based measure.

(Dollars, except per share amounts, and shares in thousands)	2022	2021	2020
Tangible book value per common share			
Shareholders' equity (most directly comparable GAAP-based measure)	**$ 228,896**	$ 271,656	$ 246,249
Less: Goodwill	**18,724**	18,724	18,724
Other intangible assets	**3,078**	4,183	5,458
Related tax effect	**(646)**	(878)	(1,146)
Tangible common equity (non-GAAP)	**$ 207,740**	$ 249,627	$ 223,213
Common shares outstanding	**10,671**	11,183	11,201
Book value per share (most directly comparable GAAP based measure)	**$ 21.45**	$ 24.29	$ 21.98
Intangible assets per share	**1.98**	1.97	2.05
Tangible book value per share (non-GAAP)	**$ 19.47**	$ 22.32	$ 19.93

Adjusted Net Income and Adjusted Diluted Earnings Per Share	**December 31,**
(Dollars, except per share amounts, and shares in thousands)	**2022**
Net income (most directly comparable GAAP based measure)	**$ 22,037**
Plus: Restructuring charges	**3,155**
Plus: Provision for legal settlement	**13,000**
Less: Related tax effect	**(3,393)**
Adjusted net income (non-GAAP)	**$ 34,799**
Weighted average shares - diluted (most directly comparable GAAP-based measure)	**10,706**
Diluted earnings per share (most directly comparable GAAP-based measure)	**2.06**
Weighted average shares - diluted (non-GAAP)	**10,706**
Diluted earnings per share, adjusted (non-GAAP)	**$ 3.25**

ITEM 7A – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk comprises exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks. In the banking industry, a major risk exposure is changing interest rates. The primary objective of monitoring our interest rate sensitivity, or risk, is to provide management the tools necessary to manage the balance sheet to minimize adverse changes in net interest income as a result of changes in the direction and level of interest rates. FRB monetary control efforts, the effects of deregulation, economic uncertainty and legislative changes have been significant factors affecting the task of managing interest rate sensitivity positions in recent years.

Interest Rate Risk

Interest rate risk is the exposure to fluctuations in the Company's future earnings (earnings at risk) and value (value at risk) resulting from changes in interest rates. This exposure results from differences between the amounts of interest-earning assets and interest-bearing liabilities that reprice within a specified time period as a result of scheduled maturities, scheduled and unscheduled repayments, the propensity of borrowers and depositors to react to changes in their economic interests, and loan contractual interest rate changes.

We attempt to manage the level of repricing and maturity mismatch through our asset/liability management process so that fluctuations in net interest income are maintained within policy limits across a range of market conditions, while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure the Company's profitability. Thus, the goal of interest rate risk management is to evaluate the amount of reward for taking risk and adjusting both the size and composition of the balance sheet relative to the level of reward available for taking risk.

Management endeavors to control the exposure to changes in interest rates by understanding, reviewing and making decisions based on its risk position. The Company primarily uses its securities portfolio, FHLB advances, interest rate swaps and brokered deposits to manage its interest rate risk position. Additionally, pricing, promotion and product development activities are directed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest rate risk objectives.

We use simulation analysis to assess earnings at risk and net present value analysis to assess value at risk. These methods allow management to regularly monitor both the direction and magnitude of our interest rate risk exposure. These analyses require numerous assumptions including, but not limited to, changes in balance sheet mix, prepayment rates on loans and securities, cash flows and repricing of all financial instruments, changes in volumes and pricing, future shapes of the yield curve, relationship of market interest rates to each other (basis risk), credit spread and deposit sensitivity. Assumptions are based on management's best estimates, but may not accurately reflect actual results under certain changes in interest rate due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and providing a relative gauge of our interest rate risk position over time.

Our asset/liability committee operates under management policies, approved by the Board of Directors, which define guidelines and limits on the level of risk. The committee meets regularly and reviews our interest rate risk position and monitors various liquidity ratios to ensure a satisfactory liquidity position. By utilizing our analyses, we can determine changes that may need to be made to the asset and liability mixes to mitigate the change in net interest income under various interest rate scenarios. Management continually evaluates the condition of the economy, the pattern of market interest rates and other economic data to inform the committee on the selection of investment securities. Regulatory authorities also monitor our interest rate risk position along with other liquidity ratios.

Net Interest Income Sensitivity

Simulation analysis evaluates the effect of upward and downward changes in market interest rates on future net interest income. The analysis involves changing the interest rates used in determining net interest income over the next twelve months. The resulting percentage change in net interest income in various rate scenarios is an indication of our short-term interest rate risk. The analysis assumes recent pricing trends in new loan and deposit volumes will continue while balances remain constant. Additional assumptions are applied to modify pricing under the various rate scenarios.

The simulation analysis results are presented in the table below. At December 31, 2022, the results indicated the Company could experience interest income pressure as interest rates continue to rise. This is due to the fact that interest-bearing liabilities will begin repricing faster than interest-earning assets. The faster liability repricing combined with the composition of the balance sheet between fixed- and floating-rate assets has led to the Company becoming more liability sensitive as interest rates have risen. As such, if certain model assumptions occur, further increases in interest rates in a flat balance sheet scenario could negatively impact the Company's net interest income.

Economic Value

Net present value analysis provides information on the risk inherent in the balance sheet that might not be considered in the simulation analysis due to the short time horizon used in that analysis. The net present value of the balance sheet incorporates the discounted present value of expected asset cash flows minus the discounted present value of expected liability cash flows. The analysis involves changing the interest rates used in determining the expected cash flows and in discounting the cash flows. The resulting percentage change in net present value in various rate scenarios is an indication of the longer-term repricing risk and options embedded in the balance sheet.

The results at December 31, 2022 reflect the impact of the FOMC's interest rate increases to date. As the federal funds rate increases further, the increase in asset yields is countered by the model's acceleration in the cost of liabilities as compared to a slower realized pace so far in this rate cycle. To improve the comparability across periods, the Company strives to follow best practices related to the assumption setting and maintains the size and mix of the period end balance sheet; thus, the results do not reflect actions management may take through the normal course of business that would impact results.

Earnings at Risk			Value at Risk		
	% Change in Net Interest Income			% Change in Market Value	
Change in Market Interest Rates	December 31, 2022	December 31, 2021	Change in Market Interest Rates	December 31, 2022	December 31, 2021
(100)	**4.8 %**	(1.4)%	**(100)**	**(9.3)%**	(43.8)%
100	**(2.6)%**	3.7 %	**100**	**3.8 %**	25.8 %
200	**(6.1)%**	6.7 %	**200**	**4.0 %**	41.2 %

Further discussion related to the quantitative and qualitative disclosures about market risk is included under the heading of Liquidity and Rate Sensitivity in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 8 – FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SUMMARY OF QUARTERLY FINANCIAL DATA

The following table presents unaudited quarterly results of operations for years ended December 31.

	2022 Quarter Ended				2021 Quarter Ended			
	December	September	June	March	December	September	June	March
Interest income	$ 32,095	$ 27,419	$ 25,350	$ 23,790	$ 23,919	$ 22,191	$ 23,656	$ 23,929
Interest expense	4,611	1,964	1,232	1,217	1,322	1,571	1,755	2,074
Net interest income	27,484	25,455	24,118	22,573	22,598	20,620	21,901	21,855
Provision for loan losses	585	1,500	1,775	300	1,100	365	625	(1,000)
Net interest income after provision for loan losses	26,899	23,955	22,343	22,273	21,498	20,255	21,276	22,855
Investment securities gains (losses)	3	(14)	(3)	(146)	3	479	11	145
Other noninterest income	6,223	6,072	7,197	7,620	7,290	7,172	6,653	7,399
Restructuring expenses	—	3,155	—	—	—	—	—	—
Provision for legal settlement	—	13,000	—	—	—	—	—	—
Other noninterest expenses	21,236	20,257	18,794	19,364	20,290	19,035	17,033	17,783
Income (loss) before income tax expense	11,889	(6,399)	10,743	10,383	8,501	8,871	10,907	12,616
Income tax expense (benefit)	2,263	(1,571)	1,872	2,015	1,795	1,679	2,131	2,409
Net income (loss)	$ 9,626	$ (4,828)	$ 8,871	$ 8,368	$ 6,706	$ 7,192	$ 8,776	$ 10,207
Per share information:								
Basic earnings (loss) per share (a)	$ 0.93	$ (0.47)	$ 0.84	$ 0.77	$ 0.61	$ 0.66	$ 0.80	$ 0.93
Diluted earnings (loss) per share (a)	0.91	(0.47)	0.83	0.76	0.60	0.65	0.79	0.92
Dividends paid per share	0.19	0.19	0.19	0.19	0.19	0.19	0.18	0.18

(a) Sum of the quarters may not equal the total year due to rounding.

Index to Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

The management of Orrstown Financial Services, Inc., together with its consolidated subsidiaries (the "Company"), has the responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Management maintains a comprehensive system of internal control to provide reasonable assurance of the proper authorization of transactions, the safeguarding of assets and the reliability of the financial records. The system of internal control provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees. The Company maintains an internal auditing program, under the supervision of the Audit Committee of the Board of Directors, which independently assesses the effectiveness of the system of internal control and recommends possible improvements.

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its internal control over financial reporting at December 31, 2022, using the *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon this evaluation, management has concluded that, at December 31, 2022, the Company's internal control over financial reporting is effective based on the criteria established in *Internal Control-Integrated Framework (2013)*.

Crowe LLP has audited the effectiveness of the Company's internal control over financial reporting as of December 31, 2022, as stated in their report dated March 16, 2023.

/s/ Thomas R. Quinn, Jr.	/s/ Neelesh Kalani
Thomas R. Quinn, Jr. President and Chief Executive Officer	Neelesh Kalani Executive Vice President and Chief Financial Officer

March 16, 2023

Crowe LLP
Independent Member Crowe Global

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors of Orrstown Financial Services, Inc.
Shippensburg, Pennsylvania

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Orrstown Financial Services, Inc. (the "Company") as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2022, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2022, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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, 2022 and 2021, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2022 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. 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 audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements 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 audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Critical Audit Matter

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 our especially challenging, subjective, or complex judgments. The communication of the critical audit matter 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 a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Loan Losses – Adjustments for Qualitative Factors

As more fully described in Note 1 and Note 3 to the consolidated financial statements, the Company estimates and records an allowance for loan losses for loans collectively evaluated for impairment by developing a loss rate based on historical losses and qualitative factors. Qualitative factors are used to adjust historical loss rates considering relevant factors such as nature and volume of loans; concentrations of credit and changes within credit concentrations; underwriting standards and recovery practices; delinquency trends; classified loan trends; experience, ability and depth of management/lending staff; quality of loan review; and national and local economic conditions. The application of the adjustments for qualitative factors to the historical loss rate calculation is subjective.

The principal considerations for our determination that auditing the adjustments for qualitative factors is a critical audit matter is the high degree of judgment involved in the assessment of the risk of loss associated with each risk factor. Our audit procedures included both control and substantive testing related to the adjustments for qualitative factors. Procedures included, among others:

- Testing the following controls:
    - Management's review of the accuracy of data inputs used to adjust historical loss rates.
    - Management's review of the appropriateness and adequacy of the adjustments to the historical loss rates.

  - ◦ Management’s approval of the conclusions reached over the allowance for loan losses for loans collectively evaluated for impairment.
- Substantive tests included:
  - ◦ Data inputs used to adjust historical loss rates were agreed to source documentation.
  - ◦ The adjustments to historical loss rates were evaluated for reasonableness and appropriateness including both directional consistency and the magnitude of the adjustments.
  - ◦ Analytical procedures were performed to evaluate changes that occurred in the allowance for loan losses for loans collectively evaluated for impairment.

/s/ Crowe LLP

We have served as the Company's auditor since 2014.

Washington, D.C.

March 16, 2023

Consolidated Balance Sheets
ORRSTOWN FINANCIAL SERVICES, INC.

(Dollars in thousands, except per share amounts)	December 31, 2022	2021
Assets		
Cash and due from banks	**$ 28,477**	$ 21,217
Interest-bearing deposits with banks	**32,346**	187,493
Cash and cash equivalents	**60,823**	208,710
Restricted investments in bank stocks	**10,642**	7,252
Securities available-for-sale (amortized cost of $563,278 and $466,806 at December 31, 2022 and 2021, respectively)	**513,728**	472,438
Loans held for sale, at fair value	**10,880**	8,868
Loans	**2,151,232**	1,979,986
Less: Allowance for loan losses	**(25,178)**	(21,180)
Net loans	**2,126,054**	1,958,806
Premises and equipment, net	**29,328**	34,045
Cash surrender value of life insurance	**71,760**	70,217
Goodwill	**18,724**	18,724
Other intangible assets, net	**3,078**	4,183
Accrued interest receivable	**11,027**	8,234
Deferred tax asset, net	**24,031**	11,648
Other assets	**42,333**	31,440
Total assets	**$ 2,922,408**	$ 2,834,565
Liabilities		
Deposits:		
Noninterest-bearing	**$ 494,131**	$ 553,238
Interest-bearing	**1,950,807**	1,911,691
Deposits held for assumption in connection with sale of bank branch	**31,307**	—
Total deposits	**2,476,246**	2,464,929
Securities sold under agreements to repurchase	**17,251**	23,301
FHLB advances and other	**106,139**	1,896
Subordinated notes	**32,026**	31,963
Other liabilities	**61,850**	40,820
Total liabilities	**2,693,512**	2,562,909
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, $1.25 par value per share; 500,000 shares authorized; no shares issued or outstanding	—	—
Common stock, no par value—$0.05205 stated value per share 50,000,000 shares authorized; 11,229,242 shares issued and 10,671,413 outstanding at December 31, 2022; 11,258,167 shares issued and 11,183,050 outstanding at December 31, 2021	**584**	586
Additional paid—in capital	**189,264**	189,689
Retained earnings	**92,473**	78,700
Accumulated other comprehensive (loss) income	**(39,913)**	4,449
Treasury stock— 557,829 and 75,117 shares, at cost, at December 31, 2022 and 2021, respectively	**(13,512)**	(1,768)
Total shareholders' equity	**228,896**	271,656
Total liabilities and shareholders' equity	**$ 2,922,408**	$ 2,834,565

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Income
ORRSTOWN FINANCIAL SERVICES, INC.

(Dollars in thousands, except per share amounts)	Years Ended December 31, 2022	2021	2020
Interest income			
Loans	**$ 93,528**	$ 84,227	$ 87,492
Investment securities - taxable	**10,237**	6,622	10,458
Investment securities - tax-exempt	**4,115**	2,493	1,566
Short term investments	**774**	353	115
Total interest income	**108,654**	93,695	99,631
Interest expense			
Deposits	**6,337**	4,199	12,009
Securities sold under agreements to repurchase	**44**	31	85
FHLB advances and other borrowings	**630**	482	1,924
Subordinated notes	**2,013**	2,009	2,006
Total interest expense	**9,024**	6,721	16,024
Net interest income	**99,630**	86,974	83,607
Provision for loan losses	**4,160**	1,090	5,325
Net interest income after provision for loan losses	**95,470**	85,884	78,282
Noninterest income			
Service charges on deposit accounts	**3,826**	3,047	2,874
Interchange income	**4,055**	4,129	3,423
Other service charges and fees	**788**	646	683
Swap fee income	**2,632**	293	847
Trust and investment management income	**7,631**	7,896	6,912
Brokerage income	**3,620**	3,571	2,821
Mortgage banking activities	**407**	5,909	5,274
Gain on sale of portfolio loans	**—**	—	2,803
Income from life insurance	**2,339**	2,273	2,261
Investment securities (losses) gains	**(160)**	638	(16)
Other income	**1,814**	750	427
Total noninterest income	**26,952**	29,152	28,309
Noninterest expenses			
Salaries and employee benefits	**48,004**	44,002	43,350
Occupancy	**4,729**	4,731	4,760
Furniture and equipment	**5,083**	5,115	4,756
Data processing	**4,560**	4,061	3,574
Automated teller and interchange fees	**1,287**	1,202	1,057
Advertising and bank promotions	**2,264**	2,178	1,660
FDIC insurance	**1,083**	816	686
Professional services	**3,254**	2,555	3,120
Directors' compensation	**938**	865	921
Taxes other than income	**1,391**	1,321	1,144
Intangible asset amortization	**1,105**	1,275	1,569
Provision for legal settlement	**13,000**	—	—
Restructuring expenses	**3,155**	—	1,310
Insurance claim recovery	**—**	—	(486)
Other operating expenses	**5,953**	6,020	6,659
Total noninterest expenses	**95,806**	74,141	74,080
Income before income tax expense	**26,616**	40,895	32,511
Income tax expense	**4,579**	8,014	6,048
Net income	**$ 22,037**	$ 32,881	$ 26,463
Per share information:			
Basic earnings per share	**$ 2.09**	$ 3.00	$ 2.42
Diluted earnings per share	**2.06**	2.96	2.40
Dividends paid per share	**0.76**	0.74	0.68

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Comprehensive (Loss) Income
ORRSTOWN FINANCIAL SERVICES, INC.

(Dollars in thousands)	Years Ended December 31, 2022	2021	2020
Net income	**$ 22,037**	$ 32,881	$ 26,463
Other comprehensive (loss) income, net of tax:			
Unrealized (losses) gains on securities available-for-sale arising during the period	**(55,342)**	804	6,057
Reclassification adjustment for losses (gains) realized in net income	**160**	(638)	16
Net unrealized (losses) gains on securities available-for-sale	**(55,182)**	166	6,073
Tax effect	**11,588**	(35)	(1,275)
Total other comprehensive (loss) income, net of tax and reclassification adjustments on securities available-for-sale	**(43,594)**	131	4,798
Unrealized (losses) gains on interest rate swaps used in cash flow hedges	**(972)**	473	(1,347)
Reclassification adjustment for losses realized in net income	**—**	757	117
Net unrealized (losses) gains on interest rate swaps used in cash flow hedges	**(972)**	1,230	(1,230)
Tax effect	**204**	(258)	258
Total other comprehensive (loss) gain, net of tax and reclassification adjustments on interest rate swaps used in cash flow hedges	**(768)**	972	(972)
Total other comprehensive (loss) income, net of tax and reclassification adjustments	**(44,362)**	1,103	3,826
Total comprehensive (loss) income	**$ (22,325)**	$ 33,984	$ 30,289

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Changes in Shareholders' Equity
ORRSTOWN FINANCIAL SERVICES, INC.

	Years Ended December 31, 2022, 2021 and 2020					
(Dollars in thousands, except per share amounts)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total Shareholders' Equity
Balance, January 1, 2020	$ 584	$ 188,365	$ 35,246	$ (480)	$ (466)	$ 223,249
Net income	—	—	26,463	—	—	26,463
Total other comprehensive income, net of taxes	—	—	—	3,826	—	3,826
Cash dividends ($0.68 per share)	—	—	(7,610)	—	—	(7,610)
Share-based compensation plans:						
36,442 net common shares issued and 34,999 net treasury shares acquired, including compensation expense totaling $2,092	2	701	—	—	(382)	321
Balance, December 31, 2020	586	189,066	54,099	3,346	(848)	246,249
Net income	—	—	32,881	—	—	32,881
Total other comprehensive income, net of taxes	—	—	—	1,103	—	1,103
Cash dividends ($0.74 per share)	—	—	(8,280)	—	—	(8,280)
Share-based compensation plans:						
1,121 net common shares issued and 19,388 net treasury shares acquired, including compensation expense totaling $1,949	—	623	—	—	(920)	(297)
Balance, December 31, 2021	**586**	**189,689**	**78,700**	**4,449**	**(1,768)**	**271,656**
Net income	**—**	**—**	**22,037**	**—**	**—**	**22,037**
Total other comprehensive loss, net of taxes	**—**	**—**	**—**	**(44,362)**	**—**	**(44,362)**
Cash dividends ($0.76 per share)	**—**	**—**	**(8,264)**	**—**	**—**	**(8,264)**
Share-based compensation plans:						
28,925 net common shares acquired and 482,712 net treasury shares acquired, including compensation expense totaling $2,154	**(2)**	**(425)**	**—**	**—**	**(11,744)**	**(12,171)**
Balance, December 31, 2022	**$ 584**	**$ 189,264**	**$ 92,473**	**$ (39,913)**	**$ (13,512)**	**$ 228,896**

The Notes to Consolidated Financial Statements are an integral part of these statements.

Consolidated Statements of Cash Flows
ORRSTOWN FINANCIAL SERVICES, INC.

	Years Ended December 31,		
(Dollars in thousands)	2022	2021	2020
Cash flows from operating activities			
Net income	**$ 22,037**	$ 32,881	$ 26,463
Adjustments to reconcile net income to net cash provided by operating activities:			
Net premium amortization (discount accretion)	**1,893**	(436)	(4,481)
Depreciation and amortization expense	**4,620**	5,305	6,573
Impairment of intangibles	**—**	—	153
Provision for loan losses	**4,160**	1,090	5,325
Share-based compensation	**2,154**	1,949	2,092
Gains on sales of loans originated for sale	**(1,283)**	(5,222)	(5,631)
Fair value adjustment on loans held for sale	**1,373**	255	(436)
Mortgage loans originated for sale	**(82,708)**	(197,167)	(207,051)
Proceeds from sales of loans originated for sale	**77,291**	204,102	208,987
Gains on sale of portfolio loans	**(306)**	—	(2,803)
Net (gain) loss on disposal of OREO and premises held for sale	**—**	(327)	152
Writedown of premises held for sale	**1,297**	—	544
Net loss on disposal of premises and equipment	**530**	22	2
Deferred income tax (benefit) expense	**(591)**	942	(1,973)
Investment securities losses (gains)	**160**	(638)	16
Provision for legal settlement	**13,000**	—	—
Payment of legal settlement	**(13,000)**	—	—
Return on investments in limited partnerships	**(976)**	—	—
Loss (gain) on derivative terminations	**—**	514	(226)
Income from life insurance	**(2,339)**	(2,273)	(2,261)
(Increase) decrease in accrued interest receivable	**(2,793)**	693	(2,887)
Increase in other liabilities	**20,492**	1,167	953
Other, net	**(8,819)**	(2,046)	6,660
Net cash provided by operating activities	**36,192**	40,811	30,171
Cash flows from investing activities			
Proceeds from sales of AFS securities	**31,330**	149,038	—
Maturities, repayments and calls of AFS securities	**50,105**	39,082	56,239
Purchases of AFS securities	**(181,529)**	(195,049)	(26,691)
Net (purchases) redemptions of restricted investments in bank stocks	**(3,390)**	3,311	5,621
Net distributions from investments in limited partnerships	**1,410**	—	—
Net (increase) decrease in loans	**(172,607)**	1,396	(349,947)
Proceeds from sales of portfolio loans	**4,443**	385	22,665
Purchases of bank premises and equipment	**(895)**	(1,254)	(1,303)
Proceeds from disposal of OREO and premises held for sale	**—**	1,078	4,096
Purchases of bank owned life insurance	**—**	—	(3,636)
Death benefit proceeds from life insurance contracts	**142**	—	391
Net cash used in investing activities	**(270,991)**	(2,013)	(292,565)

(continued)

(Dollars in thousands)	Years Ended December 31, 2022	2021	2020
Cash flows from financing activities			
Net increase in deposits	**11,307**	108,020	481,277
Net increase (decrease) in borrowings with original maturities less than 90 days	**98,634**	3,835	(135,402)
Proceeds from FHLB advances and other borrowings	**—**	—	126,599
Payments on FHLB advances and other borrowings	**(441)**	(56,149)	(131,622)
Settlement of terminated derivatives	**—**	(525)	218
Dividends paid	**(8,264)**	(8,280)	(7,610)
Acquisition of treasury stock	**(14,172)**	(1,869)	(1,170)
Shares repurchased as treasury stock for employee taxes associated with restricted stock vesting	**(285)**	(514)	(717)
Proceeds from issuance of employee stock purchase plan shares	**133**	136	116
Net cash provided by financing activities	**86,912**	44,654	331,689
Net (decrease) increase in cash and cash equivalents	**(147,887)**	83,452	69,295
Cash and cash equivalents at beginning of year	**208,710**	125,258	55,963
Cash and cash equivalents at end of year	**$ 60,823**	$ 208,710	$ 125,258
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	**$ 8,721**	$ 6,805	$ 16,665
Income taxes	**4,900**	4,400	550
Supplemental schedule of noncash investing and financing activities:			
Loans transferred from LHFS to portfolio loans	**1,510**	—	—
Premises and equipment transferred to held for sale	**2,991**	—	—
Lease liabilities arising from obtaining ROU assets	**94**	2,865	400
Deposits held for assumption in connection with sale of bank branch	**31,307**	—	—

The Notes to Consolidated Financial Statements are an integral part of these statements.

Notes to Consolidated Financial Statements

(All dollar amounts presented in the tables, except share and per share amounts, are in thousands)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

See the Glossary of Defined Terms at the beginning of this Report for terms used throughout the consolidated financial statements and related notes of this Form 10-K.

Nature of Operations – Orrstown Financial Services, Inc. is a financial holding company that operates Orrstown Bank, a commercial bank providing banking and financial advisory services in Berks, Cumberland, Dauphin, Franklin, Lancaster, Perry and York Counties, Pennsylvania, and in Anne Arundel, Baltimore, Howard and Washington Counties, Maryland. The Company operates in the community banking segment and engages in lending activities, including commercial, residential, commercial mortgages, construction, municipal, and various forms of consumer lending, and deposit services, including checking, savings, time, and money market deposits. The Company's lending area also includes adjacent counties in Pennsylvania and Maryland, as well as Loudon County, Virginia and Berkeley, Jefferson and Morgan Counties, West Virginia. The Company also provides fiduciary services, investment advisory, insurance and brokerage services. Effective July 31, 2020, Wheatland Advisors, Inc., a registered investment advisor non-bank subsidiary, headquartered in Lancaster County, Pennsylvania was discontinued. The Company and the Bank are subject to regulation by certain federal and state agencies and undergo periodic examinations by such regulatory authorities.

Basis of Presentation – The accompanying consolidated financial statements include the accounts of Orrstown Financial Services, Inc. and its wholly owned subsidiary, the Bank. The accounting and reporting policies of the Company conform to GAAP and, where applicable, to accounting and reporting guidelines prescribed by bank regulatory authorities. All significant intercompany transactions and accounts have been eliminated. Certain reclassifications have been made to prior year amounts to conform with current year classifications. These reclassifications did not have a material impact on the Company's consolidated financial condition or results of operations.

The Company's management has evaluated all activity of the Company and concluded that subsequent events are properly reflected in the Company's consolidated financial statements and notes as required by GAAP.

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Concentration of Credit Risk – The Company grants commercial, residential, construction, municipal, and various forms of consumer lending to clients primarily in its market area in south central Pennsylvania and in the greater Baltimore region and Washington County, Maryland, in addition to adjacent counties in Pennsylvania and Maryland, as well as Loudon County, Virginia and Berkeley, Jefferson and Morgan Counties, West Virginia. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in those areas. Although the Company maintains a diversified loan portfolio, a significant portion of its clients' ability to honor their contracts is dependent upon economic sectors for commercial real estate, including office space, retail strip centers, sales finance, sub-dividers and developers, and multi-family, hospitality, and residential building operators. Management evaluates each clients' creditworthiness on a case-by-case basis. The amount of collateral obtained upon the extension of credit is based on management's credit evaluation of the client. Types of collateral held varies, but generally include real estate and equipment.

The types of securities the Company invests in are included in Note 2, Investment Securities, and the types of lending the Company engages in are included in Note 3, Loans and Allowance for Loan Losses.

Cash and Cash Equivalents – Cash and cash equivalents include cash, balances due from banks, federal funds sold and interest-bearing deposits due on demand, all of which have original maturities of 90 days or less. Net cash flows are reported for client loan and deposit transactions, loans held for sale, redemption (purchases) of restricted investments in bank stocks, and short-term borrowings.

Under the FRB regulations, the Bank generally had been required to maintain cash reserves against specified deposit liabilities. The FRB issued a final rule on December 22, 2020 that amended Regulation D by lowering the reserve requirement on all net transaction accounts maintained at depository institutions to 0%. Effective January 1, 2023, the FRB will establish the new reserve requirement exemption amount and low reserve tranche for 2023, but will not elevate the current reserve percentage of zero for depository institutions.

Balances with correspondent banks may, at times, exceed federally insured limits. The Company considers this to be a normal business risk and reviews the financial condition of its correspondent banks on a quarterly basis.

Restricted Investments in Bank Stocks – Restricted investments in bank stocks consist of Federal Reserve Bank of Philadelphia stock, FHLB of Pittsburgh stock and Atlantic Community Bankers Bank stock. Federal law requires a member institution of the district Federal Reserve Bank and FHLB to hold stock according to predetermined formulas. Atlantic Community Bankers Bank requires its correspondent banking institutions to hold stock as a condition of membership. The restricted investment in bank stocks is carried at cost. On a quarterly basis, management evaluates the bank stocks for impairment based on assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as operating performance, liquidity, funding and capital positions, stock repurchase history, dividend history, and impact of legislative and regulatory changes.

Investment Securities – The Company typically classifies debt securities as available-for-sale ("AFS") on the date of purchase. At December 31, 2022 and 2021, the Company had no held to maturity or trading securities. AFS securities are reported at fair value. Interest income and dividends on debt securities are recognized in interest income on an accrual basis. Purchase premiums and discounts on debt securities are amortized to interest income using the interest method over the terms of the investment securities and approximate the level yield method.

Changes in unrealized gains and losses, net of related deferred taxes, for AFS securities are recorded in AOCI. Realized gains and losses on securities are recorded on the trade date using the specific identification method and are included in noninterest income on the consolidated statements of income.

AFS securities include investments that management intends to use as part of its asset/liability management strategy. Investment securities may be sold in response to changes in interest rates, changes in prepayment rates and other factors. The Company does not have the intent to sell any of its AFS securities that are in an unrealized loss position and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost.

Management evaluates securities for OTTI on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as an impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components: OTTI related to other factors, which is recognized in OCI, and the remaining OTTI, which is recognized in earnings. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

The Company's securities are exposed to various risks, such as interest rate risk, market risk, and credit risk. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment securities reported in the consolidated financial statements.

Loans Held for Sale – The Company has elected to record the mortgage loans held for sale portfolio at fair market value as opposed to the lower of cost or market. The Company economically hedges its residential loans held for sale portfolio with forward sale agreements, which are reported at fair value. A lower of cost or market accounting treatment would not allow the Company to record the excess of the fair market value over book value, but would require the Company to record the corresponding reduction in value on the hedges. Both the loans and related hedges are carried at fair value, which reduces earnings volatility as the amounts more closely offset, particularly in environments when interest rates are declining. For loans held for sale for which the fair value option has been elected, the aggregate fair value was less than the aggregate principal balance by $1.2 million and $150 thousand as of December 31, 2022 and 2021, respectively. There were no loans held for sale that were nonaccrual or 90 or more days past due as of December 31, 2022 and 2021. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income. Interest income on these loans is recognized in interest and fees on loans in the consolidated statements of income.

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances adjusted for charge-offs, the ALL, and any corresponding deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and amortized as a yield adjustment over the respective term of the loan using the interest method. For SBA PPP loans, the loan origination fees, net of certain direct origination costs, are deferred and accreted into interest income as a yield adjustment under the effective yield method over the estimated life of the PPP loans, with any unamortized net fees being recognized as interest income at the time of forgiveness. For purchased loans that are not deemed impaired at the acquisition date, premiums and discounts are amortized or accreted as adjustments to interest income using the effective yield method.

For all classes of loans, the accrual of interest income on loans, including impaired loans, ceases when principal or interest is past due 90 days or more or immediately if, in the opinion of management, full collection is unlikely. Interest will continue to accrue on loans past due 90 days or more if the collateral is adequate to cover principal and interest, and the loan is in the process of collection. Interest accrued, but not collected, at the date of placement on nonaccrual status, is reversed and charged against interest income, unless fully collateralized. Subsequent payments received are either applied to the outstanding principal balance or recorded as interest income, depending upon management's assessment of the ultimate collectability of principal. Loans are returned to accrual status, for all loan classes, when all the principal and interest amounts contractually due are brought current, the loan has performed in accordance with the contractual terms of the note for a reasonable period of time, generally six months, and the ultimate collectability of the total contractual principal and interest is reasonably assured. Past due status is based on the contractual terms of the loan.

Loans, the terms of which are modified, are classified as TDRs if a concession was granted in connection with the modification, for legal or economic reasons, related to the debtor's financial difficulties. Concessions granted under a TDR typically involve a temporary deferral of scheduled loan payments, an extension of a loans' stated maturity date, a temporary reduction in interest rates, or granting of an interest rate below market rates given the risk of the transaction. If a modification occurs while the loan is on accrual status, it will continue to accrue interest under the modified terms. Nonaccrual TDRs may be restored to accrual status if scheduled principal and interest payments, under the modified terms, are current for six months after modification, and the borrower continues to demonstrate its ability to meet the modified terms. TDRs are evaluated individually for impairment on a quarterly basis including monitoring of performance according to their modified terms.

In an effort to assist clients that were negatively impacted by the COVID-19 pandemic, the Bank offered various mitigation options, including a loan payment deferral program. Under this program, most commercial deferrals were for a 90-day period, while most consumer deferrals were for a 180-day period. In accordance with the revised *Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronaviru*s issued by the federal bank regulatory agencies on April 7, 2020, these deferrals are exempt from TDR status as they meet the specified requirements. As of December 31, 2021, the Company had a consumer loan under this deferral program of $56 thousand for which the deferral period subsequently expired in 2022. There were no loans under this deferral program as of December 31, 2022.

Allowance for Loan Losses – The ALL is evaluated on at least a quarterly basis, as losses are estimated to be probable and incurred, and, if deemed necessary, is increased or decreased through the provision for loan losses on the consolidated statements of income. Loan losses are charged against the ALL when management determines that all or a portion of the loan is uncollectible. Recoveries on previously charged-off loans are credited to the ALL when received. The ALL is allocated to loan portfolio classes on a quarterly basis, but the entire balance is available to cover losses from any of the portfolio classes when those losses are confirmed.

Management uses internal policies and bank regulatory guidance in periodically evaluating loans for collectability and incorporates historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

See Note 3, Loans and Allowance for Loan Losses, for additional information.

Acquired Loans - Loans acquired in connection with business combinations are recorded at fair value with no carryover of any allowance for loan losses. Fair value of the loans involves estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest.

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. These loans are accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"). The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases in expected cash flows will require us to evaluate the need for an addition to the allowance for loan losses. Subsequent improvement in expected cash flows will result in the reversal of a corresponding amount of the nonaccretable discount, which we will then reclassify as accretable discount to be recognized into interest income over the remaining life of the loan.

Loans acquired through business combinations that do meet the specific criteria of ASC 310-30 are individually evaluated each period to analyze expected cash flows. To the extent that the expected cash flows of a loan have decreased due to credit deterioration, the Company establishes an allowance.

Loans acquired through business combinations that do not meet the specific criteria of ASC 310-30 are accounted for under ASC 310-20, Receivables - Nonrefundable Fees and Other Costs. These loans are initially recorded at fair value, and include credit and interest rate marks associated with acquisition accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these loans subsequent to acquisition.

Acquired loans that meet the criteria for impairment or nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the client is contractually delinquent if the Company expects to fully collect the new carrying value (i.e., fair value) of the loans. As such, the Company may no longer consider the loan to be nonperforming and may accrue interest on these loans, including the impact of any accretable discount. In addition, charge-offs on such loans would be first applied to the nonaccretable difference portion of the fair value adjustment.

Loan Commitments and Related Financial Instruments – Financial instruments include off-balance sheet credit commitments issued to meet client financing needs, such as commitments to make loans and commercial letters of credit. These financial instruments are recorded when they are funded. The face amount represents the exposure to loss, before considering client collateral or ability to repay. The Company maintains a reserve for probable losses on off-balance sheet commitments, which is included in other liabilities on the consolidated balance sheets.

Loans Serviced – The Bank administers secondary market mortgage programs available through the FHLB and the Federal National Mortgage Association ("FNMA") and offers residential mortgage products and services to clients. The Bank originates single-family residential mortgage loans for sale in the secondary market and retains the servicing of those loans. At December 31, 2022 and 2021, the balance of loans serviced for others totaled $495.0 million and $502.5 million, respectively.

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

Cash Surrender Value of Life Insurance – The Company has purchased life insurance policies on certain employees. Life insurance is recorded at the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Derivatives - FASB ASC 815, *Derivatives and Hedging* (“ASC 815”), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company’s objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments.

As required by ASC 815, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge.

The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting. The Company's objectives in using interest rate derivatives are to add stability to interest income and to manage its exposure to interest rate movements. To accomplish this objective, the Company uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of fixed amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the agreements without exchange of the underlying notional amount.

Changes to the fair value of derivatives designated and that qualify as cash flow hedges are recorded in AOCI and are subsequently reclassified into earnings in the period that the hedged transaction affects earnings. The Company discontinues cash flow hedge accounting if it is probable the forecasted hedged transactions will not occur in the initially identified time period due to circumstances, such as the impact of the COVID-19 pandemic. Upon discontinuance, the associated gains and losses deferred in AOCI are reclassified immediately into earnings and subsequent changes in the fair value of the cash flow hedge are recognized in earnings. During 2022, the Company entered into two interest rate swaps designated as hedging instruments with a total notional value of $100.0 million for the purpose of hedging the variable cash flows of selected AFS securities or loans. The Company had no interest rate swaps designated as a hedging instrument at December 31, 2021.

Derivatives not designated as hedges are not speculative and result from a service the Company provides to certain customers. The Company executes interest rate swaps and interest rate caps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps and interest rate caps are simultaneously hedged by offsetting derivatives that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate derivatives associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer derivatives and the offsetting derivatives are recognized directly in earnings. At December 31, 2022 and 2021, the Company had interest rate swaps and interest rate caps not designated as hedges with total notional value of $268.8 million and $75.8 million, respectively.

The Company also may enter into risk participation agreements with a financial institution counterparty for an interest rate derivative contract related to a loan in which the Company may be a participant or the agent bank. The risk participation agreement provides credit protection to the agent bank should the borrower fail to perform on its interest rate derivative contracts with the agent bank. The Company manages its credit risk on risk participation agreements by monitoring the creditworthiness of the borrower, which follows the same credit review process as derivative instruments entered into directly with the borrower. The notional amount of a risk participation agreement reflects the Company's pro-rata share of the derivative instrument, consistent with its share of the related participated loan. Changes in the fair value of the risk participation agreement are recognized directly into earnings. At December 31, 2022 and 2021, the Company had a risk participation with sold protection with a notional value of $29.0 million and $15.9 million, respectively, and a risk participation with purchased protection with a notional value of $4.9 million and zero at December 31, 2022 and 2021, respectively.

As a part of its normal residential mortgage operations, the Company will enter into an interest rate lock commitment with a potential borrower. The Company may enter into a corresponding commitment with an investor to sell that loan at a specific price shortly after origination. In accordance with FASB ASC 820, adjustments are recorded through earnings to account for the net change in fair value of these held for sale loans. The fair value of held for sale loans can vary based on the interest rate locked with the customer and the current market interest rate at the balance sheet date. At December 31, 2022 and 2021, the Company had interest rate lock commitments with a notional value of $1.4 million and $16.6 million, respectively, and forward sale loan commitments with a notional value of $3.5 million and $8.7 million, respectively.

Premises and Equipment – Buildings, improvements, equipment, and furniture and fixtures are carried at cost less accumulated depreciation and amortization. Land is carried at cost. Depreciation and amortization has been recognized generally on the straight-line method and is computed over the estimated useful lives of the various assets as follows: buildings and improvements, including leasehold improvements – 10 to 40 years; and furniture and equipment – 3 to 15 years. Leasehold improvements are amortized over the shorter of the lease term or the indicated life. Repairs and maintenance are charged to operations as incurred, while additions and improvements are typically capitalized. Gains or losses on the retirement or disposal of individual assets is recorded as income or expense in the period of retirement or disposal. Premises no longer in use and held for sale are included in other assets on the consolidated balance sheets at the lower of carrying value or fair value and no depreciation is charged on them. At December 31, 2022 and 2021, premises held for sale totaled $2.0 million and $321 thousand, respectively.

Leases - The Company evaluates its contracts at inception to determine if an arrangement either is a lease or contains one. Operating lease ROU assets are included in other assets and operating lease liabilities in accrued interest payable and other liabilities in the consolidated balance sheets. The Company had no finance leases at December 31, 2022.

ROU assets represent the right to use an underlying asset for the lease term, and lease liabilities represent an obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Company's leases do not provide an implicit rate, so the Company's incremental borrowing rate is used, which approximates its fully collateralized borrowing rate, based on the information available at commencement date in determining the present value of lease payments. The incremental borrowing rate is reevaluated upon lease modification. The operating lease ROU asset also includes any initial direct costs and prepaid lease payments made less any lease incentives. In calculating the present value of lease payments, the Company may include options to extend the lease when it is reasonably certain that it will exercise that option.

In accordance with ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), the Company keeps leases with an initial term of 12 months or less off of the balance sheet. The Company recognizes these lease payments in the consolidated statements of income on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components and has elected the practical expedient to account for them as a single lease component.

The Company's operating leases relate primarily to bank branches and office space. The difference between the lease assets and lease liabilities primarily consists of deferred rent liabilities to reduce the measurement of the lease assets.

Goodwill and Other Intangible Assets – Goodwill is calculated as the purchase premium, if any, after adjusting for the fair value of net assets acquired in purchase transactions. Goodwill is not amortized, but is reviewed for potential impairment on at least an annual basis, with testing between annual tests if an event occurs or circumstances change that could potentially reduce the fair value of a reporting unit. Other intangible assets represent purchased assets that can be distinguished from goodwill because of contractual or other legal rights. The Company's other intangible assets have finite lives and are amortized on either an accelerated amortization method or straight-line basis over their estimated lives, generally 10 years for deposit premiums and 10 to 15 years for other client relationship intangibles.

Mortgage Servicing Rights – The estimated fair value of MSRs related to loans sold and serviced by the Company is recorded as an asset upon the sale of such loans. MSRs are amortized as a reduction to servicing income over the estimated lives of the underlying loans. MSRs are evaluated periodically for impairment by comparing the carrying amount to estimated fair value. Fair value is determined periodically through a discounted cash flow valuation performed by a third party. Significant inputs to the valuation include expected servicing income, net of expense, the discount rate and the expected life of the underlying loans. To the extent the amortized cost of the MSRs exceeds their estimated fair values, a valuation allowance is established for such impairment through a charge against servicing income on the consolidated statements of income. If the Company determines, based on subsequent valuations, that the impairment no longer exists or is reduced, the valuation allowance is reduced through a credit to earnings. MSRs, net of the valuation allowance, totaled $4.0 million at both December 31, 2022 and December 31, 2021, and are included in other assets on the consolidated balance sheets.

Foreclosed Real Estate – Real estate acquired through foreclosure or other means is initially recorded at the fair value of the related real estate collateral at the transfer date less estimated selling costs, and subsequently at the lower of its carrying value or fair value less estimated costs to sell. Fair value is determined based on an independent third party appraisal of the property or, when appropriate, a recent sales offer. Costs to maintain such real estate are expensed as incurred. Costs that significantly improve the value of the properties are capitalized. The Company had no real estate acquired through foreclosure or other means at December 31, 2022 and 2021.

Investments in Real Estate Partnerships – The Company has a 99% limited partnership interest in several real estate partnerships in central Pennsylvania. These investments are affordable housing projects, which entitle the Company to tax deductions and credits that expire through 2025. The Company accounts for its investments in affordable housing projects under the proportional amortization method when the criteria are met, which is limited to one investment at December 31, 2022. There are five other investments accounted for under the equity method of accounting. The investment in these real estate partnerships, included in other assets on the consolidated balance sheets, totaled $2.1 million and $2.6 million at December 31, 2022 and 2021, respectively, of which $707 thousand and $921 thousand are accounted for under the proportional amortization method.

Equity method losses totaled $274 thousand, $272 thousand and $299 thousand for the years ended December 31, 2022, 2021 and 2020, respectively, and are included in other noninterest income on the consolidated statements of income. Proportional amortization method losses totaled $214 thousand for the years ended December 31, 2022, 2021 and 2020, and are included in income tax expense on the consolidated statements of income. During 2022, 2021 and 2020, the Company recognized federal tax credits from these projects totaling $260 thousand, $315 thousand and $460 thousand, respectively, which are included in income tax expense on the consolidated statements of income.

Advertising – The Company expenses advertising as incurred. Advertising expense totaled $482 thousand, $677 thousand and $392 thousand for the years ended December 31, 2022, 2021 and 2020, respectively.

Repurchase Agreements – The Company may enter into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities which are included in short-term borrowings on the consolidated balance sheets. Under these agreements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability on the Company's consolidated balance sheets, while the securities underlying the repurchase agreements remaining are reflected in AFS securities. The repurchase obligation and underlying securities are not offset or netted as the Company does not enter into reverse repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fail to make an interest payment to the counterparty). For the repurchase agreements, the collateral is held by the Company in a segregated custodial account under a third party agreement. Repurchase agreements are secured by U.S. government or government-sponsored debt securities and mature overnight.

Stock Compensation Plans – The Company has stock compensation plans that cover employees and non-employee directors. Compensation expense relating to share-based payment transactions is measured based on the grant date fair value of the share award, including a Black-Scholes model for stock options. Compensation expense for all stock awards is calculated and recognized over the employees' or non-employee directors' service period, generally defined as the vesting period. There were no outstanding and exercisable stock options at December 31, 2022 and 2021.

Income Taxes – Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of enacted tax law to taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance when, based on the weight of available evidence, it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company recognizes interest and penalties, if any, on income taxes as a component of income tax expense.

The Company may earn federal tax credits from its investments in real estate and solar tax equity partnerships. The Company accounts for its investments in affordable housing projects under the proportional amortization method when the criteria are met and under the deferral method of accounting for its solar tax equity investments.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Treasury Stock – Common stock shares repurchased are recorded as treasury stock, at cost on the consolidated balance sheets, on a settlement date basis.

Earnings Per Share – Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Restricted stock awards are included in weighted average common shares outstanding as they are earned. Diluted earnings per share includes additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate solely to outstanding stock options and restricted stock awards and are determined using the treasury stock method. Treasury shares are not deemed outstanding for earnings per share calculations. There were no outstanding and exercisable stock options at December 31, 2022 and 2021.

Comprehensive Income – Comprehensive income consists of net income and OCI. Unrealized gains (losses) on AFS securities and interest rate swaps used in cash flow hedges, net of tax, were the components of AOCI at December 31, 2022 and 2021. The Company had no interest rate swaps designated as a hedging instrument at December 31, 2021.

Fair Value – Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in the Note 19 to the consolidated financial statements. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Segment Reporting – The Company operates in one segment – Community Banking. The Company's non-community banking activities are insignificant to the consolidated financial statements.

Recent Accounting Pronouncements - *ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (*"ASU 2016-13"*).* The amendments in this update require an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today are still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the amendments in this update amend the accounting for credit losses on AFS debt securities and purchased financial assets with credit deterioration. For certain public companies, this update was effective for interim and annual periods beginning after December 15, 2019. The implementation deadline of ASU 2016-13 was extended for smaller reporting and other companies until the fiscal year and interim periods beginning after December 15, 2022. The Company will implement ASU 2016-13 effective January 1, 2023.

ASU No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates* ("ASU 2019-10"), extended the implementation deadline of ASU 2016-13 for smaller reporting and other companies until the fiscal year and interim periods beginning after December 15, 2022. The Company meets the requirements to be considered a smaller reporting company under SEC Regulation S-K and SEC Rule 405, and will adopt ASU 2016-13 effective January 1, 2023.

To implement the new standard, the Company established a cross-discipline governance structure, which included a dedicated working group and a CECL Committee consisting of members from different functions including Finance, Credit, Risk and Lending, who will provide implementation oversight and review policy elections, key assumptions, processes, and model results. The working group is responsible for the implementation process that includes developing the loan segmentation, data sourcing and validation, loss driver inputs, qualitative factors, parallel model runs, scenario testing and back testing.

The Company is utilizing a third-party vendor to assist in the implementation process of its new model to calculate credit losses over the estimated life of the applicable financial assets. The Company elected to use the discounted cash flow (“DCF”) methodology for the quantitative analysis for the majority of its loan segments, which applies the probability of default and loss given default factors to future cash flows, and then adjusts to the net present value to derive the required reserve. Reasonable and supportable macroeconomic conditions include unemployment and gross domestic product. Model assumptions include the discount rate, prepayments and curtailments. The development and validation of credit models also included determining the length of the reasonable and supportable forecast and regression period and utilizing national peer group’s historical loss rates. In addition, the remaining life methodology was selected for the consumer loan segments as practical expediency and based on the risk characteristics.

The Company has completed parallel model runs, and continues to test and refine the credit loss models in parallel with the existing incurred loss approach. In addition, the Company is in the process of finalizing the review of the most recent model run and certain assumptions, completing policies, procedures and control enhancements, and concluding model validation by another third-party vendor. The status of the Company's implementation has been periodically presented to the Enterprise Risk Committee and Audit Committee. The Company expects to recognize a one-time cumulative-effect adjustment to the allowance for credit losses as of the January 1, 2023 date of adoption of the new standard, which is estimated to be between $2.0 million and $4.0 million. The Company will be electing the three-year phase in option of the day-one impact of this standard to regulatory capital.

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting* ("ASU 2020-04"). ASU 2020-04 contains optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The optional expedients apply consistently to all contracts or transactions within the scope of this topic, while the optional expedients for hedging relationships can be elected on an individual basis. The Company has formed a cross-functional working group to lead the transition from LIBOR to a planned adoption of an alternate index. The Company currently plans to replace LIBOR with the 30-Day Average SOFR or Term SOFR in its loan agreements. The Company implemented fallback language for loans with maturities after 2021. The Company expects to adopt the LIBOR transition relief allowed under this standard, and is currently evaluating the potential impact of this guidance on its financial statements.

In March 2022, the FASB issued *ASU No. 2022-02, Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures (“ASU 2022-02”).* ASU 2022-02 eliminates the troubled debt restructuring accounting model, and requires that the Company evaluate, based on the accounting for loan modifications, whether the modification results in a more-than-insignificant direct change in the contractual cash flows and represents a new loan or a continuation of an existing loan. This change will require all loan modifications to be accounted for under the general loan modification guidance in Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs, and subject entities to new disclosure requirements on loan modifications to borrowers experiencing financial difficulty. For entities that have adopted Topic 326, ASU 2022-02 is effective for periods beginning after December 15, 2022. For entities adopting Topic 326 in periods after December 15, 2022, A*SU 20*22-02 is effective when the company adopts Topic 326. The Company will implement ASU 2022-02 effective January 1, 2023. The adoption of ASU No. 2022-02 is not expected to have a significant impact on the Company’s consolidated financial statements.

NOTE 2. INVESTMENT SECURITIES

At December 31, 2022 and 2021, all investment securities were classified as AFS. The following table summarizes amortized cost and fair value of AFS securities, and the corresponding amounts of gross unrealized gains and losses recognized in AOCI at December 31, 2022 and 2021.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2022				
U.S. Treasury securities	**$ 20,070**	**$ —**	**$ 2,779**	**$ 17,291**
U.S. government agencies	**4,907**	**228**	**—**	**5,135**
States and political subdivisions	**225,825**	**19**	**28,430**	**197,414**
GSE residential MBSs	**63,778**	**—**	**4,376**	**59,402**
GSE residential CMOs	**75,446**	**—**	**7,068**	**68,378**
Non-agency CMOs	**42,298**	**243**	**2,783**	**39,758**
Asset-backed	**130,577**	**—**	**4,604**	**125,973**
Other	**377**	**—**	**—**	**377**
Totals	**$ 563,278**	**$ 490**	**$ 50,040**	**$ 513,728**
December 31, 2021				
U.S. Treasury securities	$ 20,084	$ —	$ 382	$ 19,702
States and political subdivisions	185,437	8,606	673	193,370
GSE residential MBSs	41,260	44	578	40,726
GSE residential CMOs	66,430	436	944	65,922
Non-agency CMOs	30,676	—	978	29,698
Asset-backed	122,520	401	300	122,621
Other	399	—	—	399
Totals	$ 466,806	$ 9,487	$ 3,855	$ 472,438

The following table summarizes investment securities with unrealized losses at December 31, 2022 and 2021, aggregated by major security type and length of time in a continuous unrealized loss position.

	Less Than 12 Months			12 Months or More			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
December 31, 2022									
U.S. Treasury securities	**—**	**$ —**	**$ —**	**3**	**$ 17,291**	**$ 2,779**	**3**	**$ 17,291**	**$ 2,779**
States and political subdivisions	**29**	**135,579**	**13,809**	**17**	**60,102**	**14,621**	**46**	**195,681**	**28,430**
GSE residential MBSs	**5**	**26,100**	**925**	**10**	**33,302**	**3,451**	**15**	**59,402**	**4,376**
GSE residential CMOs	**8**	**28,732**	**1,884**	**9**	**39,646**	**5,184**	**17**	**68,378**	**7,068**
Non-agency CMOs	**4**	**26,555**	**1,135**	**2**	**8,639**	**1,648**	**6**	**35,194**	**2,783**
Asset-backed	**17**	**78,873**	**2,432**	**5**	**47,100**	**2,172**	**22**	**125,973**	**4,604**
Totals	**63**	**$ 295,839**	**$ 20,185**	**46**	**$ 206,080**	**$ 29,855**	**109**	**$ 501,919**	**$ 50,040**
December 31, 2021									
U.S. Treasury securities	3	$ 19,702	$ 382	—	$ —	$ —	3	$ 19,702	$ 382
States and political subdivisions	12	45,522	673	—	—	—	12	45,522	673
GSE residential MBSs	9	37,899	578	—	—	—	9	37,899	578
GSE residential CMOs	7	41,163	944	—	—	—	7	41,163	944
Non-agency CMOs	3	24,661	978	—	—	—	3	24,661	978
Asset-backed	3	21,245	138	3	34,180	162	6	55,425	300
Totals	37	$ 190,192	$ 3,693	3	$ 34,180	$ 162	40	$ 224,372	$ 3,855

The Company determines whether unrealized losses are temporary in nature in accordance with FASB ASC 320-10, *Investments - Overall*, ("FASB ASC 320-10") and FASB ASC 325-40, *Investments – Beneficial Interests in Securitized Financial Assets*, when applicable. The evaluation is based upon factors such as the creditworthiness of the underlying borrowers, performance of the underlying collateral, if applicable, and the level of credit support in the security structure. Management also evaluates other factors and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost and near-term prospects of the issuer.

FASB ASC 320-10 requires the Company to assess if an OTTI exists by considering whether the Company has the intent to sell the security or it is more likely than not that it will be required to sell the security before recovery. If either of these situations applies, the guidance requires the Company to record an OTTI charge to earnings on debt securities for the difference between the amortized cost basis of the security and the fair value of the security. If neither of these situations applies, the Company is required to assess whether it is expected to recover the entire amortized cost basis of the security. If the Company is not expected to recover the entire amortized cost basis of the security, the guidance requires the Company to bifurcate the identified OTTI into a credit loss component and a component representing loss related to other factors. A discount rate is applied which equals the effective yield of the security. The difference between the present value of the expected flows and the amortized book value is considered a credit loss, which would be recorded through earnings as an OTTI charge. When a market price is not readily available, the market value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from the open market and other sources as appropriate for the security. The difference between the market value and the present value of cash flows expected to be collected is recognized in accumulated other comprehensive loss on the consolidated statements of financial condition.

At December 31, 2022, 2021 and 2020, the Company had no cumulative OTTI. During 2022, unrealized losses were substantially higher due to market uncertainty resulting from inflation and rising interest rates.

U.S. Treasury Securities. The unrealized losses presented in the table above have been caused by an increase in rates from the time these securities were purchased. Management considers the full faith and credit of the U.S. government in determining whether a security is OTTI. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell them before recovery of their amortized cost basis, which may be maturity, the Company does not consider these securities to be OTTI at December 31, 2022 and 2021.

States and Political Subdivisions. The unrealized losses presented in the table above have been caused by a widening of spreads and/or a rise in interest rates from the time these securities were purchased. Management considers the investment rating, the state of the issuer of the security and other credit support in determining whether the security is OTTI. As of December 31, 2022 and 2021, management concluded that an OTTI did not exist on any of the aforementioned securities based upon its assessment. Management also concluded that it does not intend to sell nor will it be required to sell the securities, before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of these securities.

GSE Residential CMOs and GSE Residential MBS. The unrealized losses presented in the table above have been caused by a widening of spreads and/or a rise in interest rates from the time these securities were purchased. The contractual terms of these securities do not permit the issuer to settle the securities at a price less than its par value basis. As of December 31, 2022 and 2021, management concluded that an OTTI did not exist on any of the aforementioned securities based upon its assessment. Management also concluded that it does not intend to sell nor will it be required to sell the securities, before their recovery, which may be maturity, and management expects to recover the entire amortized cost basis of these securities.

Non-agency CMOs. The unrealized losses presented in the table above were caused by a widening of spreads and a rise in interest rates from the time the securities were purchased. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell them before recovery of their amortized cost basis, which may be maturity, the Company does not consider these securities to be OTTI at December 31, 2022 and 2021. For the year ended December 31, 2022, the Company recognized a loss of $171 thousand on the call of a non-agency CMO security at a price below its par value of $14.7 million, The realized loss was included in securities gains and losses in noninterest income in the consolidated statements of income.

Asset-backed. The unrealized losses presented in the table above have been caused by a widening of spreads from the time the securities were purchased. Management considers the investment rating and other credit support in determining whether a security is other-than-temporarily impaired. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell them before recovery of their amortized cost basis, which may be maturity, the Company does not consider these securities to be OTTI at December 31, 2022 and 2021.

The following table summarizes amortized cost and fair value of investment securities by contractual maturity at December 31, 2022. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Amortized Cost	Fair Value
Due in one year or less	$ 249	$ 249
Due after one year through five years	6,403	6,043
Due after five years through ten years	83,348	72,161
Due after ten years	161,179	141,764
CMOs and MBSs	181,522	167,538
Asset-backed	130,577	125,973
	$ 563,278	$ 513,728

The following table summarizes proceeds from sales of investment securities and gross gains and gross losses for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Proceeds from sale of investment securities	$ 31,330	$ 149,038	$ —
Gross gains	35	1,847	—
Gross losses	25	1,209	16

During the year ended December 31, 2022, the Company recorded net investment security gains of $10 thousand compared to a net gain of $638 thousand for year ended December 31, 2021. A net loss of $16 thousand was recorded for year ended December 31, 2020 to adjust an equity security to market value. During 2022, the principal balance of $31.3 million of 19 securities were sold for proceeds of $31.3 million compared to 18 securities with a principal balance of $148.4 million that were sold for proceeds of $149.0 million during 2021. The Company recorded a loss of $171 thousand on the aforementioned call of a non-agency CMO for the year ended December 31, 2022. Investment securities with a fair value of $396.8 million and $295.6 million at December 31, 2022 and 2021, respectively, were pledged to secure public funds and for other purposes as required or permitted by law.

NOTE 3. LOANS AND ALLOWANCE FOR LOAN LOSSES

Consistent with ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses,* the Company's loan portfolio is grouped into segments, which are further broken down into classes to allow management to monitor the performance by the borrower and to monitor the yield on the portfolio.

The risks associated with lending activities differ among the various loan classes and are subject to the impact of changes in interest rates, market conditions of collateral securing the loans, and general economic conditions. All of these factors may adversely impact both the borrower’s ability to repay its loans and associated collateral.

The Company has various types of commercial real estate loans, which have differing levels of credit risk. Owner occupied commercial real estate loans are generally dependent upon the successful operation of the borrower’s business, with the cash flows generated from the business being the primary source of repayment of the loan. If the business suffers a downturn in sales or profitability, the borrower’s ability to repay the loan could be in jeopardy.

Non-owner occupied and multi-family commercial real estate loans and non-owner occupied residential loans present a different credit risk to the Company than owner occupied commercial real estate loans, as the repayment of the loan is dependent upon the borrower’s ability to generate a sufficient level of occupancy to produce rental income that exceeds debt service requirements and operating expenses. Lower occupancy or lease rates may result in a reduction in cash flows, which hinders the ability of the borrower to meet debt service requirements, and may result in lower collateral values. The Company generally recognizes that greater risk is inherent in these credit relationships as compared to owner occupied loans mentioned above.

Acquisition and development loans consist of 1-4 family residential construction and commercial and land development loans. The risk of loss on these loans is largely dependent on the Company’s ability to assess the property’s value at the completion of the project, which should exceed the property’s construction costs. During the construction phase, a number of factors could potentially negatively impact the collateral value, including cost overruns, delays in completing the project, competition, and real estate market conditions which may change based on the supply of similar properties in the area. In the event the collateral value at the completion of the project is not sufficient to cover the outstanding loan balance, the Company must rely upon other repayment sources, if any, including the guarantors of the project or other collateral securing the loan.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security ("CARES") Act was enacted. The CARES Act established the SBA PPP. The SBA PPP is intended to provide economic relief to small businesses nationwide adversely impacted under the COVID-19 Emergency Declaration issued on March 13, 2020. The SBA PPP, which began on April 3, 2020, provided small businesses with funds to cover up to 24 weeks of payroll costs and other expenses, including benefits. It also provides for forgiveness of up to the full principal amount of qualifying loans. In total, the Bank closed and funded almost 6,500 loans for a total gross loan amount of $699.4 million through December 31, 2021.

Commercial and industrial loans include advances to local and regional businesses for general commercial purposes and include permanent and short-term working capital, machinery and equipment financing, and may be either in the form of lines of credit or term loans. Although commercial and industrial loans may be unsecured to our highest-rated borrowers, the majority of these loans are secured by the borrower's accounts receivable, inventory and machinery and equipment. In a significant number of these loans, the collateral also includes the business real estate or the business owner's personal real estate or assets. Commercial and industrial loans present credit exposure to the Company, as they are more susceptible to risk of loss during a downturn in the economy as borrowers may have greater difficulty in meeting their debt service requirements and the value of the collateral may decline. The Company attempts to mitigate this risk through its underwriting standards, including evaluating the creditworthiness of the borrower and, to the extent available, credit ratings on the business. Additionally, monitoring of the loans through annual renewals and meetings with the borrowers are typical. However, these procedures cannot eliminate the risk of loss associated with commercial and industrial lending. At December 31, 2022 and 2021, commercial and industrial loans include $13.8 million and $189.9 million, respectively, of loans, net of deferred fees and costs, originated through the SBA PPP. At December 31, 2022, the Bank has $262 thousand of net deferred SBA PPP fees remaining to be recognized through net interest income. The timing of the recognition of these fees is dependent upon the loan forgiveness process established by the SBA. As these loans are 100% guaranteed by the SBA, there is no associated allowance for loan losses at December 31, 2022 and 2021.

Municipal loans consist of extensions of credit to municipalities and school districts within the Company's market area. These loans generally present a lower risk than commercial and industrial loans, as they are generally secured by the municipality's full taxing authority, by revenue obligations, or by its ability to raise assessments on its clients for a specific utility.

The Company originates loans to its retail clients, including fixed-rate and adjustable first lien mortgage loans with the underlying 1-4 family owner occupied residential property securing the loan. The Company's risk exposure is minimized in these types of loans through the evaluation of the creditworthiness of the borrower, including credit scores and debt-to-income ratios, and underwriting standards which limit the loan-to-value ratio to generally no more than 80% upon loan origination, unless the borrower obtains private mortgage insurance.

Home equity loans, including term loans and lines of credit, present a slightly higher risk to the Company than 1-4 family first liens, as these loans can be first or second liens on 1-4 family owner occupied residential property, but can have loan-to-value ratios of no greater than 85% of the value of the real estate taken as collateral. The creditworthiness of the borrower is considered including credit scores and debt-to-income ratios.

Installment and other loans' credit risk are mitigated through prudent underwriting standards, including evaluation of the creditworthiness of the borrower through credit scores and debt-to-income ratios and, if secured, the collateral value of the assets. These loans can be unsecured or secured by assets the value of which may depreciate quickly or may fluctuate, and may present a greater risk to the Company than 1-4 family residential loans.

The following table presents the loan portfolio by segment and class, excluding residential LHFS, at December 31, 2022 and 2021.

	2022	2021
Commercial real estate:		
Owner-occupied	**$ 315,770**	$ 238,668
Non-owner occupied	**608,043**	551,783
Multi-family	**138,832**	93,255
Non-owner occupied residential	**104,604**	106,112
Acquisition and development:		
1-4 family residential construction	**25,068**	12,279
Commercial and land development	**158,308**	93,925
Commercial and industrial [(1)]	**357,774**	485,728
Municipal	**12,173**	14,989
Residential mortgage:		
First lien	**229,849**	198,831
Home equity – term	**5,505**	6,081
Home equity – lines of credit	**183,241**	160,705
Installment and other loans	**12,065**	17,630
Total loans	**$ 2,151,232**	$ 1,979,986

[(1)] This balance includes $13.8 million and $189.9 million of SBA PPP loans, net of deferred fees and costs, at December 31, 2022 and 2021, respectively.

In order to monitor ongoing risk associated with its loan portfolio and specific loans within the segments, management uses an internal grading system. The first several rating categories, representing the lowest risk to the Bank, are combined and given a “Pass” rating. Management generally follows regulatory definitions in assigning criticized ratings to loans, including "Special Mention," "Substandard," "Doubtful" or "Loss." The Special Mention category includes loans that have potential weaknesses that may, if not monitored or corrected, weaken the asset or inadequately protect the Bank's position at some future date. These assets pose elevated risk, but their weakness does not yet justify a more severe, or classified rating. Substandard loans are classified as they have a well-defined weakness, or weaknesses that jeopardize liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Substandard loans include loans that management has determined not to be impaired, as well as loans considered to be impaired. A Doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as Loss is deferred. Loss loans are considered uncollectible, as the borrowers are often in bankruptcy, have suspended debt repayments, or have ceased business operations. Once a loan is classified as Loss, there is little prospect of collecting the loan’s principal or interest and it is charged-off.

The Company has a loan review policy and program, which is designed to identify and monitor risk in the lending function. The Management ERM Committee, comprised of executive and senior officers and loan department personnel, is charged with the oversight of overall credit quality and risk exposure of the Company's loan portfolio. This includes the monitoring of the lending activities of all Company personnel with respect to underwriting and processing new loans and the timely follow-up and corrective action for loans showing signs of deterioration in quality. A loan review program provides the Company with an independent review of the commercial loan portfolio on an ongoing basis. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as extended delinquencies, bankruptcy, repossession or death of the borrower occurs, which heightens awareness as to a possible credit event.

Internal loan reviews are completed annually on all commercial relationships with a committed loan balance in excess of $1.0 million, which includes confirmation of risk rating by an independent credit officer. In addition, all commercial relationships greater than $500 thousand rated substandard, doubtful or loss are reviewed quarterly and corresponding risk ratings are changed or reaffirmed by the Company's Problem Loan Committee, with subsequent reporting to the Management ERM Committee and the Board of Directors.

The following summarizes the Company's loan portfolio ratings based on its internal risk rating system at December 31, 2022 and 2021:

	Pass	Special Mention	Non-Impaired Substandard	Impaired - Substandard	Doubtful	PCI Loans	Total
December 31, 2022							
Commercial real estate:							
Owner-occupied	**$ 305,159**	**$ 2,109**	**$ 3,532**	**$ 2,767**	**$ —**	**$ 2,203**	**$ 315,770**
Non-owner occupied	**601,244**	**4,243**	**2,273**	**—**	**—**	**283**	**608,043**
Multi-family	**130,851**	**7,739**	**242**	**—**	**—**	**—**	**138,832**
Non-owner occupied residential	**102,674**	**810**	**482**	**81**	**—**	**557**	**104,604**
Acquisition and development:							
1-4 family residential construction	**25,068**	**—**	**—**	**—**	**—**	**—**	**25,068**
Commercial and land development	**142,424**	**458**	**—**	**15,426**	**—**	**—**	**158,308**
Commercial and industrial	**331,103**	**17,579**	**7,013**	**31**	**—**	**2,048**	**357,774**
Municipal	**12,173**	**—**	**—**	**—**	**—**	**—**	**12,173**
Residential mortgage:							
First lien	**222,849**	**—**	**215**	**2,520**	**—**	**4,265**	**229,849**
Home equity – term	**5,485**	**—**	**—**	**5**	**—**	**15**	**5,505**
Home equity – lines of credit	**182,801**	**—**	**45**	**395**	**—**	**—**	**183,241**
Installment and other loans	**12,017**	**—**	**—**	**40**	**—**	**8**	**12,065**
	$ 2,073,848	**$ 32,938**	**$ 13,802**	**$ 21,265**	**$ —**	**$ 9,379**	**$ 2,151,232**
December 31, 2021							
Commercial real estate:							
Owner-occupied	$ 219,250	$ 7,239	$ 6,087	$ 3,763	$ —	$ 2,329	$ 238,668
Non-owner occupied	528,010	23,297	166	—	—	310	551,783
Multi-family	84,414	8,238	603	—	—	—	93,255
Non-owner occupied residential	102,588	1,065	1,153	122	—	1,184	106,112
Acquisition and development:							
1-4 family residential construction	12,279	—	—	—	—	—	12,279
Commercial and land development	92,049	1,385	491	—	—	—	93,925
Commercial and industrial	470,579	7,917	4,720	250	—	2,262	485,728
Municipal	14,989	—	—	—	—	—	14,989
Residential mortgage:							
First lien	191,386	—	225	2,635	—	4,585	198,831
Home equity – term	6,058	—	—	7	—	16	6,081
Home equity – lines of credit	160,203	20	46	436	—	—	160,705
Installment and other loans	17,584	—	—	40	—	6	17,630
	$ 1,899,389	$ 49,161	$ 13,491	$ 7,253	$ —	$ 10,692	$ 1,979,986

For commercial real estate, acquisition and development, and commercial and industrial loans, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Generally, loans that are more than 90 days past due are deemed impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed to determine if the loan should be placed on nonaccrual status. Nonaccrual loans in the commercial and commercial real estate portfolios and any TDRs are, by definition, deemed to be impaired. Impairment is measured on a loan-by-loan basis for commercial, construction and restructured loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. For loans that are deemed to be impaired for extended periods of time, periodic updates on fair values are obtained, which may include updated appraisals. Updated fair values are incorporated into the impairment analysis in the next reporting period.

Loan charge-offs, which may include partial charge-offs, are taken on an impaired loan that is collateral dependent if the loan's carrying balance exceeds its collateral's appraised value, the loan has been identified as uncollectible, and it is deemed to be a confirmed loss. Typically, impaired loans with a charge-off or partial charge-off will continue to be considered impaired, unless the note is split into two, and management expects the performing note to continue to perform and is adequately secured. The second, or non-performing note, would be charged-off. Generally, an impaired loan with a partial charge-off may continue to have an impairment reserve on it after the partial charge-off, if factors warrant.

At December 31, 2022 and 2021, nearly all of the Company's loan impairments were measured based on the estimated fair value of the collateral securing the loan, except for TDRs. By definition, TDRs are considered impaired. All TDR impairment analyses are initially based on discounted cash flows for those loans. For real estate loans, collateral generally consists of commercial real estate or 1-4 family residential properties, but in the case of commercial and industrial loans, it could also consist of accounts receivable, inventory, equipment or other business assets. Commercial and industrial loans may also have real estate collateral.

Updated appraisals are generally required every 18 months for classified commercial loans in excess of $250 thousand. The "as is" value provided in the appraisal is often used as the fair value of the collateral in determining impairment, unless circumstances, such as subsequent improvements, approvals, or other circumstances, dictate that another value than that provided by the appraiser is more appropriate.

Generally, impaired commercial loans secured by real estate, other than performing TDRs, are measured at fair value using certified real estate appraisals that had been completed within the last 18 months. Appraised values are discounted for estimated costs to sell the property and other selling considerations to arrive at the property's fair value. In those situations, in which it is determined an updated appraisal is not required for loans individually evaluated for impairment, fair values are based on either an existing appraisal or a discounted cash flow analysis as determined by management. The approaches are discussed below:

- Existing appraisal – if the existing appraisal provides a strong loan-to-value ratio (generally 70% or lower) and, after consideration of market conditions and knowledge of the property and area, it is determined by the Credit Administration staff that there has not been a significant deterioration in the collateral value, the existing certified appraised value may be used. Discounts to the appraised value, as deemed appropriate for selling costs, are factored into the fair value.

- Discounted cash flows – in limited cases, discounted cash flows may be used on projects in which the collateral is liquidated to reduce the borrowings outstanding, and is used to validate collateral values derived from other approaches.

Collateral on certain impaired loans is not limited to real estate, and may consist of accounts receivable, inventory, equipment or other business assets. Estimated fair values a determined based on borrowers' financial statements, inventory ledgers, accounts receivable agings or appraisals from individuals with knowledge in the business. Stated balances are generally discounted for the age of the financial information or the quality of the assets. In determining fair value, liquidation discounts are applied to this collateral based on existing loan valuation policies.

The Company distinguishes substandard loans on both an impaired and non-impaired basis, as it places less emphasis on a loan's classification, and increased reliance on whether the loan was performing in accordance with the contractual terms. A substandard classification does not automatically meet the definition of impaired. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual extensions of credit classified as substandard. As a result, the Company's methodology includes an evaluation of certain accruing commercial real estate, acquisition and development, and commercial and industrial loans rated substandard to be collectively evaluated for impairment. Although the Company believes these loans meet the definition of substandard, they are generally performing and management has concluded that it is likely the Company will be able to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement.

Larger groups of smaller balance homogeneous loans are collectively evaluated for impairment. Generally, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

The following table, which excludes accruing PCI loans, summarizes impaired loans by segment and class, segregated by those for which a specific allowance was required and those for which a specific allowance was not required at December 31, 2022 and 2021. The recorded investment in loans excludes accrued interest receivable due to insignificance. Related allowances established generally pertain to those loans in which loan forbearance agreements were in the process of being negotiated or updated appraisals were pending and any partial charge-off will be recorded when final information is received.

	Impaired Loans with a Specific Allowance			Impaired Loans with No Specific Allowance	
	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)	Related Allowance	Recorded Investment (Book Balance)	Unpaid Principal Balance (Legal Balance)
December 31, 2022					
Commercial real estate:					
Owner-occupied	**$ —**	**$ —**	**$ —**	**$ 2,767**	**$ 3,799**
Non-owner occupied residential	**—**	**—**	**—**	**81**	**207**
Acquisition and development:					
Commercial and land development	**—**	**—**	**—**	**15,426**	**15,426**
Commercial and industrial	**—**	**—**	**—**	**31**	**112**
Residential mortgage:					
First lien	**178**	**178**	**28**	**2,342**	**3,126**
Home equity—term	**—**	**—**	**—**	**5**	**8**
Home equity—lines of credit	**—**	**—**	**—**	**395**	**684**
Installment and other loans	**—**	**—**	**—**	**40**	**40**
	$ 178	**$ 178**	**$ 28**	**$ 21,087**	**$ 23,402**
December 31, 2021					
Commercial real estate:					
Owner-occupied	$ —	$ —	$ —	$ 3,763	$ 4,902
Non-owner occupied residential	—	—	—	122	259
Commercial and industrial	—	—	—	250	547
Residential mortgage:					
First lien	341	341	28	2,294	3,337
Home equity—term	—	—	—	7	10
Home equity—lines of credit	—	—	—	436	653
Installment and other loans	—	—	—	40	40
	$ 341	$ 341	$ 28	$ 6,912	$ 9,748

The following table, which excludes accruing PCI loans, summarizes the average recorded investment in impaired loans and related recognized interest income for the years ended December 31, 2022, 2021 and 2020.

	2022		2021		2020	
	Average Impaired Balance	**Interest Income Recognized**	**Average Impaired Balance**	**Interest Income Recognized**	**Average Impaired Balance**	**Interest Income Recognized**
Commercial real estate:						
Owner-occupied	**$ 3,050**	**$ —**	$ 3,825	$ 1	$ 4,636	$ 1
Non-owner occupied	**—**	**—**	—	—	83	—
Multi-family	**—**	**—**	—	—	205	—
Non-owner occupied residential	**96**	**—**	225	—	388	—
Acquisition and development:						
Commercial and land development	**1,187**	**—**	187	—	641	—
Commercial and industrial	**109**	**—**	3,030	—	1,196	—
Residential mortgage:						
First lien	**2,389**	**33**	2,539	43	2,995	48
Home equity – term	**6**	**—**	11	—	11	—
Home equity – lines of credit	**405**	**—**	521	—	692	1
Installment and other loans	**44**	**—**	25	—	25	—
	$ 7,286	**$ 33**	$ 10,363	$ 44	$ 10,872	$ 50

The following table presents impaired loans that are TDRs, with the recorded investment at December 31, 2022 and 2021.

	2022		2021	
	Number of Contracts	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
Accruing:				
Residential mortgage:				
First lien	**8**	**682**	8	804
	8	**682**	8	804
Nonaccruing:				
Residential mortgage:				
First lien	**4**	**212**	5	285
Installment and other loans	**1**	**2**	—	—
	5	**214**	5	285
	13	**$ 896**	13	$ 1,089

The following table presents the number of loans modified as TDRs, and their pre-modification and post-modification investment balances for the year ended December 31, 2022. There were two new TDRs, both on non-accrual status for the year ended December 31, 2022. During 2022, one of the two new TDRs was paid off in full. There were no loans modified as TDRs during 2021 and 2020.

The loan presented in the table below was considered a TDR as a result of the Company agreeing to a below market interest rate given the risk of the transaction and a term extension, in order to give the borrowers an opportunity to improve their cash flows. For new and accruing TDRs, impairment is generally assessed using a discounted cash flow analysis. For TDRs in default of their modified terms, impairment is generally determined on a collateral dependent approach.

	Number of Contracts	Pre-Modification Investment Balance	Post-Modification Investment Balance
December 31, 2022			
Installment and other loans	**1**	**$ 5**	**$ 2**

Management further monitors the performance and credit quality of the loan portfolio by analyzing the length of time a portfolio is past due, by aggregating loans based on their delinquencies. The following table presents the classes of the loan portfolio summarized by aging categories of performing loans and nonaccrual loans at December 31, 2022 and 2021.

		Days Past Due					
	Current	30-59	60-89	90+ (still accruing)	Total Past Due	Non-Accrual	Total Loans
December 31, 2022							
Commercial real estate:							
Owner-occupied	$ 310,769	$ 31	$ —	$ —	$ 31	$ 2,767	$ 313,567
Non-owner occupied	607,760	—	—	—	—	—	607,760
Multi-family	138,832	—	—	—	—	—	138,832
Non-owner occupied residential	103,782	184	—	—	184	81	104,047
Acquisition and development:							
1-4 family residential construction	24,622	446	—	—	446	—	25,068
Commercial and land development	142,613	269	—	—	269	15,426	158,308
Commercial and industrial	355,179	464	52	—	516	31	355,726
Municipal	12,173	—	—	—	—	—	12,173
Residential mortgage:							
First lien	219,715	3,485	414	132	4,031	1,838	225,584
Home equity – term	5,485	—	—	—	—	5	5,490
Home equity – lines of credit	181,350	1,395	101	—	1,496	395	183,241
Installment and other loans	11,953	64	—	—	64	40	12,057
Subtotal	2,114,233	6,338	567	132	7,037	20,583	2,141,853
Loans acquired with credit deterioration:							
Commercial real estate:							
Owner-occupied	2,203	—	—	—	—	—	2,203
Non-owner occupied	283	—	—	—	—	—	283
Non-owner occupied residential	452	—	—	105	105	—	557
Commercial and industrial	2,048	—	—	—	—	—	2,048
Residential mortgage:							
First lien	3,657	327	79	202	608	—	4,265
Home equity – term	15	—	—	—	—	—	15
Installment and other loans	8	—	—	—	—	—	8
Subtotal	8,666	327	79	307	713	—	9,379
	$ 2,122,899	$ 6,665	$ 646	$ 439	$ 7,750	$ 20,583	$ 2,151,232

		Days Past Due					
	Current	30-59	60-89	90+ (still accruing)	Total Past Due	Non-Accrual	Total Loans
December 31, 2021							
Commercial real estate:							
Owner-occupied	$ 231,371	$ 314	$ —	$ 891	$ 1,205	$ 3,763	$ 236,339
Non-owner occupied	551,473	—	—	—	—	—	551,473
Multi-family	93,255	—	—	—	—	—	93,255
Non-owner occupied residential	104,645	161	—	—	161	122	104,928
Acquisition and development:							
1-4 family residential construction	12,279	—	—	—	—	—	12,279
Commercial and land development	93,793	132	—	—	132	—	93,925
Commercial and industrial	483,088	128	—	—	128	250	483,466
Municipal	14,989	—	—	—	—	—	14,989
Residential mortgage:							
First lien	189,043	2,995	281	96	3,372	1,831	194,246
Home equity – term	6,042	16	—	—	16	7	6,065
Home equity – lines of credit	159,628	641	—	—	641	436	160,705
Installment and other loans	17,467	109	8	—	117	40	17,624
Subtotal	1,957,073	4,496	289	987	5,772	6,449	1,969,294
Loans acquired with credit deterioration:							
Commercial real estate:							
Owner-occupied	2,329	—	—	—	—	—	2,329
Non-owner occupied	310	—	—	—	—	—	310
Non-owner occupied residential	479	—	587	118	705	—	1,184
Commercial and industrial	2,262	—	—	—	—	—	2,262
Residential mortgage:							
First lien	3,937	387	166	95	648	—	4,585
Home equity – term	15	—	—	1	1	—	16
Installment and other loans	6	—	—	—	—	—	6
Subtotal	9,338	387	753	214	1,354	—	10,692
	$ 1,966,411	$ 4,883	$ 1,042	$ 1,201	$ 7,126	$ 6,449	$ 1,979,986

The Company maintains its ALL at a level management believes adequate for probable incurred credit losses. The ALL is established and maintained through a provision for loan losses charged to earnings. On a quarterly basis, management assesses the adequacy of the ALL utilizing a defined methodology which considers specific credit evaluation of impaired loans as discussed above, historical loan loss experience, and qualitative factors. Management believes its approach properly addresses relevant accounting guidance for loans individually identified as impaired and for loans collectively evaluated for impairment, and other bank regulatory guidance.

In connection with its quarterly evaluation of the adequacy of the ALL, management reviews its methodology to determine if it properly addresses the current risk in the loan portfolio. For each loan class, general allowances based on quantitative factors, principally historical loss trends, are provided for loans that are collectively evaluated for impairment. An adjustment to historical loss factors may be incorporated for delinquency and other potential risk not elsewhere defined within the ALL methodology.

In addition to this quantitative analysis, adjustments to the ALL requirements are allocated on loans collectively evaluated for impairment based on additional qualitative factors, including:

Nature and Volume of Loans – including loan growth in the current and subsequent quarters based on the Company's targeted growth and strategic plan, coupled with the types of loans booked based on risk management and credit culture; the number of exceptions to loan policy; and supervisory loan to value exceptions.

Concentrations of Credit and Changes within Credit Concentrations – including the composition of the Company's overall portfolio makeup and management's evaluation related to concentration risk management and the inherent risk associated with the concentrations identified.

Underwriting Standards and Recovery Practices – including changes to underwriting standards and perceived impact on anticipated losses; trends in the number of exceptions to loan policy; supervisory loan to value exceptions; and administration of loan recovery practices.

Delinquency Trends – including delinquency percentages noted in the portfolio relative to economic conditions; severity of the delinquencies; and whether the ratios are trending upwards or downwards.

Classified Loans Trends – including internal loan ratings of the portfolio; severity of the ratings; whether the loan segment's ratings show a more favorable or less favorable trend; and underlying market conditions and impact on the collateral values securing the loans.

Experience, Ability and Depth of Management/Lending staff – including the years' experience of senior and middle management and the lending staff; turnover of the staff; and instances of repeat criticisms of ratings.

Quality of Loan Review – including the years of experience of the loan review staff; in-house versus outsourced provider of review; turnover of staff and the perceived quality of their work in relation to other external information.

National and Local Economic Conditions – including trends in the consumer price index, unemployment rates, the housing price index, housing statistics compared to the prior year, bankruptcy rates, regulatory and legal environment risks and competition.

All factors noted above were evaluated and remained unchanged during the year ended December 31, 2022, except for a reduction in the *National and Local Economic Conditions* factor during the first quarter of 2022. This factor had been increased previously for economic concerns in the commercial real estate portfolio associated with the COVID-19 pandemic. The additional allocation was removed during 2022 as these concerns had subsided.

The following table presents activity in the ALL for the years ended December 31, 2022, 2021 and 2020.

	Commercial					Consumer				
	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
December 31, 2022										
Balance, beginning of year	**$ 12,037**	**$ 2,062**	**$ 3,814**	**$ 30**	**$ 17,943**	**$ 2,785**	**$ 215**	**$ 3,000**	**$ 237**	**$ 21,180**
Provision for loan losses	**1,489**	**1,142**	**640**	**(6)**	**3,265**	**669**	**218**	**887**	**8**	**4,160**
Charge-offs	**—**	**—**	**—**	**—**	**—**	**(50)**	**(360)**	**(410)**	**—**	**(410)**
Recoveries	**32**	**10**	**51**	**—**	**93**	**40**	**115**	**155**	**—**	**248**
Balance, end of year	**$ 13,558**	**$ 3,214**	**$ 4,505**	**$ 24**	**$ 21,301**	**$ 3,444**	**$ 188**	**$ 3,632**	**$ 245**	**$ 25,178**
December 31, 2021										
Balance, beginning of year	$ 11,151	$ 1,114	$ 3,942	$ 40	$ 16,247	$ 3,362	$ 324	$ 3,686	$ 218	$ 20,151
Provision for loan losses	710	938	23	(10)	1,661	(517)	(73)	(590)	19	1,090
Charge-offs	(293)	—	(663)	—	(956)	(92)	(70)	(162)	—	(1,118)
Recoveries	469	10	512	—	991	32	34	66	—	1,057
Balance, end of year	$ 12,037	$ 2,062	$ 3,814	$ 30	$ 17,943	$ 2,785	$ 215	$ 3,000	$ 237	$ 21,180
December 31, 2020										
Balance, beginning of year	$ 7,634	$ 959	$ 2,356	$ 100	$ 11,049	$ 3,147	$ 319	$ 3,466	$ 140	$ 14,655
Provision for loan losses	2,745	146	2,096	(60)	4,927	203	117	320	78	5,325
Charge-offs	(3)	—	(748)	—	(751)	(114)	(146)	(260)	—	(1,011)
Recoveries	775	9	238	—	1,022	126	34	160	—	1,182
Balance, end of year	$ 11,151	$ 1,114	$ 3,942	$ 40	$ 16,247	$ 3,362	$ 324	$ 3,686	$ 218	$ 20,151

The following table summarizes the ending loan balances individually evaluated for impairment based upon loan segment, as well as the related ALL loss allocation for each at December 31, 2022 and 2021. Accruing PCI loans are excluded from loans individually evaluated for impairment.

	Commercial					Consumer				
	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Municipal	Total	Residential Mortgage	Installment and Other	Total	Unallocated	Total
December 31, 2022										
Loans allocated by:										
Individually evaluated for impairment	**$ 2,848**	**$ 15,426**	**$ 31**	**$ —**	**$ 18,305**	**$ 2,920**	**$ 40**	**$ 2,960**	**$ —**	**$ 21,265**
Collectively evaluated for impairment	**1,164,401**	**167,950**	**357,743**	**12,173**	**1,702,267**	**415,675**	**12,025**	**427,700**	**—**	**2,129,967**
	$ 1,167,249	**$ 183,376**	**$ 357,774**	**$ 12,173**	**$ 1,720,572**	**$ 418,595**	**$ 12,065**	**$ 430,660**	**$ —**	**$ 2,151,232**
Allowance for loan losses allocated by:										
Individually evaluated for impairment	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 28**	**$ —**	**$ 28**	**$ —**	**$ 28**
Collectively evaluated for impairment	**13,558**	**3,214**	**4,505**	**24**	**21,301**	**3,416**	**188**	**3,604**	**245**	**25,150**
	$ 13,558	**$ 3,214**	**$ 4,505**	**$ 24**	**$ 21,301**	**$ 3,444**	**$ 188**	**$ 3,632**	**$ 245**	**$ 25,178**
December 31, 2021										
Loans allocated by:										
Individually evaluated for impairment	$ 3,885	$ —	$ 250	$ —	$ 4,135	$ 3,078	$ 40	$ 3,118	$ —	$ 7,253
Collectively evaluated for impairment	985,933	106,204	485,478	14,989	1,592,604	362,539	17,590	380,129	—	1,972,733
	$ 989,818	$ 106,204	$ 485,728	$ 14,989	$ 1,596,739	$ 365,617	$ 17,630	$ 383,247	$ —	$ 1,979,986
Allowance for loan losses allocated by:										
Individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ 28	$ —	$ 28	$ —	$ 28
Collectively evaluated for impairment	12,037	2,062	3,814	30	17,943	2,757	215	2,972	237	21,152
	$ 12,037	$ 2,062	$ 3,814	$ 30	$ 17,943	$ 2,785	$ 215	$ 3,000	$ 237	$ 21,180

The following table provides activity for the accretable yield of purchased impaired loans for the years ended December 31, 2022 and 2021.

	2022	2021
Accretable yield, beginning of period	**$ 2,661**	$ 3,438
Accretion of income	**(949)**	(1,093)
Reclassifications from nonaccretable difference due to improvement in expected cash flows	**388**	160
Other changes, net	**335**	156
Accretable yield, end of period	**$ 2,435**	$ 2,661

NOTE 4. PREMISES AND EQUIPMENT

The following table summarizes premises and equipment at December 31, 2022 and 2021.

	2022	2021
Land	$ 7,583	$ 8,586
Buildings and improvements	24,813	27,852
Leasehold improvements	5,359	5,593
Furniture and equipment	21,849	23,681
Construction in progress	59	171
	59,663	65,883
Less accumulated depreciation	30,335	31,838
	$ 29,328	$ 34,045

Depreciation expense totaled $2.1 million, $2.3 million, and $3.2 million for the years ended December 31, 2022, 2021 and 2020, respectively. During 2022, the Company announced strategic initiatives to drive long-term growth and improve operating efficiencies, which included the planned closure of five branch locations in Pennsylvania, and resulted in reductions to gross premises and equipment by $6.2 million and accumulated depreciation by $2.9 million due to write-downs of premises and equipment and the transfer of land and buildings to held-for-sale.

NOTE 5. LEASES

A lease provides the lessee the right to control the use of an identified asset for a period of time in exchange for consideration. The Company has primarily entered into operating leases for branches and office space. Most of the Company's leases contain renewal options, which the Company is reasonably certain to exercise. Including renewal options, the Company's leases range from 5 to 30 years. Operating lease right-of-use assets and lease liabilities are included in other assets and accrued interest and other liabilities on the Company's consolidated balance sheets.

The Company uses its incremental borrowing rate to determine the present value of the lease payments, as the rate implicit in the Company's leases is not readily determinable. Lease agreements that contain non-lease components are generally accounted for as a single lease component, while variable costs, such as common area maintenance expenses and property taxes, are expensed as incurred.

The following table summarizes the Company's right-of-use assets and related lease liabilities for the year ended December 31, 2022 and 2021.

	December 31, 2022	December 31, 2021
Operating lease ROU assets	$ 9,270	$ 10,515
Operating lease ROU liabilities	9,976	11,119
Weighted-average remaining lease term (in years)	14.3	14.6
Weighted-average discount rate	4.1 %	4.1 %

The following table presents information related to the Company's operating leases for the years ended December 31, 2022 and 2021:

	December 31, 2022	December 31, 2021
Cash paid for operating lease liabilities	$ 1,170	$ 1,266
Operating lease expense	1,406	1,544

The following table presents maturities of the Company's lease liabilities by year.

2023	$	**1,153**
2024		**1,179**
2025		**1,201**
2026		**1,233**
2027		**1,267**
Thereafter		**8,187**
		14,220
Less: imputed interest		**4,244**
Total lease liabilities	$	**9,976**

NOTE 6. GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2022 and 2021, goodwill was $18.7 million. No impairment charges were recorded in December 31, 2022 and 2021.

Goodwill is not amortized, but is reviewed for potential impairment on at least an annual basis, with testing between annual tests if an event occurs or circumstances change that could potentially reduce the fair value of a reporting unit.

The Company conducted its last annual goodwill impairment test as of November 30, 2022 using generally accepted valuation methods. As a result of that impairment test, no goodwill impairment was identified. No changes occurred that would impact the results of that analysis through December 31, 2022.

The following table presents changes in and components of other intangible assets for the years ended December 31, 2022 and 2021. No impairment charge was recorded on other intangible assets during the years ended December 31, 2022 and 2021.

	2022		**2021**	
Balance, beginning of year	$	**4,183**	$	5,458
Amortization expense		**(1,105)**		(1,275)
Balance, end of year	$	**3,078**	$	4,183

The following table presents the components of other identifiable intangible assets at December 31, 2022 and 2021.

	2022				**2021**			
	Gross Carrying Amount		**Accumulated Amortization**		Gross Carrying Amount		Accumulated Amortization	
Amortized intangible assets:								
Core deposit intangibles	$	**8,390**	$	**5,312**	$	8,390	$	4,208
Other client relationship intangibles		**25**		**25**		25		24
Total	$	**8,415**	$	**5,337**	$	8,415	$	4,232

The following table presents future estimated aggregate amortization expense at December 31, 2022.

2023	$	**935**
2024		**766**
2025		**596**
2026		**427**
2027		**258**
Thereafter		**96**
	$	**3,078**

The Company incurred amortization expense of $1.1 million, $1.3 million and $1.6 million in the years ending December 31, 2022, 2021 and 2020, respectively.

NOTE 7. INCOME TAXES

The Company files income tax returns in the U.S. federal jurisdiction, the Commonwealth of Pennsylvania and the State of Maryland. The Company is no longer subject to tax examination by tax authorities for years before 2019.

The following table summarizes income tax expense for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Current expense	**$ 5,170**	$ 7,072	$ 6,602
Deferred (benefit) expense	**(591)**	942	(554)
Income tax expense	**$ 4,579**	$ 8,014	$ 6,048

The following table reconciles the Company's effective income tax rate to its statutory federal rate for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Statutory federal tax rate	**21.0 %**	21.0 %	21.0 %
Increase (decrease) resulting from:			
State taxes, net of federal benefit	**1.6**	1.1	1.0
Tax exempt interest income	**(4.1)**	(1.7)	(2.0)
Income from life insurance	**(1.3)**	(0.9)	(1.1)
Disallowed interest expense	**0.3**	—	0.1
Low-income housing credits and related expense	**(0.2)**	(0.2)	(0.8)
Share-based compensation and related expense	**(0.5)**	0.2	—
Other	**0.4**	0.1	0.4
Effective income tax rate	**17.2 %**	19.6 %	18.6 %

For the year ended December 31, 2022, net security losses resulted in an income tax benefit of $34 thousand, compared to income tax expense of $134 thousand related to net security gains for the year ended December 31, 2021, and an income tax benefit of $3 thousand related to net security losses for the year ended December 31, 2020.

The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the results of operations. There were no penalties or interest related to income taxes recorded in the consolidated statements of income for the years ended December 31, 2022, 2021 and 2020 and no amounts accrued for penalties at December 31, 2022 and 2021.

The following table summarizes the Company's deferred tax assets and liabilities at December 31, 2022 and 2021.

	2022	2021
Deferred tax assets:		
Allowance for loan losses	**$ 5,594**	$ 4,655
Deferred compensation	**434**	515
Retirement and salary continuation plans	**3,000**	2,633
Share-based compensation	**774**	681
Off-balance sheet reserves	**359**	353
Nonaccrual loan interest	**467**	220
Deferred loan fees	**493**	1,604
Net unrealized losses on AFS securities	**10,405**	—
Net unrealized losses on cash flow hedges	**204**	—
Purchase accounting adjustments	**896**	1,236
Bonus accrual	**1,241**	930
Right-of-use lease liability	**2,194**	2,444
Net operating loss carryforward	**1,974**	2,218
Depreciation and other	**99**	67
Total deferred tax assets	**28,134**	17,556
Deferred tax liabilities:		
Depreciation	**—**	368
Net unrealized gains on AFS securities	**—**	1,183
Mortgage servicing rights	**884**	887
Purchase accounting adjustments	**675**	915
Right-of-use lease asset	**2,054**	2,311
Investment in partnerships	**473**	229
Other	**17**	15
Total deferred tax liabilities	**4,103**	5,908
Deferred tax asset, net	**$ 24,031**	$ 11,648

At December 31, 2022, the Company had acquired federal and state net operating loss carryforwards of $9.0 million each, subject to annual loss limitation limits per IRC Section 382, that expire beginning in 2033. A deferred tax asset is recognized for these carryforwards because the benefit is more likely than not to be realized.

FASB ASC 740, Income Taxes, ("ASC 740") clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in ASC 740 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. ASC 740 was applied to all existing tax positions upon initial adoption. There was no liability for uncertain tax positions and no known unrecognized tax benefits at December 31, 2022 or 2021.

NOTE 8. RETIREMENT PLANS

The Company maintains a 401(k) profit-sharing plan for all qualified employees. Employees are eligible to participate in the 401(k) profit-sharing plan following completion of one month of service and attaining age 18. Pursuant to the 401(k) profit-sharing plan, employees can contribute up to the lesser of $61 thousand, or 100% of their compensation. Substantially all of the Company's employees are covered by the plan, which contains limited match or safe harbor provisions. The Company will match 50% of the first 6% of the base contribution that an employee contributes. The Company's match is immediately vested and paid at the end of the year. Employer contributions to the plan are based on the performance of the Company and are at the discretion of the Board of Directors. Employer contribution expense totaled $780 thousand, $669 thousand and $626 thousand for the years ended December 31, 2022, 2021 and 2020, respectively.

The Company has deferred compensation agreements with certain present and former directors, whereby a director or his beneficiaries will receive a monthly retirement benefit beginning at age 65. The arrangement is funded by an amount of life insurance on the participating director, which is calculated to meet the Company's obligations under the compensation agreement. The cash value of the life insurance policies is an unrestricted asset of the Company. The estimated present value of future benefits to be paid totaled $18 thousand and $36 thousand at December 31, 2022 and 2021, respectively. Expense for this plan totaled $4 thousand, $5 thousand and $7 thousand for the years ended December 31, 2022, 2021 and 2020, respectively.

The Company also has supplemental discretionary deferred compensation plans for directors and executive officers. The plans are funded annually with director fees and salary reductions which are either placed in a trust account invested by the Bank's OFA division or recognized as a liability. The trust account balance totaled $2.0 million and $2.3 million at December 31, 2022 and 2021, respectively, and is directly offset in other liabilities. Expense for these plans totaled $51 thousand for the year ended December 31, 2022 and $61 thousand for each of the years ended December 31, 2021 and 2020.

In addition, the Company has two supplemental retirement and salary continuation plans for directors and executive officers. These plans are funded with single premium life insurance on the plan participants. The cash value of the life insurance policies is an unrestricted asset of the Company. The estimated present value of future benefits to be paid on these plans totaled $13.6 million and $12.3 million at December 31, 2022 and 2021, respectively. Expense for these plans totaled $2.0 million, $1.7 million and $1.5 million, for the years ended December 31, 2022, 2021 and 2020, respectively.

The Company has promised a continuation of life insurance coverage to certain persons post-retirement. The estimated present value of future benefits to be paid totaled $1.7 million and $1.6 million at December 31, 2022 and 2021, respectively. Expense for this plan totaled $105 thousand, $104 thousand and $25 thousand for the years ended December 31, 2022, 2021 and 2020, respectively.

Trust account balances, and estimated present values of future benefits and deferred compensation liabilities, noted above are included in other assets and other liabilities, respectively, on the consolidated balance sheets.

NOTE 9. SHARE-BASED COMPENSATION PLANS

The Company maintains share-based compensation plans under the shareholder-approved 2011 Plan. The purpose of the share-based compensation plans is to provide officers, employees, and non-employee members of the Board of Directors of the Company with additional incentive to further the success of the Company. At the Company's 2022 Annual Meeting of Shareholders held on April 26, 2022, the Company's shareholders approved an amendment to the 2011 Plan increasing the number of shares available for issuance under the 2011 Plan by 400,000. At December 31, 2022, 1,281,920 shares of the common stock of the Company were reserved to be issued and 537,027 shares were available to be issued.

The 2011 Plan incentive awards may consist of grants of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, deferred stock units and performance shares. All employees and members of the Board of Directors of the Company and its subsidiaries, are eligible to participate in the 2011 Plan. The 2011 Plan allows for the Compensation Committee of the Board of Directors to determine the type of incentive to be awarded, its term, manner of exercise, vesting and restrictions on shares. Generally, awards are nonqualified under the IRC, unless the awards are deemed to be incentive awards to employees at the Compensation Committee's discretion.

The following table presents a summary of nonvested restricted shares activity for 2022.

	Shares	Weighted Average Grant Date Fair Value
Nonvested shares, beginning of year	**274,697**	**$ 20.05**
Granted	**145,349**	**24.95**
Forfeited	**(33,606)**	**21.37**
Vested	**(101,531)**	**20.19**
Nonvested shares, end of year	**284,909**	**$ 22.35**

The following table presents restricted shares compensation expense, with tax benefit information, and fair value of shares vested at December 31, 2022, 2021 and 2020.

	2022	2021	2020
Restricted share award expense	**$ 2,012**	$ 1,901	$ 1,710
Restricted share award federal tax benefit	**423**	334	359
Fair value of shares vested	**2,498**	1,539	1,384

At December 31, 2022, 2021 and 2020, unrecognized compensation expense related to the share awards totaled $3.0 million, $2.3 million, and $2.0 million, respectively. The unrecognized compensation expense at December 31, 2022 is expected to be recognized over a weighted-average period of 1.8 years.

There were no outstanding and exercisable stock options at December 31, 2022 and 2021.

The Company maintains an employee stock purchase plan to provide employees of the Company an opportunity to purchase Company common stock. Eligible employees may purchase shares in an amount that does not exceed the lesser of the IRS limit of $25,000 or 10% of their annual salary at the lower of 95% of the fair market value of the shares on the semi-annual offering date, or related purchase date. The Company reserved 350,000 shares of its common stock to be issued under the employee stock purchase plan. At December 31, 2022, 145,595 shares were available to be issued.

The following table presents information for the employee stock purchase plan for years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Shares purchased	**5,885**	8,755	7,831
Weighted average price of shares purchased	**$ 22.53**	$ 15.58	$ 14.85
Compensation expense recognized	**$ 15**	$ 48	$ 6

The Company issues new shares or treasury shares, depending on market conditions, in its share-based compensation plans.

NOTE 10. DEPOSITS

The following table summarizes deposits by type at December 31, 2022 and 2021. During the fourth quarter of 2022, the Bank announced that it had entered into a Purchase and Assumption Agreement providing for the sale of its Path Valley branch and associated deposit liabilities. At December 31, 2022, approximately $31.3 million of deposits were expected to be conveyed in a branch sale, are reported within total deposits at cost on the consolidated balance sheets, and are comprised of $23.5 million in interest-bearing deposits and $7.8 million in non-interest bearing deposits. The transaction is expected to close in the second quarter of 2023.

	2022	2021
Noninterest-bearing demand deposits	**$ 501,963**	$ 553,238
Interest-bearing demand deposits	**987,158**	903,155
Savings	**736,124**	706,451
Time ($250,000 or less)	**214,484**	258,064
Time (over $250,000)	**36,517**	44,021
Total	**$ 2,476,246**	$ 2,464,929

The following table summarizes scheduled future maturities of time deposits as of December 31, 2022.

2023	**$ 179,009**
2024	**56,780**
2025	**6,518**
2026	**3,890**
2027	**3,341**
Thereafter	**1,463**
	$ 251,001

Brokered time deposits totaled zero at December 31, 2022 and 2021, respectively. Management evaluates brokered deposits as a funding option, taking into consideration regulatory views on such deposits as non-core funding sources.

NOTE 11. RELATED PARTY TRANSACTIONS

Directors and executive officers of the Company, including their immediate families and companies in which they have a direct or indirect material interest, are considered to be related parties. In the ordinary course of business, the Company engages in various related party transactions, including extending credit, taking deposits and bank service transactions. The Company relies on the directors and executive officers for the identification of their associates.

Federal banking regulations require that any extensions of credit to insiders and their related interests not be offered on terms more favorable than would be offered to non-related borrowers of similar creditworthiness. The following table presents the aggregate activity in loans to related parties during 2022.

Balance, beginning of year	**$ 904**
New loans	**225**
Repayments	**(908)**
Director and officer relationship changes	**(130)**
Balance, end of year	**$ 91**

None of these loans are past due, on nonaccrual status or have been restructured to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrower. There were no loans to a related party that were considered classified loans at December 31, 2022 or 2021.

At December 31, 2022 and 2021, the Company had approximately $4.0 million and $4.7 million, respectively, in deposits from related parties, including directors and certain executive officers.

NOTE 12. SHORT-TERM BORROWINGS

The Company has short-term borrowing capability from the FHLB, federal funds purchased and the FRB discount window. The following table summarizes these short-term borrowings at and for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Balance at year-end	**$ 104,684**	$ —	$ 55,729
Weighted average interest rate at year-end	**4.45 %**	— %	0.41 %
Average balance during the year	**$ 13,846**	$ 38,546	$ 138,310
Average interest rate during the year	**3.97 %**	0.33 %	0.67 %
Maximum month-end balance during the year	**$ 104,684**	$ 55,729	$ 178,729

The Company also enters into borrowing arrangements with certain of its deposit clients by agreements to repurchase ("repurchase agreements") under which the Company pledges investment securities owned and under its control as collateral against the borrowing arrangement, which generally matures within one day from the transaction date. The Company is required to hold U.S. Treasury, U.S. Agency or U.S. GSE securities as underlying securities for repurchase agreements. The following table provides additional details for repurchase agreements at and for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Balance at year-end	**$ 17,251**	$ 23,301	$ 19,466
Weighted average interest rate at year-end	**0.60 %**	0.11 %	0.23 %
Average balance during the year	**$ 22,294**	$ 22,888	$ 18,064
Average interest rate during the year	**0.20 %**	0.14 %	0.47 %
Maximum month-end balance during the year	**$ 26,399**	$ 27,595	$ 24,403
Fair value of securities underlying the agreements at year-end	**$ 17,188**	$ 32,662	$ 29,477

NOTE 13. LONG-TERM DEBT

The following table presents components of the Company's long-term debt at December 31, 2022, and 2021.

	Amount		Weighted Average rate	
	2022	2021	2022	2021
Total FHLB amortizing advance requiring monthly principal and interest payments, maturing:				
2025	**$ 1,455**	$ 1,896	**4.74 %**	4.74 %

There were no new long term borrowings in 2022 or 2021. The following table summarizes the future annual principal payments required on these borrowings at December 31, 2022.

2023	**$ 462**
2024	**485**
2025	**508**
2026	**—**
2027	**—**
Thereafter	**—**
	$ 1,455

The Bank is a member of the FHLB of Pittsburgh and has access to the FHLB program of overnight and term advances. Under terms of a blanket collateral agreement for advances, lines and letters of credit from the FHLB, collateral for all outstanding advances, lines and letters of credit consisted of 1-4 family mortgage loans and other real estate secured loans totaling $1.0 billion at December 31, 2022. The Bank had additional availability of $909.6 million at the FHLB on December 31, 2022 based on its qualifying collateral, net of short-term borrowings and long-term debt detailed above, deposit letters of credit totaling $1.0 million and non-deposit letters of credit totaling $1.2 million at December 31, 2022.

At December 31, 2022 and 2021, the Company had availability under FHLB lines totaling $45.3 million and $150.0 million, respectively.

The Bank has available unsecured lines of credit, with interest based on the daily Federal Funds rate, with two correspondent banks totaling $30.0 million, at December 31, 2022. There were no borrowings under these lines of credit at December 31, 2022 and 2021.

NOTE 14. SUBORDINATED NOTES

The Company has unsecured subordinated notes payable, which mature on December 30, 2028. At December 31, 2022 and 2021, subordinated notes payable outstanding totaled $32.0 million for both periods, which qualified for Tier 2 capital. The notes are recorded on the consolidated balance sheets net of remaining debt issuance costs totaling $474 thousand and $537 thousand at December 31, 2022 and 2021, respectively, which are amortized over a 10-year period on an effective yield basis. The subordinated notes have a fixed interest rate of 6.0% through December 30, 2023, which then converts to a variable rate, equivalent to the LIBOR fallback rate, or any replacement reference rate, plus 3.16% through maturity. The Company may, at its option, redeem the notes, in whole or in part, on any interest payment date on or after December 30, 2023, and at any time upon the occurrence of certain events. As of December 31, 2022, the Company was in compliance with the covenants contained in the subordinated notes payable agreement.

NOTE 15. DERIVATIVE FINANCIAL INSTRUMENTS

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of its assets and liabilities and the use of derivative financial instruments. Specifically, the Company enters into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company’s derivative financial instruments are used as risk management tools by the Company to manage differences in the amount, timing, and duration of the Company’s known or expected cash receipts and its known or expected cash payments principally related to the Company’s borrowings and are not used for trading or speculative purposes.

The Company’s objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps and interest rate caps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of fixed amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the agreements without exchange of the underlying notional amount. The Company, however, discontinues cash flow hedge accounting if it is probable the forecasted hedged transactions will not occur in the initially identified time period due to circumstances, such as the impact of the COVID-19 pandemic. Upon discontinuance, the associated gains and losses deferred in AOCI are reclassified immediately into earnings and subsequent changes in the fair value of the cash flow hedge are recognized in earnings. For the year ended December 31, 2022, the Company entered into two interest rate swaps designated as hedging instruments with a total notional value of $100.0 million for the purpose of hedging the variable cash flows of selected AFS securities or loans. For the year ended December 31, 2021, the Company had zero interest rate swaps designated as a hedging instrument as the Company terminated its interest rate derivative of $50.0 million that was designated as a cash flow hedge of interest-rate risk associated with overnight borrowings due to the unprecedented nature and impact of the COVID-19 pandemic, and reclassified $398 thousand of the realized losses from AOCI to current earnings because the hedged forecasted transaction was determined to be no longer probable of occurring.

The Company enters into interest rate swaps that allow its commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. Under these agreements, the Company enters into a variable-rate loan agreement with a customer in addition to an interest rate swap agreement, which serves to effectively swap the customer’s variable-rate loan into a fixed-rate loan. In addition, the Company may enter into interest rate caps that allow its commercial loan customers to gain protection against significant interest rate increases and provide a limit on the variable interest rate. The Company then enters into a corresponding swap or cap agreement with a third party in order to economically hedge its exposure through the customer agreement. The interest rate swaps and interest rate caps with both the customers and third parties are not designated as hedges and are marked through earnings. At December 31, 2022, the Company had 26 customer and 26 corresponding third-party broker interest rate derivatives not designated as a hedging instrument with an aggregate notional amount of $268.8 million. The Company had $75.8 million of such derivative instruments at December 31, 2021. The Company entered into 14 new interest rate swaps with its commercial loan customers and recognized swap fee income of $2.5 million for the year ended December 31, 2022 compared to swap fee income of $240 thousand from three new interest rate swaps with its commercial loan customers for the year ended December 31, 2021, which are included in noninterest income in the consolidated statements of income. In addition, the Company entered into one new interest rate cap with a commercial loan customer and recognized fee income of $14 thousand for the year ended December 31, 2022, which is included in noninterest income in the consolidated statements of income. The Company did not enter into any interest rate cap agreements for the year ended December 31, 2021.

At December 31, 2022 and 2021, the Company provided cash collateral of $5.4 million and $260 thousand with a counterparty for these derivatives, respectively. At December 31, 2022 and 2021, the Company received cash collateral of $8.5 million and $490 thousand from a counterparty for these derivatives, respectively.

The Company also may enter into risk participation agreements with a financial institution counterparty for an interest rate derivative contract related to a loan in which the Company is a participant or the agent bank. The risk participation agreement provides credit protection to the agent bank should the borrower fail to perform on its interest rate derivative contracts with the agent bank. The Company manages its credit risk on the risk participation agreement by monitoring the creditworthiness of the borrower, which is based on the same credit review process as though the Company had entered into the derivative instruments directly with the borrower. The notional amount of such risk participation agreement reflects the Company's pro-rata share of the derivative instrument, consistent with its share of the related participated loan. At December 31, 2022 and 2021, the Company had risk participation agreements with sold protection with a notional value of $29.0 million and $15.9 million, respectively. In addition, the Company had a risk participation with purchased protection with a notional value of $4.9 million at December 31, 2022. The Company did not enter into any risk participation agreements for the year ended December 31, 2021. The Company received an upfront fee of $140 thousand upon entry into two new risk participation agreements for the year ended December 31, 2022 compared to $53 thousand upon entry into one new risk participation with sold protection for the year ended December 31, 2021, which is included in noninterest income in the consolidated statements of income.

As a part of its normal residential mortgage operations, the Company will enter into an interest rate lock commitment with a potential borrower. The Company may enter into a corresponding commitment to an investor to sell that loan at a specific price shortly after origination. In accordance with FASB ASC 820, adjustments are recorded through earnings to account for the net change in fair value of these transactions for the held for sale pipeline. In accordance with FASB ASC 820, adjustments are recorded through earnings to account for the net change in fair value of these held for sale loans. The fair value of held for sale loans can vary based on the interest rate locked with the customer and the current market interest rate at the balance sheet date.

The following table summarizes the notional values and fair value of the Company's derivative instruments at December 31, 2022 and 2021:

	December 31, 2022			December 31, 2021		
	Notional Amount	**Balance Sheet Location**	**Fair Value**	Notional Amount	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:						
Interest rate swaps - balance sheet hedge	**$ 100,000**	Other liabilities	**$ (973)**	$ —	Not applicable	$ —
Total derivatives designated as hedging instruments			**$ (973)**			$ —
Derivatives not designated as hedging instruments:						
Interest rate swaps	**$ 128,385**	Other assets	**$ 10,437**	$ 37,915	Other assets	$ 764
Interest rate swaps	**128,385**	Other liabilities	**(10,262)**	37,915	Other liabilities	(758)
Purchased Options – Rate Cap	**6,000**	Other assets	**29**	—	Not applicable	—
Written Options – Rate Cap	**6,000**	Other liabilities	**(29)**	—	Not applicable	—
Risk participations - sold credit protection	**29,019**	Other liabilities	**(69)**	15,855	Other liabilities	(2)
Risk participations - purchased credit protection	**4,941**	Other assets	**16**	—	Not applicable	—
Interest rate lock commitments with customers	**1,356**	Other assets	**35**	16,604	Other assets	353
Forward sale commitments	**3,483**	Other assets	**140**	8,665	Other assets	52
Total derivatives not designated as hedging instruments			**$ 297**			$ 409

The following tables summarize the effect of the Company's derivative financial instruments on OCI and net income at December 31, 2022 and 2021:

	Amount of (Loss) Gain Recognized in OCI on Derivative	
	2022	**2021**
Derivatives in cash flow hedging relationships:		
Interest rate products	**$ (972)**	$ 473
Total	**$ (972)**	$ 473

	Amount of Loss Reclassified from AOCI into Income		Location of Loss Recognized from AOCI into Income
	2022	**2021**	
Derivatives in cash flow hedging relationships:			
Interest rate products	**$ —**	$ (757)	Interest income[(1)] / Interest expense[(2)]
Total	**$ —**	$ (757)	

[(1)] For interest rate swaps designated as cash flow hedges entered into for the year ended December 31, 2022, the amount of loss reclassified from AOCI will be recorded to other income in the unaudited condensed consolidated statements of income.

[(2)] For the year ended December 31, 2021, the Company terminated its interest rate swap designated as a hedging instrument with a notional value of $50.0 million. The Company recorded a $514 thousand loss in other operating expenses in the consolidated statements of income.

	Amount of Gain (Loss) Recognized in Income		Location of Gain (Loss) Recognized in Income
	2022	**2021**	
Derivatives not designated as hedging instruments:			
Interest rate products	**$ 30**	$ 41	Other operating expenses
Risk participation agreements	**88**	(2)	Other operating expenses
Interest rate lock commitments with customers	**(318)**	(320)	Mortgage banking activities
Forward sale commitments	**88**	113	Mortgage banking activities
Total	**$ (113)**	$ (168)	

The following table is a summary of components for interest rate swap designated as cash flow hedges at December 31, 2022 and 2021. At December 31, 2022, the Company had two interest rate derivatives designated as cash flow hedges with a total notional of $100.0 million. During the year ended December 31, 2021, the Company terminated its remaining interest rate derivative of $50.0 million.

	December 31, 2022	December 31, 2021
Weighted average pay rate	**3.81 %**	— %
Weighted average receive rate	**3.81 %**	— %
Weighted average maturity in years	**1.2**	0.0

NOTE 16. SHAREHOLDERS' EQUITY AND REGULATORY CAPITAL

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Under the Basel Committee on Banking Supervision's capital guidelines for U.S. Banks ("Basel III rules"), an entity must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The Company and the Bank have elected not to include net unrealized gain or loss included in accumulated other comprehensive income in computing regulatory capital.

The consolidated asset limit on small bank holding companies is $3.0 billion, and a company with assets under that limit is not subject to the FRB consolidated capital rules, but may file reports that include capital amounts and ratios. The Company has elected to file those reports.

Management believes, at December 31, 2022 and 2021, that the Parent Company and the Bank met all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At December 31, 2022, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's classification.

The following table presents capital amounts and ratios at December 31, 2022 and 2021.

	Actual		For Capital Adequacy Purposes (includes applicable capital conservation buffer)		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2022						
Total risk-based capital:						
Orrstown Financial Services, Inc.	**$ 304,589**	**12.7 %**	**$ 250,939**	**10.5 %**	**n/a**	**n/a**
Orrstown Bank	**292,933**	**12.3 %**	**250,566**	**10.5 %**	**$ 238,634**	**10.0 %**
Tier 1 risk-based capital:						
Orrstown Financial Services, Inc.	**245,752**	**10.3 %**	**203,141**	**8.5 %**	**n/a**	**n/a**
Orrstown Bank	**266,122**	**11.2 %**	**202,839**	**8.5 %**	**190,907**	**8.0 %**
Tier 1 common equity risk-based capital:						
Orrstown Financial Services, Inc.	**245,752**	**10.3 %**	**167,293**	**7.0 %**	**n/a**	**n/a**
Orrstown Bank	**266,122**	**11.2 %**	**167,044**	**7.0 %**	**155,112**	**6.5 %**
Tier 1 leverage capital:						
Orrstown Financial Services, Inc.	**245,752**	**8.5 %**	**116,325**	**4.0 %**	**n/a**	**n/a**
Orrstown Bank	**266,122**	**9.2 %**	**116,219**	**4.0 %**	**145,273**	**5.0 %**
December 31, 2021						
Total risk-based capital:						
Orrstown Financial Services, Inc.	$ 297,823	15.0 %	$ 208,617	10.5 %	n/a	n/a
Orrstown Bank	278,780	14.0 %	208,550	10.5 %	$ 198,619	10.0 %
Tier 1 risk-based capital:						
Orrstown Financial Services, Inc.	243,075	12.2 %	168,880	8.5 %	n/a	n/a
Orrstown Bank	255,995	12.9 %	168,826	8.5 %	158,895	8.0 %
Tier 1 common equity risk-based capital:						
Orrstown Financial Services, Inc.	243,075	12.2 %	139,078	7.0 %	n/a	n/a
Orrstown Bank	255,995	12.9 %	139,033	7.0 %	129,102	6.5 %
Tier 1 leverage capital:						
Orrstown Financial Services, Inc.	243,075	8.5 %	114,384	4.0 %	n/a	n/a
Orrstown Bank	255,995	8.9 %	114,470	4.0 %	143,087	5.0 %

The Company maintains a stockholder dividend reinvestment and stock purchase plan. Under the plan, shareholders may purchase additional shares of the Company's common stock at the prevailing market prices with reinvestment dividends and voluntary cash payments. The Company reserved 1,045,000 shares of its common stock to be issued under the dividend reinvestment and stock purchase plan. At December 31, 2022, approximately 665,000 shares were available to be issued under the plan.

In September 2015, the Board of Directors of the Company authorized a share repurchase program pursuant to which the Company could repurchase up to 416,000 shares of the Company's outstanding shares of common stock, in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Securities Exchange Act of 1934, as amended. On April 19, 2021, the Board of Directors authorized the additional future repurchase of up to 562,000 shares of its outstanding common stock for a total of 978,000 shares. When and if appropriate, repurchases may be made in open market or privately negotiated transactions, depending on market conditions, regulatory requirements and other corporate considerations, as determined by management. Share repurchases may not occur and may be discontinued at any time. At December 31, 2022, 818,941 shares had been repurchased under the program at a total cost of $18.7 million, or $22.78 per share. Common stock available for future repurchase totals 159,059 shares, or 1%, of the Company's outstanding common stock at December 31, 2022.

On January 24, 2023, the Board declared a cash dividend of $0.20 per common share, which was paid on February 14, 2023 to shareholders of record on February 7, 2023.

Banking regulations limit the ability of the Bank to pay dividends or make loans or advances to the Parent Company. Dividends that may be paid in any calendar year are limited to the current year's net profits, combined with the retained net profits of the preceding two years. At December 31, 2022, dividends from the Bank available to be paid to the Parent Company, without prior approval of the Bank's regulatory agency, totaled $45.9 million, subject to the Bank meeting or exceeding regulatory capital requirements. The Parent Company's principal source of funds for dividend payments to shareholders is dividends received from the Bank.

At December 31, 2022, there were no loans from the Bank to any nonbank affiliate, including the Parent Company. The Bank's loans to a single affiliate may not exceed 10%, and loans to all affiliates may not exceed 20%, of the Bank's capital stock, surplus, and undivided profits, plus the ALL (as defined by regulation). Loans from the Bank to nonbank affiliates, including the Parent Company, are also required to be collateralized according to regulatory guidelines. At December 31, 2022 and 2021, the maximum amount the Bank had available to loan to a nonbank affiliate was $29.3 million and $27.9 million, respectively.

NOTE 17. EARNINGS PER SHARE

The following table presents earnings per share for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Net income	**$ 22,037**	$ 32,881	$ 26,463
Weighted average shares outstanding - basic	**10,553**	10,967	10,942
Dilutive effect of share-based compensation	**153**	139	92
Weighted average shares outstanding - diluted	**10,706**	11,106	11,034
Per share information:			
Basic earnings per share	**$ 2.09**	$ 3.00	$ 2.42
Diluted earnings per share	**2.06**	2.96	2.40

For the years ended December 31, 2022 and 2021, there were zero average outstanding stock options and restricted award shares to exclude from the computation of earnings per share because the effect was antidilutive, as the exercise price exceeded the average market price. For the year ended December 31, 2020, there were 16,109 average outstanding stock options and restricted award shares excluded from the computation of earnings per share because the effect was antidilutive. The dilutive effect of share-based compensation in each year above relates principally to restricted stock awards.

NOTE 18. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The following table presents these contractual, or notional, amounts at December 31, 2022, and 2021.

	2022	2021
Commitments to fund:		
Home equity lines of credit	**$ 296,213**	$ 261,580
1-4 family residential construction loans	**49,538**	40,348
Commercial real estate, construction and land development loans	**156,560**	124,488
Commercial, industrial and other loans	**338,286**	378,996
Standby letters of credit	**23,229**	19,724

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

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a client to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to clients. The Company holds collateral supporting those commitments when deemed necessary by management. The liability, at December 31, 2022 and 2021, for guarantees under standby letters of credit issued was not considered to be material.

The Company maintains a reserve, based on historical loss experience of the related loan class, for off-balance sheet credit exposures that currently are not funded, in other liabilities on the condensed consolidated balance sheets. This reserve totaled $1.6 million at both December 31, 2022 and 2021. The net amount expensed for this off-balance sheet credit exposures reserve was $28 thousand, $57 thousand and $511 thousand for the years ended December 31, 2022, 2021 and 2020, respectively.

The Company may sell loans to the FHLB of Chicago as part of its MPF Program. Under the terms of the MPF Program, there is limited recourse back to the Company for loans that do not perform in accordance with the terms of the loan agreement. Each loan that is sold under the program is "credit enhanced" such that the individual loan's rating is raised to a minimum "BBB," as determined by the FHLB of Chicago. Outstanding loans sold under the MPF Program totaled $10.7 million and $13.5 million at December 31, 2022 and 2021, respectively, with limited recourse back to the Company on these loans of $387 thousand and $714 thousand at December 31, 2022 and 2021, respectively. Many of the loans sold under the MPF Program have primary mortgage insurance, which reduces the Company's overall exposure. The net amount expensed or recovered for the Company's estimate of losses under its recourse exposure for loans foreclosed, or in the process of foreclosure, is recorded in other operating expenses on the consolidated statements of income. These amounts were not material for the years ended December 31, 2022, 2021 and 2020.

NOTE 19. FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are:

Level 1 – quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access at the measurement date.

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

Level 3 – at least one significant unobservable input that reflects a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In instances in which multiple levels of inputs are used to measure fair value, hierarchy classification is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The Company used the following methods and significant assumptions to estimate fair value for financial instruments measured on a recurring basis:

Where quoted prices are available in an active market, investment securities are classified within Level 1 of the valuation hierarchy. Level 1 investment securities include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, investment securities are classified within Level 2 and fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flow. Level 2 investment securities include U.S. agency securities, mortgage-backed securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, investment securities are classified within Level 3 of the valuation hierarchy. All of the Company's investment securities are classified as available-for-sale.

The fair values of interest rate swaps, interest rate caps and risk participation derivatives are determined using models that incorporate readily observable market data into a market standard methodology. This methodology nets the discounted future cash receipts and the discounted expected cash payments. The discounted variable cash receipts and payments are based on expectations of future interest rates derived from observable market interest rate curves. In addition, fair value is adjusted for the effect of nonperformance risk by incorporating credit valuation adjustments for the Company and its counterparties. These assets and liabilities are classified as Level 2 fair values, based upon the lowest level of input that is significant to the fair value measurements.

The following table summarizes assets and liabilities measured at fair value on a recurring basis at December 31, 2022 or 2021.

	Level 1	Level 2	Level 3	Total Fair Value Measurements
December 31, 2022				
Financial Assets				
Investment securities:				
U.S. Treasury securities	**$ 17,291**	**$ —**	**$ —**	**$ 17,291**
U.S. Government Agencies	**—**	**5,135**	**—**	**5,135**
States and political subdivisions	**—**	**191,488**	**5,926**	**197,414**
GSE residential MBSs	**—**	**59,402**	**—**	**59,402**
GSE residential CMOs	**—**	**68,378**	**—**	**68,378**
Non-agency CMOs	**—**	**18,491**	**21,267**	**39,758**
Asset-backed	**—**	**125,973**	**—**	**125,973**
Other	**377**	**—**	**—**	**377**
Loans held for sale	**—**	**10,880**	**—**	**10,880**
Derivatives	**—**	**10,482**	**35**	**10,517**
Totals	**$ 17,668**	**$ 490,229**	**$ 27,228**	**$ 535,125**
Financial Liabilities				
Derivatives	**$ —**	**$ 11,333**	**$ —**	**$ 11,333**
December 31, 2021				
Financial Assets				
Investment securities:				
U.S. Treasury securities	$ 19,702	$ —	$ —	$ 19,702
States and political subdivisions	—	183,171	10,199	193,370
GSE residential MBSs	—	40,726	—	40,726
GSE residential CMOs	—	65,922	—	65,922
Non-agency CMOs	—	16,750	12,948	29,698
Asset-backed	—	122,621	—	122,621
Other	399	—	—	399
Loans held for sale	—	8,868	—	8,868
Derivatives	—	764	353	1,117
Totals	$ 20,101	$ 438,822	$ 23,500	$ 482,423
Financial Liabilities				
Derivatives	$ —	$ 760	$ —	$ 760

The Company had one municipal bond and three CMOs measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at December 31, 2022 compared to one municipal bond and one non-agency CMO measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at December 31, 2021. The Level 3 valuation is based on a non-executable broker quote, which is considered a significant unobservable input. Such quotes are updated as available and may remain constant for a period of time for certain broker-quoted securities that do not move with the market or that are not interest rate sensitive as a result of their structure or overall attributes.

The Company's residential mortgage loans held-for-sale were recorded at fair value utilizing Level 2 measurements. This fair value measurement is determined based upon third party quotes obtained on similar loans. For loans held-for-sale for which the fair value option has been elected, the aggregate fair value falls below the aggregate principal balance by $1.2 million as of December 31, 2022 and exceeded the aggregate principal balance $150 thousand as of December 31, 2021.

The determination of the fair value of interest rate lock commitments on residential mortgages is based on agreed upon pricing with the respective investor on each loan and includes a pull through percentage. The pull through percentage represents an estimate of loans in the pipeline to be delivered to an investor versus the total loans committed for delivery. Significant changes in this input could result in a significantly higher or lower fair value measurement. As the pull through percentage is a significant unobservable input, this is deemed a Level 3 valuation input. The average pull through percentage, which is based upon historical experience, was 92% as of December 31, 2022. An increase or decrease of 5% in the pull through assumption would result in a positive or negative change of $1 thousand in the fair value of interest rate lock commitments at December 31, 2022.

The following provides details of the Level 3 fair value measurement activity for the years ended December 31, 2022 or 2021.

Investment securities:

	2022	2021
Balance, beginning of year	**$ 23,147**	$ 31,503
Unrealized (loss) gain included in OCI	**(1,859)**	31
Purchases	**21,237**	—
Net discount accretion	**56**	—
Principal payments and other	**(10)**	(4,842)
Sales	**(3,053)**	(3,545)
Calls	**(12,154)**	—
OTTI	**(171)**	—
Balance, end of year	**$ 27,193**	$ 23,147

There were no transfers into or out of Level 3 at December 31, 2022 and 2021.

Interest rate lock commitments on residential mortgages:

	2022	2021
Balance, beginning of year	**$ 353**	$ 673
Total losses included in earnings	**(318)**	(320)
Balance, end of year	**$ 35**	$ 353

Certain financial assets are measured at fair value on a nonrecurring basis. Adjustments to the fair value of these assets usually results from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The Company used the following methods and significant assumptions to estimate fair value for these financial assets.

Impaired Loans

Loans are designated as impaired when, in the judgment of management and based on current information and events, it is probable that all amounts due, according to the contractual terms of the loan agreement, will not be collected. The measurement of loss associated with impaired loans for all loan classes can be based on either the observable market price of the loan, the fair value of the collateral, or discounted cash flows using the rate of return implicit in the original loan for TDRs. For collateral-dependent loans, fair value is measured based on the value of the collateral securing the loan, less estimated costs to sell. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of the real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction, or if management adjusts the appraisal value, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal, if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). Impaired loans with an allocation to the ALL are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statements of income.

Changes in the fair value of impaired loans for those still held at December 31 considered in the determination of the provision for loan losses totaled a nominal amount for the year ended December 31, 2022, and $(247) thousand and $244 thousand for the years ended December 31, 2021 and 2020, respectively.

Foreclosed Real Estate

OREO property acquired through foreclosure is initially recorded at the fair value of the property at the transfer date less estimated selling cost. Subsequently, OREO is carried at the lower of its carrying value or the fair value less estimated selling cost. Fair value is usually determined based upon an independent third-party appraisal of the property or occasionally upon a recent sales offer. The Company had no OREO balances at December 31, 2022 and 2021.

Mortgage Servicing Rights

The MSR fair value is estimated to be equal to its carrying value, unless the quarterly valuation model calculates the present value of the estimated net servicing income as less than its carrying value, in which case an impairment charge is taken. At December 31, 2022 and 2021, an impairment reserve of zero and $79 thousand, respectively, existed on the mortgage servicing right portfolio. For the years ended December 31, 2022 and 2021, an impairment valuation allowance reversal of $79 thousand and $987 thousand were included, respectively, in mortgage banking activities on the consolidated statement of income. The reversals during the years ended December 31, 2022 and 2021 were due to increases in market rates, which increased the MSR fair value.

The following table summarizes assets measured at fair value on a nonrecurring basis at December 31, 2022 and 2021.

	Level 1	Level 2	Level 3	Total Fair Value Measurements
December 31, 2022				
Impaired loans				
Commercial real estate:				
Owner-occupied	**$ —**	**$ —**	**$ 116**	**$ 116**
Non-owner occupied residential	**—**	**—**	**9**	**9**
Residential mortgage:				
First lien	**—**	**—**	**309**	**309**
Home equity - lines of credit	**—**	**—**	**86**	**86**
Total impaired loans	**$ —**	**$ —**	**$ 520**	**$ 520**
Mortgage servicing rights	$ —	$ —	$ —	$ —
December 31, 2021				
Impaired loans				
Commercial real estate:				
Owner-occupied	$ —	$ —	$ 751	$ 751
Non-owner occupied residential	—	—	24	24
Residential mortgage:				
First lien	—	—	545	545
Home equity - lines of credit	—	—	72	72
Total impaired loans	$ —	$ —	$ 1,392	$ 1,392
Mortgage servicing rights	$ —	$ —	$ 322	$ 322

The following table presents additional qualitative information about assets measured on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value.

	Fair Value Estimate		Valuation Techniques	Unobservable Input	Range
December 31, 2022					
Impaired loans	**$**	**520**	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	10% - 25% discount
				- Management adjustments for liquidation expenses	6.08% - 17.93% discount
December 31, 2021					
Impaired loans	$	1,392	Appraisal of collateral	Management adjustments on appraisals for property type and recent activity	10% - 25% discount
				- Management adjustments for liquidation expenses	6.08% - 17.93% discount
Mortgage servicing rights		322	Discounted cash flows	Weighted average CPR	12.60%
				Discount rate	9.03%

Fair values of financial instruments

GAAP requires disclosure of the fair value of financial assets and liabilities, including those that are not measured and reported at fair value on a recurring or nonrecurring basis. The following table presents the carrying amounts and estimated fair values of financial assets and liabilities at December 31, 2022, and 2021.

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
December 31, 2022					
Financial Assets					
Cash and due from banks	**$ 28,477**	**$ 28,477**	**$ 28,477**	**$ —**	**$ —**
Interest-bearing deposits with banks	**32,346**	**32,346**	**32,346**	**—**	**—**
Restricted investments in bank stock	**10,642**	**n/a**	**n/a**	**n/a**	**n/a**
Investment securities	**513,728**	**513,728**	**17,668**	**468,867**	**27,193**
Loans held for sale	**10,880**	**10,880**	**—**	**10,880**	**—**
Loans, net of allowance for loan losses	**2,126,054**	**1,991,164**	**—**	**—**	**1,991,164**
Derivatives	**10,517**	**10,517**	**—**	**10,482**	**35**
Accrued interest receivable	**11,027**	**11,027**	**—**	**4,441**	**6,586**
Financial Liabilities					
Deposits	**2,444,939**	**2,440,660**	**—**	**2,440,660**	**—**
Deposits held for assumption in connection with sale of bank branches	**31,307**	**29,429**	**—**	**29,429**	**—**
Securities sold under agreements to repurchase	**17,251**	**17,251**	**—**	**17,251**	**—**
FHLB advances and other	**106,139**	**106,141**	**—**	**106,141**	**—**
Subordinated notes	**32,026**	**31,321**	**—**	**31,321**	**—**
Derivatives	**11,333**	**11,333**	**—**	**11,333**	**—**
Accrued interest payable	**457**	**457**	**—**	**457**	**—**
Off-balance sheet instruments	**—**	**—**	**—**	**—**	**—**
December 31, 2021					
Financial Assets					
Cash and due from banks	$ 21,217	$ 21,217	$ 21,217	$ —	$ —
Interest-bearing deposits with banks	187,493	187,493	187,493	—	—
Restricted investments in bank stock	7,252	n/a	n/a	n/a	n/a
Investment securities	472,438	472,438	20,101	429,190	23,147
Loans held for sale	8,868	8,868	—	8,868	—
Loans, net of allowance for loan losses	1,958,806	1,946,365	—	—	1,946,365
Derivatives	1,117	1,117	—	764	353
Accrued interest receivable	8,234	8,235	—	2,203	6,032
Financial Liabilities					
Deposits	2,464,929	2,466,191	—	2,466,191	—
Securities sold under agreements to repurchase	23,301	23,301	—	23,301	—
FHLB advances and other	1,896	2,035	—	2,035	—
Subordinated notes	31,963	31,815	—	31,815	—
Derivatives	760	760	—	760	—
Accrued interest payable	154	154	—	154	—
Off-balance sheet instruments	—	—	—	—	—

In accordance with the Company's adoption of ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*,* the methods utilized to measure the fair value of financial instruments at December 31, 2022 and 2021 represents an approximation of exit price; however, an actual exit price may differ. For deposits held for assumption in connection with the sale of bank branches, the Company announced on

December 23, 2022 that it had entered into a Purchase and Assumption Agreement providing for the sale of a branch and associated deposit liabilities at an agreed upon premium of 6.0% of the financial deposit balance transferred.

NOTE 20. REVENUE FROM CONTRACTS WITH CLIENTS

On January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and all subsequent amendments (collectively "ASC 606"). The update implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASC 606 is that an entity should recognize revenue to depict the transfer of promised goods or services to clients in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The majority of the Company's revenue comes from interest income, including loans and securities, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within noninterest income on the consolidated statements of income and are recognized as revenue as the Company satisfies its obligation to the client. Services within the scope of ASC 606 include service charges on deposit accounts, income from trust and investment management and brokerage activities and interchange fees from service charges on ATM and debit card transactions. ASC 606 did not result in a change to the accounting for any in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Descriptions of revenue generating activities that are within the scope of ASC 606 are as follows:

Service Charges on Deposit Accounts - The Company earns fees from its deposit clients for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the client's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the client's account balance.

Interchange Income - The Company earns interchange fees from debit/credit cardholder transactions conducted through the MasterCard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Interchange income is presented net of cardholder rewards.

Swap Referral Fee Income - Through May 2020, the Company earned fees from a third-party service provider for loan hedging referrals provided to lending clients. The Company acted as an agent in arranging the relationship between our client and the third-party service provider. The Company was paid and recognized income upon completion of the loan hedge between our client and the third-party service provider.

Trust and Investment Management Income - The Company earns wealth management and investment brokerage fees from its contracts with trust and wealth management clients to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Company provides the contracted services and are generally assessed based on a tiered scale of the market value of assets under management. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided included financial planning services and the associated fees the Company earns, which are based on a fixed fee schedule, are recognized when the services are rendered. Services are generally billed in arrears and a receivable is recorded until fees are paid.

Brokerage Income - The Company earns fees from investment management and brokerage services provided to its clients through a third-party service provider. The Company receives commissions from the third-party service provider and recognizes income on a weekly basis based upon client activity. As the Company acts as an agent in arranging the relationship between the client and the third-party service provider and does not control the services rendered to the clients, brokerage income is presented net of related costs.

At December 31, 2022, 2021 and 2020, the Company had receivables from trust and wealth management clients totaling $641 thousand, $702 thousand and $661 thousand, respectively.

The following table presents the Company's noninterest income disaggregated by revenue source for the years ended December 31, 2022, 2021 and 2020.

	2022	2021	2020
Noninterest income			
Service charges on deposit accounts and ATM fees	**$ 4,157**	$ 3,337	$ 3,113
Swap referral fee income	**—**	—	208
Trust and investment management income	**7,631**	7,896	6,912
Brokerage income	**3,620**	3,571	2,821
Interchange income	**4,056**	4,129	3,423
Revenue from contracts with clients	**19,464**	18,933	16,477
Other service charges	**456**	356	444
Mortgage banking activities	**407**	5,909	5,274
Gain on sale of commercial loans	**—**	—	2,803
Income from life insurance	**2,339**	2,273	2,261
Swap dealer fee income	**2,632**	293	639
Other income	**1,814**	750	427
Investment securities (losses) gains	**(160)**	638	(16)
Total noninterest income	**$ 26,952**	$ 29,152	$ 28,309

NOTE 21. ORRSTOWN FINANCIAL SERVICES, INC. (PARENT COMPANY ONLY) CONDENSED FINANCIAL INFORMATION

Condensed Balance Sheets

	December 31,	
	2022	2021
Assets		
Cash in bank subsidiary	**$ 8,477**	$ 18,545
Investment in bank subsidiary	**249,266**	284,577
Other assets	**3,466**	553
Total assets	**$ 261,209**	$ 303,675
Liabilities		
Subordinated notes	**$ 32,026**	$ 31,963
Accrued interest and other liabilities	**287**	56
Total liabilities	**32,313**	32,019
Shareholders’ Equity		
Common stock	**584**	586
Additional paid-in capital	**189,264**	189,689
Retained earnings	**92,473**	78,700
Accumulated other comprehensive (loss) income	**(39,913)**	4,449
Treasury stock	**(13,512)**	(1,768)
Total shareholders’ equity	**228,896**	271,656
Total liabilities and shareholders’ equity	**$ 261,209**	$ 303,675

Condensed Statements of Income

	For the Years Ended December 31,		
	2022	2021	2020
Income			
Dividends from bank subsidiary	**$ 27,000**	$ 16,000	$ 14,000
Interest income from bank subsidiary	**29**	25	76
Other income	**16**	119	62
Total income	**27,045**	16,144	14,138
Expenses			
Interest on subordinated notes	**2,013**	2,009	2,006
Share-based compensation	**511**	433	463
Management fee to bank subsidiary	**1,341**	1,089	1,254
Provision for legal settlement	**13,000**	—	—
Other expenses	**912**	704	1,324
Total expenses	**17,777**	4,235	5,047
Income before income tax benefit and equity in undistributed income of subsidiaries	**9,268**	11,909	9,091
Income tax benefit	**(3,726)**	(863)	(1,022)
Income before equity in undistributed income of subsidiaries	**12,994**	12,772	10,113
Equity in undistributed income of subsidiaries	**9,043**	20,109	16,350
Net income	**$ 22,037**	$ 32,881	$ 26,463

Condensed Statements of Cash Flows

	For the Years Ended December 31,		
	2022	**2021**	**2020**
Cash flows from operating activities:			
Net income	**$ 22,037**	$ 32,881	$ 26,463
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Amortization	**63**	59	56
Deferred income taxes	**(7)**	(4)	(39)
Equity in undistributed income of subsidiaries	**(9,043)**	(20,109)	(16,350)
Share-based compensation	**511**	433	463
Net change in other liabilities	**231**	(40)	(141)
Net change in other assets	**(2,915)**	375	(221)
Net cash provided by operating activities	**10,877**	13,595	10,231
Cash flows from investing activities:			
Net cash paid for acquisitions	**—**	—	(85)
Net cash used in investing activities	**—**	—	(85)
Cash flows from financing activities:			
Dividends paid	**(8,264)**	(8,280)	(7,610)
Proceeds from issuance of common stock	**1,644**	1,516	1,628
Payments to repurchase common stock	**(14,468)**	(2,383)	(1,887)
Other, net	**143**	136	116
Net cash used in financing activities	**(20,945)**	(9,011)	(7,753)
Net (decrease) increase in cash	**(10,068)**	4,584	2,393
Cash, beginning	**18,545**	13,961	11,568
Cash, ending	**$ 8,477**	$ 18,545	$ 13,961

NOTE 22. CONTINGENCIES

The nature of the Company's business generates a certain amount of litigation involving matters arising out of the ordinary course of business. Except as described below, in the opinion of management, there are no legal proceedings that might have a material effect on the results of operations, liquidity, or the financial position of the Company at this time.

On March 5, 2019, Paul Parshall, a purported individual stockholder of Hamilton, filed, on behalf of himself and all of Hamilton's stockholders other than the named defendants and their affiliates (the "Purported Class"), a derivative and putative class action complaint in the Circuit Court for Baltimore City, Maryland, captioned Paul Parshall v. Carol Coughlin et. al., naming each Hamilton director, Orrstown, and Hamilton as defendants (the "Action"). The Action alleged, among other things, that Hamilton's directors breached their fiduciary duties to the Purported Class in connection with the merger, and that the Proxy Statement/Prospectus omitted certain material information regarding the merger. Orrstown was alleged to have aided and abetted the Hamilton directors' alleged breaches of their fiduciary duties. The Action sought, among other remedies, to enjoin the merger or, in the event the merger was completed, rescission of the merger or rescissory damages; unspecified damages; and costs of the lawsuit, including attorneys' and experts' fees. A settlement was reached on the Action in March 2020, which resulted in a payment by the Company of $135 thousand in mootness fees to the defendants in April 2020.

On May 25, 2012, the Southeastern Pennsylvania Transportation Authority ("SEPTA") filed a putative class action complaint in the U.S. District Court for the Middle District of Pennsylvania against the Company, the Bank and nine independent current and former directors and three current and former officers of the Company and the Bank. The complaint asserted claims under Sections 11, 12(a) and 15 of the Securities Act, Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder, and sought class certification, unspecified money damages, interest, costs, fees and equitable or injunctive relief. Under the Private Securities Litigation Reform Act of 1995, the Court appointed SEPTA Lead Plaintiff on August 20, 2012.

On March 4, 2013, SEPTA filed an amended complaint. The amended complaint expanded the list of defendants in the action to include the Company's former independent registered public accounting firm and the underwriters of the Company's

March 2010 public offering of common stock. In addition, among other things, the amended complaint extended the purported Exchange Act class period from March 15, 2010 through April 5, 2012.

After years of litigation, on November 7, 2022, the Company, in order to avoid the cost, risks and distraction of continued litigation, entered into a Memorandum of Understanding (the “MOU”) to settle and resolve the lawsuit. The MOU memorialized the parties’ agreement to execute and submit a formal, binding settlement agreement for the Court’s approval, setting forth all of the material terms of the settlement reached by the plaintiffs and defendants. On December 7, 2022, the Company entered into a Stipulation and Agreement of Settlement (the “Stipulation”) providing for a payment to the Plaintiffs of $15.0 million, to which the Company agreed to contribute and has funded $13.0 million in escrow, a mutual release of claims against all parties, and a stipulation that the lawsuit will be dismissed with prejudice. The Stipulation does not include any admission of wrongdoing by any party. The Stipulation provides that the defendants have the option to terminate the settlement if class members who in the aggregate purchased more than a certain number of shares of the Company’s common stock during the class period, timely and validly exclude themselves from the class.

The Stipulation was filed with the Court on December 8, 2022. On February 1, 2023, the Court issued an order which, among other things, preliminarily approved the Stipulation. The Stipulation is subject to final Court approval.

On March 25, 2022, a customer of the Bank filed a putative class action complaint against the Bank in the Court of Common Pleas of Cumberland County, Pennsylvania, in a case captioned Alleman, on behalf of himself and all others similarly situated, v. Orrstown Bank. The complaint alleges, among other things, that the Bank breached its account agreements by charging certain overdraft fees. The complaint seeks a refund of all allegedly improper fees, damages in an amount to be proven at trial, attorneys’ fees and costs, and an injunction against the Bank’s allegedly improper overdraft practices. This lawsuit is similar to lawsuits recently filed against other financial institutions pertaining to overdraft fee disclosures. The Bank believes that the allegations and claims against the Bank are without merit.

ITEM 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A – CONTROLS AND PROCEDURES

Based on the evaluation required by Securities Exchange Act Rules 13a-15(b) and 15d-15(b), the Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e), at December 31, 2022. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at December 31, 2022. There have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during the fourth quarter of 2022.

Management's Report on Internal Controls Over Financial Reporting is included in Part II, Item 8, "Financial Statements and Supplementary Data." The effectiveness of the Company's internal control over financial reporting at December 31, 2022 has been audited by Crowe LLP, an independent registered public accounting firm, as stated in the Report of Independent Registered Public Accounting Firm appearing in Part II, Item 8, "Financial Statements and Supplementary Data."

ITEM 9B – OTHER INFORMATION

None.

ITEM 9C - DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not Applicable.

PART III

ITEM 10 – DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The Company has adopted a code of ethics that applies to all senior financial officers (including its Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and any person performing similar functions). You can find a copy of the Code of Ethics for Senior Financial Officers by visiting our website at www.orrstown.com and following the links to “Investor Relations” and “Governance Documents.” A copy of the Code of Ethics for Senior Financial Officers may also be obtained, free of charge, by written request to Orrstown Financial Services, Inc., 77 East King Street, PO Box 250, Shippensburg, Pennsylvania 17257, Attention: Secretary. The Company intends to disclose any amendments to or waivers from a provision of the Company’s Code of Ethics for Senior Financial Officers in a timely manner.

All other information required by Item 10 is incorporated by reference from the Company’s definitive proxy statement for the 2023 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A, under Delinquent Section 16(a) Reports, Proposal 1 – Election of Directors – Biographical Summaries of Nominees and Directors; Information About Executive Officers; Involvement in Certain Legal Proceedings; and Proposal 1 – Election of Directors – Nomination of Directors, and Board Structure, Committees and Meeting Attendance.

ITEM 11 – EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference from the Company’s definitive proxy statement for the 2023 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A, under Proposal 1 – Election of Directors – Compensation of Directors, Compensation Discussion and Analysis, Compensation Committee Report, Executive Compensation Tables, Potential Payments Upon Termination or Change in Control, Pay versus Performance and Compensation Committee Interlocks and Insider Participation.

In accordance with Items 402(v) and 407(e)(5) of SEC Regulation S-K, the information set forth under the captions "Pay versus Performance" and "Compensation Committee Report" in such proxy statement will be deemed to be furnished in this Report and will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act as a result of furnishing the disclosure in this manner.

ITEM 12 – SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table presents equity compensation plan information at December 31, 2022.

Plan Category	Number of securities 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 securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plan approved by security holders	—	n/a	537,027
Total	—	n/a	537,027

All other information required by Item 12 is incorporated, by reference, from the Company's definitive proxy statement for the 2023 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A, under Share Ownership of Certain Beneficial Owners and Management.

ITEM 13 – CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated by reference from the Company's definitive proxy statement for the 2023 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A, under Proposal 1 – Election of Directors – Director Independence, and Transactions with Related Persons, Promoters and Certain Control Persons.

ITEM 14 – PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is incorporated by reference from the Company's definitive proxy statement for the 2023 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A, under Proposal 4 – Ratification of the Audit Committee's Selection of Crowe LLP as the Company's Independent Registered Public Accounting Firm for the Fiscal Year Ending December 31, 2023 – Relationship with Independent Registered Public Accounting Firm.

PART IV
ITEM 15 – EXHIBIT AND FINANCIAL STATEMENT SCHEDULES

a. The following documents are filed as part of this report:

(1) – Financial Statements

Consolidated financial statements of the Company and subsidiaries required in response to this Item are incorporated by reference from Item 8 of this report.

(2) – Financial Statement Schedules

All financial statement schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

(3) – Exhibits

2.1	Purchase and Assumption Agreement, dated December 23, 2022 between Orrstown Bank and the Juniata Valley Bank, incorporated by reference to the Registrant's Form 8-K filed December 28, 2022.
3.1	Articles of Incorporation as amended, incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K filed on January 29, 2010.
3.2	By-laws as amended, incorporated by reference to Exhibit 3.2 to the Registrant's Report on Form 8-K filed June 2, 2021.
4.1	Specimen Common Stock Certificate, incorporated by reference to the Registrant's Registration Statement on Form S-3 filed February 8, 2010 (File No. 333-164780).
4.2	Subordinated Indenture, dated December 19, 2018, by and between Orrstown Financial Services, Inc., and U.S. Bank, National Association, incorporated by reference to Exhibit 4.1 of the Registrant's Form 8-K filed on December 20, 2018.
4.3	Form of Global Note for Subordinated Notes, incorporated by reference to Exhibit 4.2 of the Registrant's Form 8-K filed December 20, 2018.
4.4	Form of Registration Rights Agreement for Subordinated Notes, incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K filed December 20, 2018.
4.5	Description of Registrant's Securities, incorporated by reference to Exhibit 4.5 of the Registrant's Form 10-K filed on March 11, 2022.
10.1	Change in Control Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Thomas R. Quinn, Jr. incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed September 27, 2019.
10.2	Change in Control Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Robert G. Coradi, incorporated by reference to Exhibit 10.8 to the Registrant's Form 8-K filed June 2, 2015.
10.3	Change in Control Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Adam L. Metz, incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed March 14, 2017.
10.4	Change in Control Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Christopher D. Holt dated July 15, 2019, incorporated by reference to Exhibit 10.5 to the Registrant's Form 10-K filed March 15, 2021.
10.5	Amended and Restated Change in Control Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Neelesh Kalani incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed April 11, 2022.
10.6	Salary Continuation Agreement between Orrstown Bank and Thomas R. Quinn, Jr. – incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed January 8, 2010.
10.7	First Amendment to the Salary Continuation Agreement between Orrstown Bank and Thomas R. Quinn, Jr. – incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed September 27, 2019.
10.8	Salary Continuation Agreement between Orrstown Bank and Robert Coradi dated March 26, 2018 – incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q filed November 5, 2020.
10.9	Officer Group Term Replacement Plan for Selected Officers – incorporated by reference to Exhibit 10.2 to Registrant's Form 10-K for the year ended December 31, 1999 filed March 28, 2000.
10.10	Director Retirement Agreement, as amended, between Orrstown Bank and Andrea Pugh, incorporated by reference to Exhibit 10.4(c) to the Registrant's Form 10-K filed March 15, 2010.

10.11	Director Retirement Agreement, as amended, between Orrstown Bank and Glenn W. Snoke, incorporated by reference to Exhibit 10.4(f) to the Registrant's Form 10-K filed March 15, 2010.
10.12	Director Retirement Agreement, as amended, between Orrstown Bank and Joel R. Zullinger, incorporated by reference to Exhibit 10.4(h) to the Registrant's Form 10-K filed March 15, 2010.
10.13	Revenue neutral retirement plan – incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-K filed March 28, 2000.
10.14	2011 Orrstown Financial Services, Inc. Stock Incentive Plan – incorporated by reference to Exhibit 10.1 of the Registrant's registration statement on Form S-8 filed May 27, 2022.
10.15	Employment Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Thomas R. Quinn, Jr. incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed June 8, 2015.
10.16	Employment Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Robert G. Coradi, incorporated by reference to Exhibit 10.7 to the Registrant's Form 8-K filed June 2, 2015.
10.17	Employment Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Adam L. Metz, incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed March 14, 2017.
10.18	Employment Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Christopher D. Holt dated July 15, 2019, incorporated by reference to Exhibit 10.24 to the Registrant's Form 10-K filed March 15, 2021.
10.19	Employment Agreement between Orrstown Financial Services, Inc., Orrstown Bank and Neelesh Kalani incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed May 4, 2021.
10.20	Brick Plan – Deferred Income Agreement between Orrstown Bank and Joel R. Zullinger, incorporated by reference to Exhibit 10.11 to the Registrant's Form 10-K filed March 15, 2010.
10.21	Director/Executive Officer Deferred Compensation Plan.
10.22	Trust Agreement for Director/Executive Officer Deferred Compensation Plan, incorporated by reference to Exhibit 10.13(b) to the Registrant's Form 10-K filed March 15, 2010.
10.23	Deferred Compensation Agreement between Orrstown Bank and Thomas R. Quinn, Jr., incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed September 27, 2019.
10.24	Deferred Compensation Agreement between Orrstown Bank and Christopher D. Holt, dated September 16, 2020, incorporated by reference to Exhibit 10.30 to the Registrant's Form 10-K filed March 15, 2021.
10.25	Deferred Compensation Agreement between Orrstown Bank and Adam L. Metz, incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed December 16, 2022.
10.26	Form of Subordinated Note Purchase Agreement, incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed December 20, 2018.
10.27	Form of Restricted Stock Grant Agreement - Employees
10.28	Form of Restricted Stock Grant Agreement - Nonemployee Directors
10.29	Stipulation and Agreement of Settlement, incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K filed December 7, 2022.
14	Code of Ethics Policy for Senior Financial Officers posted on Registrant's website.
21	Subsidiaries of the registrant
23.1	Consent of Crowe LLP, Independent Registered Public Accounting Firm
31.1	Rule 13a – 14(a)/15d-14(a) Certification (Chief Executive Officer)
31.2	Rule 13a – 14(a)/15d-14(a) Certifications (Chief Financial Officer)
32.1	Section 1350 Certifications (Chief Executive Officer)
32.2	Section 1350 Certifications (Chief Financial Officer)

101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

All other exhibits for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

b. Exhibits – The exhibits to this Form 10-K begin after the signature page.

c. Financial statement schedules – None required.

ITEM 16 – FORM 10-K SUMMARY

Not applicable.

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.

ORRSTOWN FINANCIAL SERVICES, INC.
(Registrant)

Dated: March 16, 2023

By: /s/ Thomas R. Quinn, Jr.
Thomas R. Quinn, Jr., President and Chief Executive Officer

Pursuant to the requirements of Section 13 or 15(d) 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 and on the dates indicated.

Signature	Title	Date
/s/ Thomas R. Quinn, Jr. Thomas R. Quinn, Jr.	President and Chief Executive Officer (Principal Executive Officer) and Director	March 16, 2023
/s/ Neelesh Kalani Neelesh Kalani	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 16, 2023
/s/ Sean P. Mulcahy Sean P. Mulcahy	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)	March 16, 2023
/s/ Joel R. Zullinger Joel R. Zullinger	Chairman of the Board and Director	March 16, 2023
/s/ Cindy J. Joiner Cindy J. Joiner	Director	March 16, 2023
/s/ Mark K. Keller Mark K. Keller	Director	March 16, 2023
/s/ Thomas D. Longenecker Thomas D. Longenecker	Director	March 16, 2023
/s/ Meera R. Modi Meera R. Modi	Director	March 16, 2023
/s/ Andrea Pugh Andrea Pugh	Director	March 16, 2023
/s/ Michael J. Rice Michael J. Rice	Director	March 16, 2023
/s/ Eric A. Segal Eric A. Segal	Director	March 16, 2023
/s/ Glenn W. Snoke Glenn W. Snoke	Director	March 16, 2023
/s/ Floyd E. Stoner Floyd E. Stoner	Director	March 16, 2023

ORRSTOWN FINANCIAL SERVICES, INC.
AND ITS WHOLLY OWNED SUBSIDIARIES

DIRECTOR/EXECUTIVE OFFICER DEFERRED COMPENSATION PLAN

WHEREAS, ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARIES, hereinafter collectively called " Company," have previously adopted the Orrstown Financial Services, Inc. Director/Executive Officer Deferred Compensation Plan effective September 1, 1995, hereinafter call "Plan," to assist it in attracting and retaining persons of outstanding competence and stature to serve as directors or executive officers by giving them the option of planning effectively for their respective futures by deferring receipt of their fees or compensation.

WHEREAS, the Board of Directors of the Company has previously approved amendments to the Plan;

WHEREAS, in order to reflect the amendments to the Plan previously approved by the Board of Directors of the Company, the Plan hereby is amended and restated as follows:

1. ***Effective Date:*** The Plan shall apply to all fees or compensation payable to directors who joined the board of director prior to September 1, 2018 or executive officers for services rendered after August 31, 1995.

2. ***Participation:*** Each director or executive officer of the Company who is entitled to receive fees or compensation for services as a director/executive officer may elect to defer receipt of the fees or compensation otherwise payable to him/her as provide for in the Plan. Each such director or executive officer who elects to defer fees or compensation shall be a participant in the Plan.

3. ***Administration:*** The Company's Compensation Committee shall act as the administrator of the Plan and shall administer, construe, and interpret the Plan. The administrator(s) shall not be liable for any act done or determination made in good faith.

4. ***Deferrals:***

   a) ***Election:*** Prior to January 1 and July 1 (and with respect to 1995, prior to September 1, 1995), any eligible director or executive officer may file with the board of directors and/or administrator(s) of the Plan an election in writing to participate in the Plan for that year or for that year and succeeding years. When such election is filed, fees or compensation will be reduced according to the election for that year, or for that year and for succeeding years. If an election is filed to participate in the Plan for succeeding years, an election to termination participation in the Plan for any year must be field prior to January 1 and July 1 of that year. An individual who first becomes a director or executive officer during a calendar year may make an election to defer fees or compensation for the remainder of the year within 30 days of such date.

   b) ***Accounting:*** An appropriate record shall be maintained by the Company called the "Directors'/Executive Officers' Compensation Account" which shall list each participant and the amount of the individual credits and earnings due. The Company shall add to each participant's account an amount equivalent to the fees or compensation that would have been paid to the participant if election had not been made to participate in the Plan. The addition shall be made on the date on which the fee or compensation would have been paid absent a deferral election

   c) ***Establishment of Trust:*** The Company will establish a trust fund to aid it in accumulating the amounts necessary to satisfy its contractual liability to pay such benefits.

The Company may make contributions to this trust from time to time, which contributions (if made) will be applied in payment of the Company's obligations to pay such benefits.

The Company will pay all benefits payable under its Directors/Executive Officer Deferred Compensation Plan from its general assets, and the establishment of this trust shall not reduce or otherwise affect the Company's continuing liability to pay benefits from such assets except that the Company's liability shall be offset by actual benefit payments made by this trust.

The trust established by this trust agreement is intended to be classified for income tax purposes as a "grantor trust" with the result that the income of the trust will be treated as income of the Company pursuant to Subpart E of Subchapter J or Chapter 1, or Subtitle A of the Internal Revenue Code 1986, as amended (the code).

d) ***Investments:*** The trust will establish several investment options for participants in the non-qualified deferred compensation plan. The participant shall direct the trustee, in writing, to invest their account in the following investment vehicles:

1. Orrstown Bank Certificates of Deposit. Minimum Investment $3,000
2. Life Insurance and annuities
3. PRS Capital Preservation Model
4. PRS Income Model
5. PRS Income & Growth Model
6. PRS Balanced Model
7. PRS Growth Model
8. PRS Aggressive Growth Model
9. Orrstown Financial Services, Inc. common stock

Any uninvested cash shall be held in a money market fund that is designated by the Trustee. Changes in the investment direction may be made on a semi-annual basis.

5. ***Distribution:*** Prior to the date on which payment shall commence, the administrator(s) shall determine the method of distribution as permitted hereunder. In the case of a director, payment must commence not later than January 15 following the year in which the director attains age 75 or terminates service as a director, whichever occurs later. In the case of an executive director, payment must commence not later than January 15 following the year in which the executive officer attains age 65 or retires, whichever occurs later. Payment may be made in equal monthly or annual installments of the principal amount of the account balance determined as of December 31 preceding commencement of distribution over not more than ten years. Monthly principal payments shall be accompanied by payment of 1/12 of the unpaid earnings credited on or before December 31 of the year ended before payment of the installments.

Notwithstanding the foregoing, the administrator(s) may accelerate distribution to a participant at the participant's request upon a finding by the administrator(s) that the participant has a severe financial hardship which was not foreseeable at the time the deferral election became effective. In such case, the amount of the accelerated distribution shall not exceed the amount needed to alleviate the hardship.

In the following situations, the administrator shall made immediate distributions in full satisfaction of the participants' deferred compensation, including all earnings thereon:

a) Development of a hostile takeover

b) Failure by an acquiring bank, bank holding company, or other acquiring organization to approve this Plan

c) Bankruptcy of the bank or acquiring bank, holding company, or other acquiring organization

6. ***Death:*** If a participant dies prior to the payment of his entire account, the Company shall pay the balance to the participant's designated beneficiary in a single lump sum payment and shall pay the earnings

credited to the account for the year of death no later than April 15 of the following year. Such payments shall be in complete satisfaction of all the rights of the participant under the Plan. If the participant has not designated a beneficiary or the designated beneficiary is not living on the date payment is to be made, the participant's estate shall be the beneficiary.

7. ***Assignment and Alienation of Benefits:*** To the maximum extent permitted by law, a participant's rights or benefits under this Plan shall not be subject to anticipation, alienation, sale, assignment, pledge, encumbrance, or charge, and any attempt to anticipate, alienate, sell, assign, pledge, encumber, or charge the same shall be void. No right or benefit hereunder shall in any manner be liable for or subject to the debts, contracts, liabilities, or torts of the person entitled to such benefit. If any participant becomes bankrupt or attempts to anticipate, alienate, sell, assign, pledge, encumber or charge any right to a benefit hereunder, then such right or benefit, in the discretion of the administrator(s), may be terminated. In such event the Company may hold or apply the same or any part thereof for the benefit of the participant, his or her spouse, children or other dependents, or any of them, in such manner and portion as the administrator(s) may deem proper.

8. ***Amendment or Termination:*** The board of directors of the Company may amend or terminate this Plan at any time. Any amendment or termination of this Plan shall not affect the rights of the participant accrued prior thereto without his written consent. The Plan shall automatically terminate if it is determined by the Internal Revenue Service to not qualify as a deferred compensation agreement deferring income taxes of the director or officer. Such automatic termination shall be effective the first day of the month following the determination by the Internal Revenue Service.

9. ***Status of Amounts Due:*** No liability of the Company hereunder shall be deemed to be secured by any pledge or other encumbrance on any property of the Company. In not event may the Company create a security interest in the Plan assets in favor of participants or beneficiaries of the Plan.

ORRSTOWN FINANCIAL SERVICES, INC.

RESTRICTED SECURITY GRANT AGREEMENT FOR EMPLOYEES
Pursuant to the 2011 Incentive Stock Plan

This Restricted Security Grant Agreement (this “Agreement”) is delivered by Orrstown Financial Services, Inc., a Pennsylvania corporation (the “Company”), pursuant to the Summary of Grant delivered with this Agreement to the individual named in the Summary of Grant (the "Participant"). The Summary of Grant, which specifies the Participant, the date as of which the grant is made (the "Date of Grant"), the type of security granted, the vesting schedule and other specific details of the grant is incorporated herein by reference.

1. **Grant of Restricted Securities.** Upon the terms and conditions set forth in this Agreement and in the Company’s 2011 Incentive Stock Plan (the “Plan”), the Company hereby grants to the Participant the number of shares of restricted stock or restricted stock units set forth in the Summary of Grant (the "Restricted Securities"). The Participant also acknowledges the receipt of a copy of the Plan and that copies of the Plan are available from the Human Resources Department of the Company. Each grant of Restricted Securities will entitle the Participant to receive, at such time as is determined in accordance with the provisions of this Agreement, one fully paid, unrestricted share of common stock of the Company (the "Company Stock"). This Agreement is made pursuant to the Plan and is subject in its entirety to all applicable provisions of the Plan. Capitalized terms used herein and not otherwise defined will have the meanings set forth in the Plan. The Participant agrees to be bound by all of the terms and conditions of the Plan.

2. **Vesting of Restricted Securities**.

(a) The Restricted Securities will become vested as set forth in the Summary of Grant, provided that the Participant continues to be employed by, or provide service to, the Company or any of its Affiliates, collectively referred to as the Employer, through the Vesting Date (as defined in the Summary of Grant). For purposes of this Agreement, the term "Affiliate" has the meaning ascribed to such term in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended.

(b) Except as set forth in the Summary of Grant, if the Participant ceases to be employed by, or provide service to, the Employer for any reason prior to the Vesting Date, the Participant will forfeit all rights to receive shares of Company Stock hereunder and the Participant will not have any rights with respect to any portion of the shares of Company Stock that have not yet become vested as of the date the Participant ceases to be employed by, or provide service to, the Employer. Any certificates or book entries for the Restricted Securities granted pursuant to this Agreement shall bear an appropriate legend, as determined by the Committee in its sole discretion, to the effect that such shares are subject to restrictions as set forth herein and in the Plan. The Restricted Securities granted pursuant to this Agreement may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of by the Participant prior to the Vesting Date except to a Successor Grantee pursuant to Article 10 of the Plan.

3. **Issuance of Company Stock**. One share of Company Stock will be issued to the Participant for each vested Restricted Security in accordance with the vesting schedule set forth in the Summary of Grant. Any Restricted Securities not vested will be

forfeited. Participant understands and agrees that all Restricted Securities that are not fully vested at the time Participant ceases to be employed by, or provide service to, the Employer shall be returned to Company. In no event will any fractional shares of Company Stock be issued. Accordingly, the total number of shares of Company Stock to be issued pursuant to this Agreement will, to the extent necessary, be rounded down to the next whole share of Company Stock in order to avoid the issuance of a fractional share.

4. **Taxes**.

(a) The Participant acknowledges that the Company has not advised the Participant regarding the Participant's income tax liability in connection with the grant or vesting of the Restricted Securities and the delivery of unrestricted shares of Company Stock in connection therewith. The Participant has reviewed with the Participant's own tax advisors the federal, state, and local tax consequences of the grant and vesting of the Restricted Securities and the delivery of unrestricted shares of Company Stock in connection therewith as contemplated by this Agreement. The Participant is relying solely on such advisors and not on any statements or representations of the Company or any of its agents. The Participant understands that the Participant (and not the Company) will be responsible for the Participant's own tax liability that may arise as a result of the transactions contemplated by this Agreement.

(b) To the extent applicable, the Participant shall, not later than the date as of which the receipt of this grant becomes a taxable event for federal income tax purposes, pay to the Company or make arrangements satisfactory to the Compensation Committee of the Company’s Board of Directors (the “Committee”) for payment of any Federal, state, and local taxes required by law to be withheld on account of such taxable event. Except in the case where an election is made pursuant to Paragraph (c) below, the Company shall have the authority to cause the required tax withholding obligation to be satisfied, in whole or in part, by withholding from shares of Company Stock to be issued or released by the transfer agent a number of shares of Company Stock with an aggregate Fair Market Value (as defined in the Plan) that would satisfy the withholding amount due.

(c) The Participant and the Employer hereby agree that the Participant may, within 30 days following the Date of Grant, file with the Internal Revenue Service and the Employer an election under Section 83(b) of the Internal Revenue Code. In the event the Participant makes such an election, he or she agrees to provide a copy of the election to the Employer. The Participant acknowledges that he or she is responsible for obtaining the advice of his or her tax advisors with regard to the Section 83(b) election and that he or she is relying solely on such advisors and not on any statements or representations of the Employer or any of its agents with regard to such election.

5. **Rights of Participant**.

(a) Prior to the issuance, if any, of unrestricted shares of Company Stock to the Participant pursuant to the vesting schedule set forth in the Summary of Grant, the Participant will not have any rights of a shareholder of the Company on account of the Restricted Securities, other than, with respect to shares of restricted stock but not with respect to restricted stock units, to vote said Restricted Securities.

(b) Notwithstanding the foregoing, if any dividend or other distribution, whether regular or extraordinary and whether payable in cash, securities or other property (other than shares of Company Stock), is declared and paid on the outstanding Company Stock prior to the issuance of unrestricted shares of Company Stock with respect to the shares of restricted stock pursuant to the vesting schedule (i.e. those shares are otherwise issued and outstanding for purposes of entitlement to the dividend or distribution), then a special book account will be established for the Participant and credited with a phantom dividend equal to the actual dividend or distribution which would have been paid on the shares of restricted stock subject to this Agreement had shares been issued unrestricted with respect to such shares of restricted stock and been outstanding and entitled to that dividend or distribution. The phantom dividend equivalents so credited will vest at the same time as the shares of restricted stock to which they relate and will be distributed to the Participant (in the same form the actual dividend or distribution was paid to the holders of the Company Stock entitled to that dividend or distribution or in such other form as the Committee deems appropriate) concurrently with the issuance of shares of Company Stock pursuant to the vesting schedule set forth in the Summary of Grant. Restricted stock units shall not be entitled to any dividend or other distribution, whether regular or extraordinary and whether payable in cash, securities or other property, if declared and paid on the outstanding Company Stock prior to the issuance of unrestricted shares of Company Stock upon the vesting of the restricted stock units.

6. **Restrictions on Issuance of Company Stock**. The obligation of the Company to deliver unrestricted shares of Company Stock to the Participant with respect to vested Restricted Securities will be subject to the condition that, if at any time the Committee determines in its discretion that the listing, registration or qualification of the shares of Company Stock upon any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the issuance of shares of Company Stock, the shares of Company Stock may not be issued in whole or in part unless such listing, registration, qualification, consent or approval will have been effected or obtained free of any conditions not acceptable to the Committee.

7. **Recoupment Policy**. The Participant agrees that the Participant will be subject to any compensation, clawback and recoupment policies that may be applicable to the Participant as an employee of the Company, as in effect from time to time and as approved by the Board of Directors or a duly authorized committee thereof, whether or not approved before or after the Date of Grant.

8. **Successors and Assigns**. Except to the extent otherwise provided in this Agreement, the provisions of this Agreement will inure to the benefit of, and be binding upon, the Company and its successors and assigns. During the period prior to the Vesting Date, the right to receive shares of Company Stock may not be assigned, transferred, pledged or otherwise disposed of by the Participant, except as permitted under the Plan or by the Committee. Any attempt to assign, transfer, pledge or otherwise dispose of the right to receive shares of Company Stock contrary to the provisions the Summary of Grant, this Agreement and the Plan, and the levy of any execution, attachment or similar process upon the right to receive the shares, will be null, void and without effect.

9. **Entire Agreement**. This Agreement contains the entire agreement of the parties with respect to the Restricted Securities granted hereby and supersedes all prior agreements and discussions between the parties concerning such subject matter. This Agreement may not be changed orally but only by an instrument in writing signed by

the party against whom enforcement of any change, modification or extension is sought.

10. **Grant Subject to Plan Provisions**. This grant is made pursuant to the Plan, the terms of which are incorporated herein by reference, and in all respects will be interpreted in accordance with the Plan. This grant is subject to interpretations, regulations and determinations concerning the Plan established from time to time by the Committee in accordance with the provisions of the Plan, including, but not limited to, provisions pertaining to (a) rights and obligations with respect to withholding taxes, (b) the registration, qualification or listing of the shares, (c) changes in capitalization of the Company and (d) other requirements of applicable law. The Committee will have the authority to interpret and construe this grant pursuant to the terms of the Plan, and its decisions will be conclusive as to any questions arising hereunder.

11. **No Obligation to Continue Employment or Service as a Director**. This Agreement will not confer upon the Participant any right to be retained in the employment or service as a director of the Company and will not interfere in any way with the right of the Company to terminate the Participant's employment, if applicable, at any time. The right of the Company to terminate at will the Participant's employment at any time for any reason is specifically reserved.

12. **Notice**. Any notice to the Company provided for in this instrument will be addressed to the Company in care of the Corporate Secretary at the Company's corporate headquarters, and any notice to the Participant will be addressed to such Participant at the current address shown on the payroll records of the Company, or to such other address as the Participant may designate to the Company in writing. Any notice will be delivered by hand, sent by email or enclosed in a properly sealed envelope addressed as stated above, registered and deposited, postage prepaid, in a post office regularly maintained by the United States Postal Service or by overnight courier.

13. **Applicable Law**. The validity, construction, interpretation and effect of this Agreement will be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania, without giving effect to the conflicts of laws provisions thereof.

14. **Application of Section 409A of the Code**. This Agreement is intended to comply with section 409A of the Internal Revenue Code of 1986, as amended (the "Code") and will in all respects be administered in accordance with section 409A of the Code. The issuance of Company Stock pursuant this Agreement is intended to be subject to a "substantial risk of forfeiture" under section 409A of the Code, and issued within the "short term deferral" exception under such statute following the lapse of the applicable forfeiture condition. Notwithstanding any provision in this Agreement to the contrary, if the Participant is a "specified employee" (as defined in section 409A of the Code) and it is necessary to postpone the commencement of any payments otherwise payable under this Agreement to prevent any accelerated or additional tax under section 409A of the Code, then the Company will postpone the payment until five (5) days after the end of the six-month period following the original payment date. If the Participant dies during the postponement period prior to the payment of postponed amount, the amounts withheld on account of section 409A of the Code will be paid to the personal representative of the Participant's estate within sixty (60) days after the date of the Participant's death. The determination of who is a specified employee, including the number and identity of persons considered specified employees and the

identification date, will be made by the Board of Directors or its delegate in accordance with the provisions of sections 416(i) and 409A of the Code. In no event will the Participant, directly or indirectly, designate the calendar year of distribution. This Agreement may be amended without the consent of the Participant in any respect deemed by the Committee or its delegate to be necessary in order to preserve compliance with section 409A of the Code.

15. **Data Privacy Consent**. In order to administer the Plan and this Agreement and to implement or structure future equity grants, the Employer and certain agents thereof (together, the "Relevant Companies") may process any and all personal or professional data, including but not limited to Social Security or other identification number, home address and telephone number, date of birth and other information that is necessary or desirable for the administration of the Plan and/or this Agreement (the "Relevant Information"). By entering into this Agreement, the Participant (i) authorizes the Company to collect, process, register and transfer to the Relevant Companies all Relevant Information; (ii) waives any privacy rights the Participant may have with respect to the Relevant Information; (iii) authorizes the Relevant Companies to store and transmit such information in electronic form; and (iv) authorizes the transfer of the Relevant Information to any jurisdiction in which the Relevant Companies consider appropriate. The Participant shall have access to, and the right to change, the Relevant Information. Relevant Information will only be used in accordance with applicable law.

IN WITNESS WHEREOF, the parties hereto, each intending to be legally bound, have executed this Agreement as set forth below.

ORRSTOWN FINANCIAL SERVICES, INC.

____
Thomas R. Quinn, Jr.
President and Chief Executive Officer

______
Date

PARTICIPANT

________________________________ *
Name:

________________________________ *
Date

ORRSTOWN FINANCIAL SERVICES, INC.

RESTRICTED SECURITY GRANT AGREEMENT
FOR
NON-EMPLOYEE DIRECTORS
Pursuant to the 2011 Incentive Stock Plan

This Restricted Security Grant Agreement (this “Agreement”) is delivered by Orrstown Financial Services, Inc., a Pennsylvania corporation (the “Company”), pursuant to the Summary of Grant delivered with this Agreement to the individual named in the Summary of Grant (the "Participant"). The Summary of Grant, which specifies the Participant, the date as of which the grant is made (the "Date of Grant"), the Vesting Schedule and other specific details of the grant is incorporated herein by reference.

1. **Grant of Restricted Stock.** Upon the terms and conditions set forth in this Agreement and in the Company’s 2011 Incentive Stock Plan (the “Plan”), the Company hereby grants to the Participant the number of shares of Restricted Stock set forth in the Summary of Grant (the "Restricted Stock"). The Participant acknowledges the receipt of a copy of the Plan and that copies of the Plan are available from the Human Resources Department of the Company. Each grant of Restricted Stock will entitle the Participant to receive, at such time as is determined in accordance with the provisions of this Agreement, one fully paid, unrestricted share of common stock of the Company (the "Company Stock"). This Agreement is made pursuant to the Plan and is subject in its entirety to all applicable provisions of the Plan. Capitalized terms used herein and not otherwise defined will have the meanings set forth in the Plan. The Participant agrees to be bound by all of the terms and conditions of the Plan.

2. **Vesting of Restricted Stock**.

(a) The Restricted Stock will become vested as set forth in the Summary of Grant, provided that the Participant continues to be employed by, or provide service to, the Company or any of its Affiliates, collectively referred to as the Employer, through the Vesting Date (as defined in the Summary of Grant). For purposes of this Agreement, the term "Affiliate" has the meaning ascribed to such term in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended.

(b) Except as set forth in the Summary of Grant, if the Participant ceases to be employed by, or provide service to, the Employer for any reason prior to the Vesting Date, the Participant will forfeit all rights to receive shares of Company Stock hereunder and the Participant will not have any rights with respect to any portion of the shares of Company Stock that have not yet become vested as of the date the Participant ceases to be employed by, or provide service to, the Employer. Any certificates or book entries for the Restricted Stock granted pursuant to this Agreement shall bear an appropriate legend, as determined by the Committee in its sole discretion, to the effect that such shares are subject to restrictions as set forth herein and in the Plan. The Restricted Stock granted pursuant to this Agreement may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of by the Participant prior to the Vesting Date except to a Successor Grantee pursuant to Article 10 of the Plan.

3. **Issuance of Company Stock**. One share of Company Stock will be issued to the Participant for each vested share of Restricted Stock in accordance with the Vesting Schedule set forth in the Summary of Grant. Any shares of Restricted Stock not vested will be forfeited. Participant understands and agrees that all shares of Restricted Stock that are not fully vested at the time Participant ceases to be employed by, or provide service to, the Employer shall be returned to Company. In no event will any fractional shares of Company Stock be issued. Accordingly, the total number of shares of Company Stock to be issued pursuant to this Agreement will, to the extent necessary, be rounded down to the next whole share of Company Stock in order to avoid the issuance of a fractional share.

4. **Taxes**.

(a) The Participant acknowledges that the Company has not advised the Participant regarding the Participant's income tax liability in connection with the grant or vesting of the Restricted Stock and the delivery of unrestricted shares of Company Stock in connection therewith. The Participant has reviewed with the Participant's own tax advisors the federal, state, and local tax consequences of the grant and vesting of the Restricted Stock and the delivery of unrestricted shares of Company Stock in connection therewith as contemplated by this Agreement. The Participant is relying solely on such advisors and not on any statements or representations of the Company or any of its agents. The Participant understands that the Participant (and not the Company) will be responsible for the Participant's own tax liability that may arise as a result of the transactions contemplated by this Agreement.

(b) To the extent applicable, the Participant shall, not later than the date as of which the receipt of this grant becomes a taxable event for federal income tax purposes, pay to the Company or make arrangements satisfactory to the Compensation Committee of the Company's Board of Directors (the "Committee") for payment of any Federal, state, and local taxes required by law to be withheld on account of such taxable event. Except in the case where an election is made pursuant to Paragraph (c) below, the Company shall have the authority to cause the required tax withholding obligation to be satisfied, in whole or in part, by withholding from shares of Company Stock to be issued or released by the transfer agent a number of shares of Company Stock with an aggregate Fair Market Value (as defined in the Plan) that would satisfy the withholding amount due.

(c) The Participant and the Employer hereby agree that the Participant may, within 30 days following the Date of Grant, file with the Internal Revenue Service and the Employer an election under Section 83(b) of the Internal Revenue Code. In the event the Participant makes such an election, he or she agrees to provide a copy of the election to the Employer. The Participant acknowledges that he or she is responsible for obtaining the advice of his or her tax advisors with regard to the Section 83(b) election and that he or she is relying solely on such advisors and not on any statements or representations of the Employer or any of its agents with regard to such election.

5. **Rights of Participant**. Prior to the issuance, if any, of unrestricted shares of Company Stock to the Participant with respect to vested Restricted Stock pursuant to the Vesting Schedule set forth in the Summary of Grant, the Participant will not have any rights of a shareholder of the Company on account of the Restricted Stock, other than as follows: Participant shall have the right to vote, and receive dividends declared on, said shares of Restricted Stock.

6. **Restrictions on Issuance of Company Stock**. The obligation of the Company to deliver unrestricted shares of Company Stock to the Participant with respect to vested shares of Restricted Stock will be subject to the condition that, if at any time the Committee determines in its discretion that the listing, registration or qualification of the shares of Company Stock upon any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the issuance of shares of Company Stock, the shares of Company Stock may not be issued in whole or in part unless such listing, registration, qualification, consent or approval will have been effected or obtained free of any conditions not acceptable to the Committee.

7. **Recoupment Policy**. The Participant agrees that the Participant will be subject to any compensation, clawback and recoupment policies that may be applicable to the Participant as a director of the Company, as in effect from time to time and as approved by the Board of Directors or a duly authorized committee thereof, whether or not approved before or after the Date of Grant.

8. **Successors and Assigns**. Except to the extent otherwise provided in this Agreement, the provisions of this Agreement will inure to the benefit of, and be binding upon, the Company and its successors and assigns. During the period prior to the Vesting Date, the right to receive shares of Company Stock may not be assigned, transferred, pledged or otherwise disposed of by the Participant, except as permitted under the Plan or by the Committee. Any attempt to assign, transfer, pledge or otherwise dispose of the right to receive shares of Company Stock contrary to the provisions the Summary of Grant, this Agreement and the Plan, and the levy of any execution, attachment or similar process upon the right to receive the shares, will be null, void and without effect.

9. **Entire Agreement**. This Agreement contains the entire agreement of the parties with respect to the Restricted Stock granted hereby and supersedes all prior agreements and discussions between the parties concerning such subject matter. This Agreement may not be changed orally but only by an instrument in writing signed by the party against whom enforcement of any change, modification or extension is sought.

10. **Grant Subject to Plan Provisions**. This grant is made pursuant to the Plan, the terms of which are incorporated herein by reference, and in all respects will be interpreted in accordance with the Plan. This grant is subject to interpretations, regulations and determinations concerning the Plan established from time to time by the Committee in accordance with the provisions of the Plan, including, but not limited to, provisions pertaining to (a) rights and obligations with respect to withholding taxes, (b) the registration, qualification or listing of the shares, (c) changes in capitalization of the Company and (d) other requirements of applicable law. The Committee will have the authority to interpret and construe this grant pursuant to the terms of the Plan, and its decisions will be conclusive as to any questions arising hereunder.

11. **No Obligation to Continue Employment or Service as a Director**. This Agreement will not confer upon the Participant any right to be retained in the employment or service as a director of the Company and will not interfere in any way with the right of the Company to terminate the Participant's employment, if applicable, at any time.

12. **Notice**. Any notice to the Company provided for in this instrument will be addressed to the Company in care of the Corporate Secretary at the Company's

corporate headquarters, and any notice to the Participant will be addressed to such Participant at the current address shown on the payroll records of the Company, or to such other address as the Participant may designate to the Company in writing. Any notice will be delivered by hand, sent by email or enclosed in a properly sealed envelope addressed as stated above, registered and deposited, postage prepaid, in a post office regularly maintained by the United States Postal Service or by overnight courier.

13. **Applicable Law**. The validity, construction, interpretation and effect of this Agreement will be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania, without giving effect to the conflicts of laws provisions thereof.

14. **Application of Section 409A of the Code**. This Agreement is intended to comply with section 409A of the Internal Revenue Code of 1986, as amended (the "Code") and will in all respects be administered in accordance with section 409A of the Code. The issuance of Company Stock pursuant this Agreement is intended to be subject to a "substantial risk of forfeiture" under section 409A of the Code, and issued within the "short term deferral" exception under such statute following the lapse of the applicable forfeiture condition. Notwithstanding any provision in this Agreement to the contrary, if the Participant is a "specified employee" (as defined in section 409A of the Code) and it is necessary to postpone the commencement of any payments otherwise payable under this Agreement to prevent any accelerated or additional tax under section 409A of the Code, then the Company will postpone the payment until five (5) days after the end of the six-month period following the original payment date. If the Participant dies during the postponement period prior to the payment of postponed amount, the amounts withheld on account of section 409A of the Code will be paid to the personal representative of the Participant's estate within sixty (60) days after the date of the Participant's death. The determination of who is a specified employee, including the number and identity of persons considered specified employees and the identification date, will be made by the Board of Directors or its delegate in accordance with the provisions of sections 416(i) and 409A of the Code. In no event will the Participant, directly or indirectly, designate the calendar year of distribution. This Agreement may be amended without the consent of the Participant in any respect deemed by the Committee or its delegate to be necessary in order to preserve compliance with section 409A of the Code.

15. **Data Privacy Consent**. In order to administer the Plan and this Agreement and to implement or structure future equity grants, the Employer and certain agents thereof (together, the “Relevant Companies”) may process any and all personal or professional data, including but not limited to Social Security or other identification number, home address and telephone number, date of birth and other information that is necessary or desirable for the administration of the Plan and/or this Agreement (the “Relevant Information”). By entering into this Agreement, the Participant (i) authorizes the Company to collect, process, register and transfer to the Relevant Companies all Relevant Information; (ii) waives any privacy rights the Participant may have with respect to the Relevant Information; (iii) authorizes the Relevant Companies to store and transmit such information in electronic form; and (iv) authorizes the transfer of the Relevant Information to any jurisdiction in which the Relevant Companies consider appropriate. The Participant shall have access to, and the right to change, the Relevant Information. Relevant Information will only be used in accordance with applicable law.

IN WITNESS WHEREOF, the parties hereto, each intending to be legally bound, have executed this Agreement as set forth below.

PARTICIPANT **ORRSTOWN FINANCIAL SERVICES, INC.**

_______________________________ _______________________________

Name: Thomas R. Quinn, Jr.
President and Chief Executive Officer

_______________________________ _______________________________

Date Date

Exhibit 21

SUBSIDIARIES OF THE REGISTRANT

1. Orrstown Bank, Shippensburg, Pennsylvania; a state-chartered bank organized under the Pennsylvania Banking Code of 1965.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-265279, 333-225169, 333-196239, 333-174720 and 333-34504 on Form S-8 and Registration Statement Nos. 333-268171 and 333-53405 on Form S-3 of Orrstown Financial Services, Inc. of our report dated March 16, 2023 relating to the consolidated financial statements and effectiveness of internal control over financial reporting appearing in this Annual Report on Form 10-K.

/s/ Crowe LLP

Washington, D.C.
March 16, 2023

Exhibit 31.1

CERTIFICATION

I, Thomas R. Quinn, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Orrstown Financial Services, Inc.;
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;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    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;
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 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 16, 2023

By: /s/ Thomas R. Quinn, Jr.
Thomas R. Quinn, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Neelesh Kalani, certify that:

1. I have reviewed this annual report on Form 10-K of Orrstown Financial Services, Inc.;
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;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   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;
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 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 16, 2023

By: /s/ Neelesh Kalani
Neelesh Kalani
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Orrstown Financial Services, Inc. (the “Company”) on Form 10-K for the period ending December 31, 2022 as filed with the Securities and Exchange Commission on the date therein specified (the “Report”), I, Thomas R. Quinn, Jr., President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: March 16, 2023	By:	/s/ Thomas R. Quinn, Jr.
		Thomas R. Quinn, Jr.
		President and Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Orrstown Financial Services, Inc. (the “Company”) on Form 10-K for the period ending December 31, 2022 as filed with the Securities and Exchange Commission on the date therein specified (the “Report”), I, Neelesh Kalani, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: March 16, 2023

By: /s/ Neelesh Kalani
Neelesh Kalani
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)