

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: 001-35021

EVANS BANCORP, INC.

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation or organization)

16-1332767

(I.R.S. Employer Identification No.)

6460 Main Street, Williamsville, New York

(Address of principal executive offices)

14221

(Zip Code)

(716) 926-2000

Registrant's telephone number (including area code)

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, \$0.50 par value | EVBN | NYSE American LLC |

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

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes _____ No X

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 X

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 X No _____

Indicate by checkmark 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 X 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 _____

Non-accelerated filer X

Accelerated filer _____

Smaller reporting company _____

Emerging growth company X

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 X

On June 30, 2022, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$178 million, based upon the closing sale price of a share of the registrant's common stock on NYSE American, LLC.

As of March 1, 2023, 5,450,308 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2023 Annual Meeting of Shareholders, to be held on May 2, 2023, which will be subsequently filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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PART I

FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K may contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that involve substantial risks and uncertainties. When used in this report, or in the documents incorporated by reference herein, the words “will,” “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “seek,” “look to,” “goal,” “target” and similar expressions identify such forward-looking statements. These forward-looking statements include statements regarding the business plans, prospects, growth and operating strategies of Evans Bancorp, Inc. (the “Company”), statements regarding the asset quality of the Company’s loan and investment portfolios, and estimates of the Company’s risks and future costs and benefits.

These forward-looking statements are based largely on the expectations of the Company’s management and are subject to a number of risks and uncertainties, including but not limited to: general economic conditions, either nationally or in the Company’s market areas, that are worse than expected; increased competition among depository or other financial institutions; inflation and changes in the interest rate environment that reduce the Company’s margins or reduce the fair value of financial instruments; changes in laws or government regulations affecting financial institutions, including changes in regulatory fees and capital requirements; the Company’s ability to enter new markets successfully and capitalize on growth opportunities; the Company’s ability to successfully integrate acquired entities; loan losses in excess of the Company’s allowance for loan losses; changes in accounting pronouncements and practices, as adopted by financial institution regulatory agencies, the Financial Accounting Standards Board (“FASB”) and the Public Company Accounting Oversight Board; the impact of such changes in accounting pronouncements and practices being greater than anticipated; the ability to realize the benefit of deferred tax assets; changes in the financial performance and/or condition of the Company’s borrowers; changes in consumer spending, borrowing and saving habits; changes in the Company’s organization, compensation and benefit plans; changes in consumer behavior and the effects of government actions taken in response to the COVID-19 pandemic, including restrictions on individual and business activities; and other factors discussed elsewhere in this Annual Report on Form 10-K including the risk factors described in Item 1A, as well as in the Company’s periodic reports filed with the Securities and Exchange Commission. Many of these factors are beyond the Company’s control and are difficult to predict.

Because of these and other uncertainties, the Company’s actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements contained herein. Forward-looking statements speak only as of the date they are made. The Company undertakes no obligation to publicly update or revise forward-looking information, whether as a result of new, updated information, future events or otherwise, except to the extent required by law.

Item 1. BUSINESS

EVANS BANCORP, INC.

Evans Bancorp, Inc. (the “Company”) is a New York business corporation which is registered as a financial holding company under the Bank Holding Company Act of 1956, as amended (the “BHCA”). The principal office of the Company is located at 6460 Main Street, Williamsville, NY 14221 and its telephone number is (716) 926-2000. The Company was incorporated on October 28, 1988, but the continuity of its banking business is traced to the organization of the Evans National Bank of Angola on January 20, 1920. Except as the context otherwise requires, the Company and its direct and indirect subsidiaries are collectively referred to in this report as the “Company.” The Company’s common stock is traded on the NYSE American, LLC under the symbol “EVBN.”

At December 31, 2022, the Company had consolidated total assets of \$2.2 billion, deposits of \$1.8 billion and stockholders’ equity of \$154 million.

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The Company's primary business is the operation of its subsidiaries. It does not engage in any other substantial business activities. The Company operates two direct wholly-owned subsidiaries: (1) Evans Bank, N.A. (the "Bank"), which provides a full range of banking services to consumer and commercial customers in Western New York ("WNY") and the Finger Lakes Region; and (2) Evans National Financial Services, LLC ("ENFS"), which owns 100% of the membership interests in The Evans Agency, LLC ("TEA"), which sells various premium-based insurance policies on a commission basis. At December 31, 2022, the Bank represented 99% and ENFS represented 1% of the consolidated assets of the Company. Further discussion of our segments is included in Note 19 to the Company's Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

EVANS BANK, N.A.

The Bank is a nationally chartered bank that has its headquarters at 6460 Main Street, Williamsville, NY, and a total of 18 full-service banking offices in Erie County, Niagara County, Monroe County and Chautauqua County, NY.

At December 31, 2022, the Bank had total assets of \$2.2 billion, investment securities of \$371 million, net loans of \$1.7 billion and deposits of \$1.8 billion. The Bank offers deposit products, which include checking and negotiable order of withdrawal ("NOW") accounts, savings accounts, and certificates of deposit, as its principal source of funding. The Bank's deposits are insured up to the maximum permitted by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a variety of loan products to its customers, including commercial and consumer loans and commercial and residential mortgage loans.

As is the case with banking institutions generally, the Bank's operations are significantly influenced by general economic conditions and by related monetary and fiscal policies of banking regulatory agencies, including the Federal Reserve Board ("FRB") and FDIC. The Bank is also subject to the supervision, regulation and examination of the Office of the Comptroller of the Currency of the United States of America (the "OCC").

THE EVANS AGENCY, LLC

TEA, a property and casualty insurance agency, is a wholly-owned subsidiary of ENFS. TEA is headquartered in Williamsville, NY, with offices located throughout WNY. TEA is a full-service insurance agency offering personal, commercial and financial services products. For the year ended December 31, 2022, TEA had total revenue of \$10 million.

TEA's primary market area is Erie, Chautauqua, Cattaraugus and Niagara Counties, NY. Most lines of personal insurance are provided, including automobile, homeowners, boat, recreational vehicle, landlord, and umbrella coverage. Commercial insurance products are also provided, consisting of property, liability, automobile, inland marine, workers compensation, bonds, crop and umbrella insurance. TEA also provides the following financial services products: employee benefits, life and disability insurance, Medicare supplements, long term care, annuities, mutual funds, retirement programs and New York State Disability.

OTHER SUBSIDIARIES

In addition to the Bank and TEA, the Company has the following direct and indirect wholly-owned subsidiaries:

Evans National Holding Corp. ("ENHC"). ENHC, a wholly-owned subsidiary of the Bank, operates as a real estate investment trust that holds commercial real estate loans and residential mortgages, providing additional flexibility and planning opportunities for the business of the Bank.

Evans National Financial Services, LLC ("ENFS"). ENFS is a wholly-owned subsidiary of the Company. ENFS's primary business is to own the business and assets of the Company's non-banking financial services subsidiaries.

Frontier Claims Services, Inc. ("FCS"). FCS is a wholly-owned subsidiary of TEA and provides claims adjusting services to various insurance companies. FCS ceased operations on December 31, 2021.

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The Company also has two special purpose entities: Evans Capital Trust I, a statutory trust formed in September 2004 under the Delaware Statutory Trust Act, solely for the purpose of issuing and selling certain securities representing undivided beneficial interests in the assets of the trust, investing the proceeds thereof in certain debentures of the Company and engaging in those activities necessary, advisable or incidental thereto; and ENB Employers Insurance Trust, a Delaware trust company formed in February 2003 for the sole purpose of holding life insurance policies under the Bank's bank-owned life insurance ("BOLI") program.

The Company operates in two operating segments – banking activities and insurance agency activities. See Note 19 to the Company's Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K for more information on the Company's operating segments.

MARKET AREA

The Company's footprint is in Western New York and the Finger Lakes Region, primarily Erie County, Monroe County, Niagara County, northern Chautauqua County and northwestern Cattaraugus County, NY. This primary market area is the area where the Bank principally receives deposits and makes loans and TEA sells insurance.

MARKET RISK

For information about, and a discussion of, the Company's "Market Risk," see Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk" of this Annual Report on Form 10-K.

COMPETITION

All phases of the Company's business are highly competitive. The Company competes actively with local, regional and national financial institutions, as well as with bank branches and insurance agency offices in the Company's primary market area. The Company's market area has a high density of financial institutions, many of which are significantly larger and have greater financial resources than the Company. The Company faces competition for loans and deposits from other commercial banks, savings banks, internet banks, savings and loan associations, mortgage banking companies, credit unions, and other financial services companies. The Company faces additional competition from non-depository competitors such as the mutual fund industry, securities and brokerage firms, and insurance companies and brokerages. In the personal insurance area, the majority of TEA's competition comes from direct writers, as well as some small local agencies located in the same towns and villages in which TEA has offices. In the commercial business segment, the majority of the competition comes from larger agencies located in and around Buffalo, NY. By offering the large number of carriers which it has available to its customers, TEA has attempted to remain competitive in all aspects of its business.

As an approximate indication of the Company's competitive position, the Bank had the seventh most deposits in the Buffalo, NY metropolitan statistical area according to the FDIC's annual deposit market share report as of June 30, 2022 with 3% of the total market's deposits of \$64 billion. By comparison, the market leaders, M&T Bank and KeyBank, had 75% of the Buffalo, NY metropolitan statistical area deposits combined. The Company attempts to be generally competitive with all financial institutions in its service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, and interest rates charged on loans.

HUMAN CAPITAL

At December 31, 2022, we employed 379 full-time equivalent employees. At that date, the average tenure of all of our full-time employees was approximately 6.5 years while the average tenure of our executive officers was approximately 13.7 years. None of our associates are represented by collective bargaining agreements. We believe our employee relations to be good.

Oversight of our corporate culture is an important element of our Board of Directors' oversight of risk because our people are critical to the success of our corporate strategy. Our Board sets the "tone at the top," and holds senior management accountable for embodying, maintaining, and communicating our culture to employees. In that regard, our culture is designed to embrace associates and create opportunities. We uphold that principle in everything we do. That commitment has been a central pillar in our approach to our employees and the communities we have proudly served for over 100 years. Our culture is designed to adhere to the timeless values of integrity, valuing others, talent, passion, ownership and alignment, and customer focus. In keeping with those values, we expect our people to treat

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each other and our customers with the highest level of honesty and respect and go out of their way to do the right thing. We dedicate resources to promote a safe and inclusive workplace; attract, develop and retain talented, diverse employees; promote a culture of integrity, caring and excellence; and reward and recognize employees for both the results they deliver and, importantly, how they deliver them. We seek to design careers that are fulfilling, with competitive compensation and benefits alongside a positive work-life balance. We also dedicate resources to fostering professional and personal growth with continuing education, on-the-job training and development programs.

Our associates are key to our success as an organization. We are committed to attracting, retaining and promoting top quality talent regardless of race, color, creed, religion, sex, national origin, age, disability, marital status, citizenship status, military status, sexual orientation, victims of domestic violence, protected veterans status, gender identity, genetic information, genetic predisposition or carrier status and any other category protected by law. We are dedicated to providing a workplace for our employees that is inclusive, supportive, and free of any form of discrimination or harassment; rewarding and recognizing our employees based on their individual results and performance as well as that of their department and the company overall; and recognizing and respecting all of the characteristics and differences that make each of our employees unique.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state laws and regulations that are intended to protect depositors and customers. Additionally, because the Company is a public company with shares traded on the NYSE American, it is subject to regulation by the Securities and Exchange Commission, as well as the listing standards required by NYSE American. To the extent that the following summary describes statutory and regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in the applicable law or regulation, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material adverse effect on the Company's business, financial condition and results of operations.

Bank Holding Company Regulation

As a bank holding company registered under the BHCA, the Company and its non-banking subsidiaries are subject to regulation and supervision under the BHCA by the FRB. The FRB requires periodic reports from the Company, and is authorized by the BHCA to make regular examinations of the Company and its subsidiaries.

The Company is required to obtain the prior approval of the FRB before merging with or acquiring all or substantially all of the assets of, or direct or indirect ownership or control of more than 5% of the voting shares of, a bank or bank holding company. The FRB will not approve any acquisition, merger or consolidation that would have a substantial anti-competitive result, unless the anti-competitive effects of the proposed transaction are outweighed by a greater public interest in meeting the needs and convenience of the public. The FRB also considers managerial, capital and other financial factors in acting on acquisition or merger applications.

Subject to various exceptions, the BHCA and the Change in Bank Control Act of 1978 (the "CIBCA"), together with related regulations, require FRB approval before any person or company acquires "control" of a bank holding company. Control is deemed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. There is a rebuttable presumption of control under the CIBCA regulations if a person or company acquires 10% or more, but less than 25%, of any class of the bank holding company's voting securities under certain circumstances including where, as is the case with the Company, the bank holding company has its shares registered under the Exchange Act. The FRB has also issued presumptions involving various relationships that may establish control or a "controlling influence" for BHCA purposes.

A bank holding company may not engage in, or acquire direct or indirect control of more than 5% of the voting shares of any company engaged in any non-banking activity, unless such activity has been determined by the FRB to be closely related to banking or managing banks. The FRB has identified by regulation various non-banking activities in which a bank holding company may engage with notice to, or prior approval by, the FRB. A bank holding company that meets specified criteria may elect to be regulated as a "financial holding company" and thereby engage in a broader range of nonbanking financial activities. The Company has made such an election.

The FRB has enforcement powers over financial holding companies and their subsidiaries, among other things, to enjoin activities that represent unsafe or unsound practices or constitute violations of law, rule, regulation,

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administrative orders, or written agreements with a federal bank regulator. These powers may be exercised through the issuance of cease and desist orders, civil monetary penalties or other actions.

Under federal law, a bank holding company must serve as a source of financial and managerial strength for its subsidiary banks and must not conduct its operations in an unsafe or unsound manner. The expectation is that a holding company will use available resources to provide capital and other support to its subsidiary institution in times of financial stress.

A bank holding company is generally required to give the FRB prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company's consolidated net worth. The FRB may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, FRB order or directive, or any condition imposed by, or written agreement with, the FRB. There is an exception to this approval requirement for well-capitalized bank holding companies that meet certain other conditions. To date, the Company has qualified for this exception.

Notwithstanding the above requirements, the FRB has issued a supervisory bulletin which indicates that a holding company should notify and consult with the FRB under certain circumstances prior to redeeming or repurchasing common stock or perpetual preferred stock. The supervisory bulletin indicates that such notification is for purposes of allowing FRB supervisory review of, and possible objection to, the proposed repurchase or redemption.

The FRB's supervisory bulletin also covers the payment of dividends. In general, the FRB's policy is that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company is consistent with the organization's capital needs, asset quality and overall financial condition. The supervisory bulletin provides for prior consultation with, and supervisory review of, proposed dividends by the FRB in certain situations, such as where a proposed dividend exceeds earnings for the period for which the dividend would be paid (e.g., calendar quarter) or where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund a proposed dividend. The guidance also provides for FRB consultation for material increases in the amount of a bank holding company's common stock dividend.

Under the prompt corrective action laws, discussed later, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized.

These laws, regulations and policies may inhibit the Company's ability to pay dividends, engage in stock repurchases or otherwise make capital distributions.

Supervision and Regulation of the Bank

The Bank is a nationally chartered banking corporation, primarily subject to supervision, examination and regulation by the OCC. The FDIC has certain backup regulatory authority as the deposit insurer.

The operations of the Bank are subject to numerous statutes and regulations. Such statutes and regulations relate to investments, loans, mergers and consolidations, issuance of securities, payment of dividends, establishment of branches and other aspects of the Bank's operations.

Federal statutes and OCC regulations govern the Bank's investment authority. A national bank has authority to originate and purchase all types of loans, including commercial, commercial real estate, consumer and residential mortgage loans. Federal law generally limits a national bank's extensions of credit to a single borrower (or related borrowers) to 15% of the bank's capital and surplus. An additional 10% may be lent if secured by specified readily marketable collateral.

Generally, a national bank is prohibited from investing in corporate equity securities for its own account. Under OCC regulations, a national bank may invest in investment securities, which are generally defined as marketable securities in the form of a note, bond or debenture. The OCC classifies investment securities into five different types and, depending on its type, a national bank may have the authority to purchase, and possibly deal in and underwrite the security, pursuant to specified limits. The OCC has also permitted national banks to purchase certain noninvestment grade securities that can be reclassified and underwritten as loans.

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The federal banking agencies have adopted uniform regulations prescribing standards for extensions of credit that are secured by liens on interests in real estate or made for the purpose of financing the construction of a building or other improvements to real estate. Under these regulations, all insured depository institutions, such as the Bank, are required to adopt written policies that establish 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. The 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, approval and reporting requirements. The real estate lending policies must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies that have been adopted by the federal bank regulators.

The Bank is subject to Sections 23A and 23B of the Federal Reserve Act and Regulation W thereunder, which govern certain “covered transactions”, by a bank with its affiliates, including its parent holding company. Covered transactions include a bank’s loans and extensions of credit to an affiliate, purchases of assets from an affiliate, and similar transactions. These restrictions limit the transfer of funds to the Company by the Bank, in the form of loans, extensions of credit, investments or purchases of assets and similar transactions. Generally, the Bank’s transactions with an affiliate (including the Company) must be on terms no less favorable to the Bank than comparable transactions between the Bank and unrelated third parties. Covered transactions by the Bank with any affiliate (including the Company) are limited in amount to 10% of the Bank’s capital and surplus, and covered transactions with all affiliates are limited in the aggregate to 20% of the Bank’s capital and surplus. Furthermore, loans and extensions of credit to affiliates are subject to various collateral requirements. These laws and regulations may limit the Company’s ability to obtain funds from the Bank for its cash needs, including funds for acquisitions, and the payment of dividends, interest and operating expenses.

The Bank is prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. For example, subject to certain exceptions, the Bank may not generally require a customer to obtain other services from the Bank or the Company, and may not require the customer to promise not to obtain other services from a competitor as a condition to an extension of credit.

The Bank is also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal stockholders, and/or any related interest of such persons (“Insiders”). Under these restrictions, the aggregate amount of loans to any Insiders and his or her related interests may not exceed the loans-to-one-borrower limit applicable to national banks, discussed above. Aggregate loans by a bank to its Insiders and their related interests may not exceed the bank’s unimpaired capital and surplus. Loans to an executive officer, other than loans for the education of the officer’s children and certain loans secured by the officer’s residence, may generally not exceed the lesser of (1) \$100,000 or (2) the greater of \$25,000 or 2.5% of the bank’s unimpaired capital and surplus. The regulations require that any proposed loan to an Insiders, or a related interest of that Insiders, be approved in advance by a majority of the Board of Directors of the bank, if that loan, combined with previous loans by the bank to the Insiders and his or her related interests, exceeds specified amounts.

Generally, loans to Insiders and their related interests must be made on substantially the same terms as, and follow credit underwriting procedures that are not less stringent than, those that are prevailing at the time for comparable transactions with persons not affiliated with the institution. The regulations contain a general exception for extensions of credit made pursuant to a benefit or compensation plan of a bank that is widely available to employees of the bank and that does not give any preference to Insiders of the bank over other employees. The management of the Bank does not know of any practice, condition or violation that might lead to termination of FDIC deposit insurance.

As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct special examinations of and to require reporting by, national banks. It may also prohibit an insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC. The FDIC has the authority to initiate enforcement actions against insured institutions under certain circumstances. The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC.

Deposit insurance premiums are based on an institution’s quarterly average total assets minus average tangible equity. For institutions of the Bank’s asset size, the FDIC operates a risk-based premium system that determines assessment rates from financial modelling designed to estimate the probability of the bank’s failure over a three year period. Total assessment rates for institutions of the Bank’s size ranged from 1.5 to 30 basis points effective through December 31, 2022. The FDIC has authority to increase insurance assessments and adopted a final rule in October 2022 to increase

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initial base deposit insurance assessment rates by 2 basis points beginning in the first quarterly assessment period of 2023. As a result, effective January 1, 2023, total assessment rates for institutions of the Bank's size will range from 2.5 to 32 basis points.

In addition to the foregoing, federal law required the federal regulators to adopt regulations establishing "safety and soundness" standards to promote the safe operation of insured institutions. Such standards specifically address, among other things: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth; (vi) ratio of classified assets to capital; (vii) minimum earnings; (viii) compensation and benefits standards for management officials; (ix) information security and (x) residential mortgage lending practices. An institution found to be noncompliant with any such standard is required to submit a compliance plan and may be subject to enforcement action if an acceptable plan is not submitted and complied with.

Dividends paid by the Bank have been the Company's primary source of operating funds and are expected to be for the foreseeable future. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceed the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years (less dividends paid over the period). As of December 31, 2022, approximately \$41 million was available for the payment of dividends without prior OCC approval. The Bank's ability to pay dividends is also subject to the Bank being in compliance with regulatory capital requirements. At December 31, 2022, the Bank was in compliance with these requirements.

Because the Company is a legal entity separate and distinct from the Bank, the Company's right to participate in the distribution of assets of the Bank in the event of the Bank's liquidation or reorganization would be subject to the prior claims of the Bank's creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of unsecured, non-deposit creditors, including a parent bank holding company (such as the Company) or any shareholder or creditor thereof.

The OCC has broad enforcement powers over national banks, including the power to issue cease and desist order, impose substantial civil money penalties, remove directors and officers, and appoint a conservator or receiver for the assets of a regulated entity. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Bank, as well as officers, directors and other institution-affiliated parties of the Bank, to administrative sanctions and potential civil penalties.

Under the Community Reinvestment Act, or "CRA," as implemented by OCC, a national bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of the communities served by the bank, including low- and moderate-income neighborhoods. The CRA requires the OCC to assess an institution's record of meeting the credit needs of its communities and to take such record into account in its evaluation of certain applications by that institution, including applications to establish branches and acquire other financial institutions. The FRB also must consider the subsidiary bank's CRA rating in connection with bank holding company applications to acquire additional institutions. The CRA requires the OCC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. The Bank's most recent OCC CRA rating was "Outstanding."

Effective January 1, 2022, the OCC rescinded a final rule which the OCC issued in June 2020 to amend the agency's CRA regulations in favor of a future joint rulemaking with the FRB and FDIC. On May 5, 2022, the OCC, FRB and FDIC released a notice of proposed rulemaking to strengthen and modernize the CRA regulations and framework.

Capital Adequacy

The Company and its subsidiary bank are required to comply with applicable capital adequacy standards established by the federal banking agencies. In July 2013, the FRB, the OCC, and the FDIC approved final rules (the "Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. These rules went into effect as to the Company and the Bank on January 1, 2015, subject to phase-in periods. Effective in August 2018, holding companies with less than \$3 billion of consolidated assets, including the Company, are generally not subject to the Capital Rules unless otherwise directed by the FRB. The Bank remains subject to the Capital Rules.

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Basel III and the Capital Rules. The Capital Rules generally implemented the Basel Committee’s December 2010 final capital framework referred to as “Basel III” for strengthening international capital standards. The Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries. The Capital Rules revised the definitions and the components of regulatory capital, and addressed other issues affecting the numerator in banking institutions’ regulatory capital ratios. The Capital Rules also addressed asset risk weights and other matters affecting the denominator in banking institutions’ regulatory capital ratios.

Among other matters, the Capital Rules: (i) introduced a “Common Equity Tier 1” (“CET1”) capital measure and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specified that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements; (iii) mandated that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expanded the scope of the deductions from and adjustments to capital as compared to the previous regulations.

Pursuant to the Capital Rules, the minimum capital ratios are as follows:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on the consolidated financial statements (known as the “leverage ratio”).

The Capital Rules also introduced a new “capital conservation buffer,” composed entirely of CET1, on top of the minimum risk-weighted asset ratios described above, which was designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer face constraints on dividends, equity and other capital instrument repurchases and executive compensation based on the amount of the shortfall. The additional capital conservation buffer of 2.5% of CET1 on top of the minimum risk-weighted asset ratios, effectively results in minimum ratios of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5% and (iii) Total capital to risk-weighted assets of at least 10.5%.

The Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1, subject to specified limits. In addition, the Capital Rules include certain exemptions to address concerns about the regulatory burden on community banks. For example, banking organizations with less than \$15 billion in consolidated assets as of December 31, 2009 are permitted to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock issued and included in Tier 1 capital prior to May 19, 2010 on a permanent basis, without any phase out (subject to a limit of 25% of Tier 1 capital). Also, community banks were able to elect, in their March 31, 2015 quarterly filings, to permanently opt-out of the requirement to include most accumulated other comprehensive income (“AOCI”) components in the calculation of common equity Tier 1 capital. Such an election, in effect, continued the AOCI treatment under the previous capital regulations. Under the Capital Rules, the Bank made the one-time, permanent election to continue to exclude AOCI from capital.

The Federal Deposit Insurance Act (the “FDIA”) establishes a system of regulatory remedies to resolve the problems of undercapitalized institutions, referred to as “prompt corrective action.” The federal banking regulators have established five capital categories (“well-capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized”) and must take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions which are undercapitalized, significantly undercapitalized or critically undercapitalized. The severity of these mandatory and discretionary supervisory actions depends upon the capital category in which the institution is placed. The federal regulators have specified by regulation the relevant capital levels for each category, which are set forth below.

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“Well-Capitalized”

CET1 ratio of 6.5%
Leverage Ratio of 5%,
Tier 1 Capital ratio of 8%,
Total Capital ratio of 10%, and
Not subject to a written agreement, order, capital directive or prompt corrective action directive requiring a specific capital level.

“Adequately Capitalized”

CET1 ratio of 4.5%
Leverage Ratio of 4%,
Tier 1 Capital ratio of 6%, and
Total Capital ratio of 8%.

“Undercapitalized”

CET1 Ratio of less than 4.5%
Leverage Ratio less than 4%,
Tier 1 Capital ratio less than 6%, or
Total Capital ratio less than 8%.

“Significantly Undercapitalized”

CET1 Ratio of less than 3%
Leverage Ratio less than 3%,
Tier 1 Capital ratio less than 4%, or
Total Capital ratio less than 6%.

“Critically Undercapitalized”

Tangible equity to total assets equal to or less than 2%.

For purposes of these regulations, the term “tangible equity” includes capital elements counted as Tier 1 Capital for purposes of the risk-based capital standards plus the amount of outstanding cumulative perpetual preferred stock (including related surplus), not included in Tier 1 capital.

An institution that is classified as well-capitalized based on its capital levels may be reclassified as adequately capitalized, and an institution that is adequately capitalized or undercapitalized based upon its capital levels may be treated as though it were undercapitalized or significantly undercapitalized, respectively. Such reclassification can occur if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment.

An institution that is categorized as undercapitalized, significantly undercapitalized or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking regulator. In order for the capital restoration plan to be accepted by the appropriate federal banking agency, the law requires that any parent holding company guarantee that its subsidiary depository institution will comply with its capital restoration plan, subject to certain limitations. The obligation of a controlling bank holding company under the FDIA to fund a capital restoration plan is limited to the lesser of 5.0% of an undercapitalized subsidiary institution’s assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except in accordance with an accepted capital restoration plan or with regulatory approval. Institutions that are significantly undercapitalized or undercapitalized and either fail to submit an acceptable capital restoration plan or fail to implement an approved capital restoration plan may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions are subject to appointment of a receiver or conservator.

The Bank’s regulatory capital ratios under risk-based capital rules in effect through December 31, 2022 are presented in Note 21 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

In an effort to reduce regulatory burden, legislation enacted in May 2018 required the federal banking agencies to establish an optional “community bank leverage ratio” of between 8% to 10% tangible equity to average total consolidated assets for qualifying institutions with assets of less than \$10 billion of assets. Pursuant to federal legislation enacted in 2020, the community bank leverage ratio was set at 9% for 2022 and thereafter. Institutions with capital meeting the specified requirements and electing to follow the alternative framework are deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements, and are considered well-capitalized under the prompt corrective action framework. Eligible institutions may opt into and out of the community bank ratio framework on their quarterly call report. The Bank has not exercised its option to use the community bank leverage ratio alternative as of December 31, 2022.

Other Laws and Regulations

In addition to the laws and regulations discussed above, the Bank is also subject to certain fair lending and consumer laws that are designed to protect consumers in transactions with banks. Many of these laws are implemented through regulations issued by the Consumer Financial Protection Bureau (the “CFPB”) though, for institutions of the Bank’s asset size, compliance is subject to examination by the federal banking regulator, i.e., the OCC in the Bank’s case. These laws include, but are not limited to, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, Federal Financial Privacy Laws, the Right to Financial Privacy Act, and the Fair and Accurate Credit Transactions Reporting Act. These laws, and their implementing regulations, generally regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers.

The USA PATRIOT Act of 2001 gave the federal government new additional powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA Patriot Act placed additional responsibilities upon financial institutions in terms of broadened anti-money laundering compliance programs and due diligence policies and controls to facilitate detection and reporting of money laundering. The Bank has established policies, procedures and systems designed to comply with these laws. Such compliance programs supplement previously existing anti-money laundering compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control regulations. The USA PATRIOT Act also requires the federal banking agencies to take into consideration the effectiveness of such controls in determining whether to approve a merger or other acquisition application. Accordingly, if the Bank seeks to engage in a merger or other acquisition, the Bank’s controls designed to combat money laundering are considered as part of the application process.

Monetary Policy and Economic Control

The commercial banking business is affected not only by general economic conditions, but also by the monetary policies of the FRB. Changes in the discount rate on member bank borrowing, availability of borrowing at the “discount window,” open market operations and the imposition of, and changes in, reserve requirements are some of the instruments of monetary policy available to the FRB. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments and deposits, and this use may affect interest rates charged on loans or paid on deposits. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. These monetary policies are influenced by various factors, including inflation, unemployment, and short-term and long-term changes in the international trade balance and in the fiscal policies of the United States Government. Future monetary policies and the effect of such policies on the future business and earnings of the Company cannot be predicted.

Regulation of Insurance Agency Subsidiary

TEA is regulated by the New York State Department of Financial Services. As of the date of this report, TEA meets and maintains all licensing and continuing education requirements required by the State of New York.

AVAILABLE INFORMATION

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished by the Company pursuant to Section 13(a) or 15(d) of the Exchange Act are available without charge on the Company's website, www.evansbancorp.com - SEC filings section, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. The Company is providing the address to its Internet site solely for the information of investors. The Company does not intend its Internet address to be an active link or to otherwise incorporate the contents of the website into this Annual Report on Form 10-K or into any other report filed with or furnished to the SEC. In addition, the SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC on its website, www.sec.gov.

Item 1A. RISK FACTORS

The following factors identified by the Company's management represent significant potential risks that the Company faces in its operations.

Credit Risks

Commercial Real Estate and Commercial Business Loans Expose the Company to Increased Credit Risks

At December 31, 2022, the Company's portfolio of commercial real estate loans totaled \$896 million, or 54% of total loans outstanding, and the Company's portfolio of commercial and industrial ("C&I") loans totaled \$250 million, or 15% of total loans outstanding. The Company plans to continue to emphasize the origination of commercial loans as they generally earn a higher rate of interest than other loan products offered by the Bank. However, commercial loans generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of commercial real estate and C&I loans often depends on the successful operations and the income stream of the borrowers. Commercial mortgages are collateralized by real property while C&I loans are typically secured by business assets such as equipment and accounts receivable. Commercial loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four-family residential mortgage loans. Also, many of the Company's commercial borrowers have more than one commercial real estate or C&I loan outstanding with the Company. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four-family residential mortgage loan. Commercial real estate loans in non-accrual status at December 31, 2022 were \$15.3 million, compared with \$8.7 million at December 31, 2021. C&I loans in non-accrual status were \$2.6 million and \$4.9 million at December 31, 2022 and December 31, 2021, respectively. Increases in the delinquency levels of commercial real estate and C&I loans could result in an increase in non-performing loans and the provision for loan losses, which could have a material adverse effect on the Company's results of operations and financial condition.

Continuing Concentration of Loans in the Company's Primary Market Area May Increase the Company's Risk

Unlike larger banks that are more geographically diversified, the Company provides banking and financial services to customers located primarily in Western New York and the Finger Lakes Region of New York State. Therefore, the Company's success depends primarily on the general economic conditions in those areas. The Company's business lending and marketing strategies focus on loans to small and medium-sized businesses in this geographic region. Moreover, the Company's assets are heavily concentrated in mortgages on properties located in Western New York and the Finger Lakes Region of New York State. Accordingly, the Company's business and operations are vulnerable to downturns in the economy of those areas. A downturn in the economy or recession in these regions could result in a decrease in loan originations and increases in delinquencies and foreclosures, which would more greatly affect the Company than if the Company's lending were more geographically diversified. In addition, the Company may suffer losses if there is a decline in the value of properties underlying the Company's mortgage loans which would have a material adverse impact on the Company's operations.

In the Event the Company's Allowance for Loan Losses is Not Sufficient to Cover Actual Loan Losses, the Company's Earnings Could Decrease

The Company maintains an allowance for loan losses in order to capture the probable incurred losses inherent in its loan portfolio. There is a risk that the Company may experience significant loan losses which could exceed the recorded amount of the allowance for loan losses. The Company adopted a new accounting standard, referred to as Current Expected Credit Loss (CECL), effective January 1, 2023. CECL requires financial institutions to determine periodic estimates of lifetime expected credit losses on loans and recognize the expected credit losses as allowances for loan losses. This represents a change from our previous method of recording allowances for loan losses that are probable, and required us to increase our allowance for loan losses and to increase the types of data we need to collect and review to determine the appropriate level of the allowance for loan losses. When determining the allowance, expected credit losses over the contractual term of the loans (taking into account prepayments) will be estimated based on various assumptions and judgments about the collectability of its loan portfolio, considering relevant information about past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The emphasis on the origination of commercial real estate and C&I loans is a significant factor in evaluating the allowance for loan losses. As the Company continues to increase the amount of these loans in the

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portfolio, additional or increased provisions for loan losses may be necessary and would adversely affect the results of operations. In addition, bank regulators periodically review the Company's loan portfolio and credit underwriting procedures, as well as its allowance for loan losses, and may require the Company to increase its provision for loan losses or recognize further loan charge-offs. An increase in our allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

At December 31, 2022, the Company had a gross loan portfolio of \$1.7 billion and the allowance for loan losses was \$19.4 million, which represented 1.16% of the total amount of gross loans. If the Company's assumptions and judgments prove to be incorrect or bank regulators require the Company to increase its provision for loan losses or recognize further loan charge-offs, the Company may have to increase its allowance for loan losses or loan charge-offs which could have an adverse effect on the Company's operating results and financial condition. Additionally, there can be no assurances that the Company's allowance for loan losses will be adequate to protect the Company against loan losses that it may incur.

Environmental Factors May Create Liability

In the course of its business, the Bank has acquired, and may acquire in the future, property securing loans that are in default. There is a risk that the Bank could be required to investigate and clean-up hazardous or toxic substances or chemical releases at such properties after acquisition by the Bank in a foreclosure action, and that the Bank may be held liable to a governmental entity or third parties for property damage, personal injury and investigation and clean-up costs incurred by such parties in connection with such contamination. The Bank may in the future be required to perform an investigation or clean-up activities in connection with environmental claims. Any such occurrence could have a material adverse effect on our business, financial condition, and results of operations.

Interest Rate Risks

Changes in Interest Rates Could Adversely Affect the Company's Business, Results of Operations and Financial Condition

The Company's results of operations and financial condition are significantly affected by changes in interest rates. The Company's results of operations depend substantially on its net interest income, which is the difference between the interest income earned on its interest-earning assets and the interest expense paid on its interest-bearing liabilities. Because the Company's interest-bearing liabilities generally re-price or mature more quickly than its interest-earning assets, changes in interest rates could result in a decrease in its net interest income. Management is unable to predict fluctuations in market interest rates, which are affected by many factors, including inflation, recession, unemployment, monetary policy, domestic and international disorder and instability in domestic and foreign financial markets, and investor and consumer demand.

Changes in interest rates also affect the value of the Company's interest-earning assets, and in particular, the Company's securities portfolio. Generally, the value of securities fluctuates inversely with changes in interest rates. At December 31, 2022, the Company's securities available for sale totaled \$364 million. Net unrealized losses on securities available for sale amounted to \$47.3 million, net of tax, at December 31, 2022, compared to \$3.2 million, net of tax, at December 31, 2021, as a result of the changing interest rate environment in 2022. Decreases in the fair value of securities available for sale could have an adverse effect on stockholders' equity or earnings.

The Company also is subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, the Company is subject to reinvestment risk to the extent that it is unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans.

During 2022, in response to accelerated inflation, the Federal Reserve implemented monetary tightening policies, resulting in significantly increased interest rates. The Federal Reserve has indicated that further rate raises may be considered.

A significant portion of our loans have fixed interest rates and longer terms than our deposits and borrowings. As is the case with many banks and savings institutions, our emphasis on increasing the development of core deposits, those with no stated maturity date, has resulted in our interest-bearing liabilities having a shorter duration than our assets. Accordingly, in a rising interest rate environment, our net interest income could be adversely affected if the rates we

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pay on deposits and borrowings increase more rapidly than the rates we earn on loans. Rising interest rates may also result in increased loan delinquencies and loan losses and a decrease in demand for our products and services.

Regulatory Risks

The Company Operates in a Highly Regulated Environment and May Be Adversely Affected By Changes in Laws and Regulations

The Company and its subsidiaries are subject to regulation, supervision and examination by the OCC, FRB, and by the FDIC, as insurer of its deposits. Such regulation and supervision govern the activities in which a bank and its holding company may engage and are intended primarily for the protection of the deposit insurance funds and depositors. Regulatory requirements affect the Company's lending practices, capital structure, investment practices, dividend policy and growth. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the imposition of deposit insurance premiums and other assessments, the classification of assets by a bank and the adequacy of a bank's allowance for loan losses. Any change in such regulation and oversight could have a material adverse impact on the Bank, the Company and its business, financial condition and results of operations.

Additionally, the CFPB has the authority to issue consumer finance regulations and is authorized, individually or jointly with bank regulatory agencies, to conduct investigations to determine whether any person is, or has, engaged in conduct that violates new and existing consumer financial laws or regulations. Because we have less than \$10 billion in total consolidated assets, the FRB and OCC, not the CFPB, are responsible for examining and supervising our compliance with these consumer protection laws and regulations. In addition, in accordance with a memorandum of understanding entered into between the CFPB and U.S. Department of Justice, the two agencies have agreed to coordinate efforts related to enforcing the fair lending laws, which includes information sharing and conducting joint investigations, and have done so on a number of occasions.

Noncompliance with applicable regulations may lead to adverse consequences for the Company. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion. 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.

The Company also faces a risk of noncompliance and subsequent enforcement action in connection with federal Bank Secrecy Act and other anti-money laundering and counter terrorist financing statutes and regulations. The federal banking agencies and the U.S. Treasury Department's Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have recently engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. If the Company violates these laws and regulations, or its policies, procedures and systems are deemed deficient, it would be subject to liability, including fines and regulatory actions, which may include restrictions on its ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, including its acquisition plans. Any of these results could have a material adverse effect on the Company's business, financial condition, results of operations and growth prospects.

Future FDIC Insurance Premium Increases May Adversely Affect the Company's Earnings

The Company is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. The FDIC has increased initial base insurance deposit assessment rates by 2 basis points effective January 1, 2023. If there are additional bank or financial institution failures or other similar occurrences, the FDIC may again increase the premiums assessed upon insured institutions. Such increases and any future increases or required prepayments of FDIC insurance premiums may adversely impact the Company's results of operations.

The Company is a Financial Holding Company and Depends on Its Subsidiaries for Dividends, Distributions and Other Payments

The Company is a legal entity separate and distinct from its banking and other subsidiaries. The Company's principal source of cash flow, including cash flow to pay dividends to the Company's stockholders and principal and interest on its outstanding debt, is dividends from the Bank. There are statutory and regulatory limitations on the payment of

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dividends by the Bank, as well as the payment of dividends by the Company to its stockholders. Regulations of the OCC affect the ability of the Bank to pay dividends and other distributions and to make loans to the Company. If the Bank is unable to make dividend payments and sufficient capital is not otherwise available, the Company may not be able to make dividend payments to its common stockholders or principal and interest payments on its outstanding debt.

If Regulators Impose Limitations on the Company's Commercial Real Estate Lending Activities, Earnings Could Be Adversely Affected

In 2006, the federal bank regulatory agencies issued joint guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" (the "CRE Guidance"). Although the CRE Guidance did not establish specific lending limits, it provides that a bank's commercial real estate lending exposure may receive increased supervisory scrutiny where total non-owner occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate and construction and land loans, represent 300% or more of an institution's total risk-based capital and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more during the preceding 36 months. The Bank's non-owner occupied commercial real estate level equaled 308% of total risk-based capital at December 31, 2022. Including owner-occupied commercial real estate, the ratio of commercial real estate loans to total risk-based capital ratio would be 382% at December 31, 2022. If the Company's regulators were to impose restrictions on the amount of commercial real estate loans it can hold in its portfolio, or require higher capital ratios as a result of the level of commercial real estate loans held, the Company's earnings would be adversely affected.

Operational Risks

The Company's Internal Controls May Fail or Be Circumvented

Management regularly reviews and updates our internal controls 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. A failure to implement and maintain effective internal control over financial reporting could result in errors in our financial statements that may lead to a restatement of our financial statements or cause us to fail to meet our reporting obligations. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have a material adverse effect on our operations, net income, financial condition, reputation, compliance with laws and regulations, or may result in untimely or inaccurate financial reporting.

The Potential for Business Interruption Exists Throughout the Company's Organization

Integral to the Company's performance is the continued efficacy of our technical systems, operational infrastructure, relationships with third parties and the vast array of associates and key executives in the Company's day-to-day and ongoing operations. Failure by any or all of these resources subjects the Company to risks that may vary in size, scale and scope. This includes, but is not limited to, operational or technical failures, pandemics, ineffectiveness or exposure due to interruption in third party support as expected, as well as the loss of key individuals or failure on the part of key individuals to perform properly. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue, cause the Company to incur additional expenses, or disrupt our third party vendors' operations, any of which could result in a material adverse effect on the Company's financial condition and results of operations. Although the Company has established disaster recovery plans and procedures, the occurrence of any such events could have a material adverse effect on the Company.

Lack of System Integrity or Credit Quality Related to Funds Settlement Could Result in a Financial Loss

The Bank settles funds on behalf of financial institutions, other businesses and consumers and receives funds from clients, card issuers, payment networks and consumers on a daily basis for a variety of transaction types. Transactions facilitated by the Bank include debit card, credit card and electronic bill payment transactions, supporting consumers, financial institutions and other businesses. These payment activities rely upon the technology infrastructure that facilitates the verification of activity with counterparties and the facilitation of the payment. If the continuity of operations or integrity of processing were compromised this could result in a financial loss to the Bank, and therefore the Company, due to a failure in payment facilitation. In addition, the Bank may issue credit to consumers, financial

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institutions or other businesses as part of the funds settlement. A default on this credit by a counterparty could result in a financial loss to the Bank, and therefore to the Company.

Financial Services Companies Depend on the Accuracy and Completeness of Information about Customers and Counterparties

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

Because the Nature of the Financial Services Business Involves a High Volume of Transactions, the Company Faces Significant Operational Risks

The Company relies on the ability of its employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from the Company's operations, including but not limited to, the risk of fraud by employees or persons outside of the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements, and business continuation and disaster recovery. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Company could suffer financial loss, face regulatory action and suffer damage to its reputation, any of which could have a material adverse effect on the Company's financial condition or results of operation.

The Company's Information Systems May Experience an Interruption or Breach in Security

The Company relies heavily on communications and information systems to conduct its business. As a financial institution, we process a significant number of customer transactions and possess a significant amount of sensitive customer information. As technology advances, the ability to initiate transactions and access data has become more widely distributed among mobile phones, personal computers, automated teller machines, remote deposit capture sites and similar access points. Any failure, interruption, or breach in security or operational integrity of our communications and information systems, or the systems of third parties on which we rely to process transactions, could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan, and other systems. There can be no assurance that failures, interruptions, or security breaches of the Company's information systems will not occur or, if they do occur, that they will be adequately addressed. Unauthorized third parties regularly seek to gain access to nonpublic, private and other information through computer systems. If customers' personal, nonpublic, confidential, or proprietary information in the Company's possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage, and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of the Company's systems, employees or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties. The occurrence of any failures, interruptions, or security breaches of the Company's information systems could, among other consequences, damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, result in increased insurance premiums, or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

In addition, as cybersecurity and data privacy risks for banking organizations and the broader financial system have significantly increased in recent years, cybersecurity and data privacy issues have become the subject of increasing legislative and regulatory focus. The federal bank regulatory agencies have proposed enhanced cyber risk management standards, which would apply to a wide range of large financial institutions and their third-party service providers, and would focus on cyber risk governance and management, management of internal and external dependencies, and incident response, cyber resilience and situational awareness. We may become subject to new legislation or regulation concerning cybersecurity or the privacy of personally identifiable information and personal financial information or of any other information we may store or maintain. We could be adversely affected if new legislation or regulations

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are adopted or if existing legislation or regulations are modified such that we are required to alter our systems or require changes to our business practices or privacy policies. If cybersecurity, data privacy, data protection, data transfer or data retention laws are implemented, interpreted or applied in a manner inconsistent with our current practices, we may be subject to fines, litigation or regulatory enforcement actions or ordered to change our business practices, policies or systems in a manner that adversely impacts our operating results. In addition, increased cost of compliance with cybersecurity regulations, at the federal and state level, could have a material adverse effect on the Company's financial condition and results of operations.

The Company May Be Adversely Affected by the Soundness of Other Financial Institutions

Financial services institutions are interrelated as a result of counterparty relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to losses or defaults by us or by other institutions and impact our business. Many of these transactions expose us to credit risk in the event of default of our counterparty or customer. In addition, our credit risk may be further increased when the collateral held by us cannot be relied upon or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due to us. Any such losses could materially and adversely affect our results of operations.

The most important counterparty for the Company, in terms of liquidity, is the Federal Home Loan Bank of New York ("FHLBNY"). The Company uses FHLBNY as its primary source of borrowed overnight funds and also has several long-term advances with FHLBNY. At December 31, 2022, the Company had a total of \$193.0 million in borrowed funds with FHLBNY. The Company has placed sufficient collateral in the form of commercial and residential real estate loans at FHLBNY. As a member of the Federal Home Loan Bank System, the Bank is required to hold stock in FHLBNY. The Bank held FHLBNY stock with a fair value of \$10.4 million as of December 31, 2022.

There are 11 branches of the FHLB, including New York. If a branch were at risk of breaching risk-based capital requirements, it could suspend dividends, cut dividend payments, and/or not buy back excess FHLB stock that members hold. FHLBNY has stated that they expect to be able to continue to pay dividends, redeem excess capital stock, and provide competitively priced advances in the future. Nonetheless, the 11 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt; other FHLB branches can be called upon to make the payment.

Systemic weakness in the FHLB could result in higher costs of FHLB borrowings, reduced value of FHLB stock, and increased demand for alternative sources of liquidity that are more expensive, such as brokered time deposits, the discount window at the Federal Reserve, or lines of credit with correspondent banks.

A Decline in the Value of the Company's Deferred Tax Assets Could Adversely Affect the Company's Operating Results and Regulatory Capital Ratios

The Company's tax strategies depend on the ability to generate taxable income in future periods. The Company's tax strategies will be less effective in the event the Company fails to generate anticipated amounts of taxable income. The value of the Company's deferred tax assets is subject to an evaluation of whether it is more likely than not that they will be realized for financial statement purposes. In making this determination, management considers all positive and negative evidence available, including the Company's historical levels of taxable income, the opportunity for net operating loss carrybacks, and projections for future taxable income over the statutory tax loss carryover period. If the Company were to conclude that a significant portion of deferred tax assets were not more likely than not to be realized, the required valuation allowance could adversely affect the Company's financial position, results of operations and regulatory capital ratios. In addition, the value of the Company's deferred tax assets could be adversely affected by a change in statutory tax rates.

The COVID-19 Outbreak Has Adversely Affected, and May Continue to Adversely Affect, the Company's Business and Results of Operations

The COVID-19 pandemic caused significant economic dislocation in the United States and globally. Certain industries were particularly hard-hit, including the travel and hospitality industry, the restaurant industry and the retail industry. Additionally, the spread of COVID-19 caused the Company to temporarily modify its business practices, including restricting employee travel and implementing remote work practices.

Given the dynamic nature of the pandemic, it is difficult to predict the full impact of the COVID-19 outbreak on the Company's business. As the result of the COVID-19 pandemic and the related adverse local and national economic consequences, and as a result of governmental responses to any outbreak, the Company may be subject to the following risks, any of which could have an adverse effect on our business, financial condition, liquidity, and results of operations: demand for the Company's products and services may decline; if consumer and business activities are restricted, loan delinquencies and foreclosures may increase, resulting in increased charge-offs and reduced income; collateral for loans, especially real estate, may decline in value, which could increase loan losses; our allowance for loan losses may have to be increased, which would adversely affect net income; a material decrease in net income or net losses could affect our ability to pay cash dividends; cyber security risks may be increased as employees work remotely; critical services provided by third party vendors may become unavailable, which could have an adverse effect on the Company's operations; government actions in response to the COVID-19 pandemic may affect our workforce, human capital resources and infrastructure; and the Company may experience unanticipated unavailability or loss of key employees, harming our ability to execute our business strategy. Any one or a combination of the foregoing factors could negatively impact our business, financial condition, results of operations and prospects.

Strategic Risks

Expansion or Contraction of the Company's Branch Network May Adversely Affect its Financial Results

The Company cannot assure that the opening of new branches will be accretive to earnings or that it will be accretive to earnings within a reasonable period of time. Numerous factors contribute to the performance of a new branch, such as suitable location, qualified personnel, and an effective marketing strategy. Additionally, it takes time for a new branch to gather sufficient loans and deposits to generate income sufficient to cover its operating expenses. Difficulties the Company experiences in opening new branches may have a material adverse effect on the Company's financial condition and results of operations. The Company cannot assure that the closing of branches will not be dilutive to earnings.

Mergers and Acquisitions Involve Numerous Risks and Uncertainties

The Company may pursue mergers and acquisitions opportunities. Mergers and acquisitions involve a number of risks and challenges, including the expenses involved; integration of branches and operations acquired; the outflow of customers from the acquired branches; the successful retention of personnel from acquired companies or branches; competing effectively in geographic areas not previously served; managing growth resulting from the transaction; and dilution in the acquirer's book and tangible book value per share.

Anti-Takeover Laws and Certain Agreements and Charter Provisions May Adversely Affect Share Value

Certain provisions of the Company's certificate of incorporation and state and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire control of the Company without approval of the Company's board of directors. Under federal law, subject to certain exemptions, a person, entity or group must notify the FRB before acquiring control of a bank holding company. Acquisition of 10% or more of any class of voting stock of a bank holding company, including shares of the Company's common stock, creates a rebuttable presumption that the acquiror "controls" the bank holding company. Also, a bank holding company must obtain the prior approval of the FRB before, among other things, acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, including the Bank. There also are provisions in the Company's certificate of incorporation that may be used to delay or block a takeover attempt. Taken as a whole, these statutory provisions and provisions in the Company's certificate of incorporation could result in the Company being less attractive to a potential acquiror and thus could adversely affect the market price of the Company's common stock.

General Risk Factors

The Company May Incur Impairment to its Goodwill

Goodwill arises when a business is purchased for an amount greater than the fair value of the net assets acquired. The Company has recognized goodwill as an asset on our balance sheet in connection with the acquisition of various insurance agencies and the acquisition of FSB on May 1, 2020. The Company evaluates goodwill for impairment at least annually. Although the Company determined that goodwill was not impaired during 2022, a significant and sustained decline in the Company's stock price and market capitalization, a significant decline in our expected future

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cash flows, a significant adverse change in the business climate, slower growth rates or other factors could result in impairment of goodwill. If the Company were to conclude that a future write-down of the goodwill was necessary, it would record the appropriate charge to earnings, which could be materially adverse to its financial condition and results of operations.

The Company's Business May Be Adversely Affected by Conditions in the Financial Markets and Economic Conditions Generally

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent upon the business environment in the markets where the Company operates, in Western New York and the Finger Lakes Region of New York State, and in the United States as a whole.

A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, declines in housing and real estate valuations, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; geopolitical conflicts; natural disasters; or a combination of these or other factors.

The Company's performance could be negatively affected to the extent there is deterioration in business and economic conditions, including persistent inflation, rising prices, and supply chain issues or labor shortages, which have direct or indirect material adverse impacts on us, our customers, and our counterparties. Recessionary conditions may significantly affect the markets in which we do business, the financial condition of our borrowers, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate values and sales volumes and increased unemployment levels may result in higher than expected loan delinquencies, increases in our levels of nonperforming and classified assets and a decline in demand for our products and services. Such events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

Strong Competition Within the Company's Market Area May Limit the Company's Growth and Profitability

Competition in the banking and financial services industry is intense. The Company competes with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, and financial technology companies operating locally within the Company's market area and elsewhere. Many of these competitors (whether regional or national institutions) have substantially greater resources and lending limits than the Company does, and may offer certain services that the Company does not or cannot provide. The Company's profitability depends upon its continued ability to successfully compete in this market area.

Loss of Key Employees May Disrupt Relationships with Certain Customers

The Company's business is primarily relationship-driven in that many of the key employees of the Bank and TEA have extensive customer relationships. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While management believes that the Company's relationships with its key business producers are good, the Company cannot guarantee that all of its key personnel will remain with the organization. Loss of such key personnel, particularly if they enter into an employment relationship with one of the Company's competitors, could result in the loss of some of the Company's customers. Such losses could have a material adverse effect on the Company's business, financial condition and results of operations.

Damage to the Company's Reputation Could Adversely Impact our Business

The Company's business reputation is important to its success. The ability to attract and retain customers, investors, employees and advisors may depend upon external perceptions of the Company. Damage to the Company's reputation could cause significant harm to its business and prospects and may arise from numerous sources, including litigation or regulatory actions, failing to deliver minimum standards of service and quality, compliance failures, unethical behavior and the misconduct of employees, advisors and counterparties. Negative perceptions or publicity regarding these matters could damage the Company's reputation among existing and potential customers, investors, employees and advisors. Adverse developments with respect to the financial services industry may also, by association, negatively impact the Company's reputation or result in greater regulatory or legislative scrutiny or litigation against the

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Company. Preserving and enhancing the Company's reputation also depends on maintaining systems and procedures that address known risks and regulatory requirements, as well as its ability to identify and mitigate additional risks that arise due to changes in businesses and the marketplaces in which the Company operates, the regulatory environment and client expectations. If any of these developments has a material effect on the Company's reputation, its business could suffer.

Furthermore, shareholders and other stakeholders have begun to consider how corporations are addressing environmental, social and governance ("ESG") issues. Governments, investors, customers and the general public are increasingly focused on ESG practices and disclosures, and views about ESG are diverse and rapidly changing. These shifts in investing priorities may result in adverse effects on the trading price of the Company's common stock if investors determine that the Company has not made sufficient progress on ESG matters. The Company could also face potential negative ESG-related publicity in traditional media or social media if shareholders or other stakeholders determine that we have not adequately considered or addressed ESG matters. If the Company, or our relationships with certain customers, vendors or suppliers became the subject of negative publicity, our ability to attract and retain customers and employees, and our financial condition and results of operations, could be adversely impacted.

Changes in the Company's Accounting Policies or in Accounting Standards Could Materially Affect How the Company Reports its Financial Results

Our accounting policies are fundamental to understanding our financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the FASB and the SEC change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our external financial statements. These changes are beyond our control, can be hard to predict and could materially impact how we report our results of operations and financial condition. We could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements in material amounts.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

At December 31, 2022, the Bank conducted its business from its administrative office and 18 branch offices. The administrative offices of the Company and the Bank are located at 6460 Main Street in Williamsville, NY. The administrative office facility is 50,000 square feet and is owned by the Bank. This facility is occupied by the Office of the President and Chief Executive Officer of the Company, as well as the Administrative and Loan Divisions of the Bank. The Bank also owns a building in Derby, NY.

The Bank has 18 branch locations. The Bank owns the building and land for five branch locations. Of the remaining branch locations, twelve are leased by the Bank and one is leased by TEA.

TEA operates from the Bank's administrative office. TEA has eight retail locations. The Bank owns three of the locations and leases two of the locations, and TEA owns one location and leases two locations.

Item 3. LEGAL PROCEEDINGS

The nature of the Company's business generates a certain amount of litigation involving matters arising in the ordinary course of business.

In the opinion of management, there are no proceedings pending to which the Company is a party or to which its property is subject, which, if determined adversely, would have a material effect on the Company's financial statements.

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

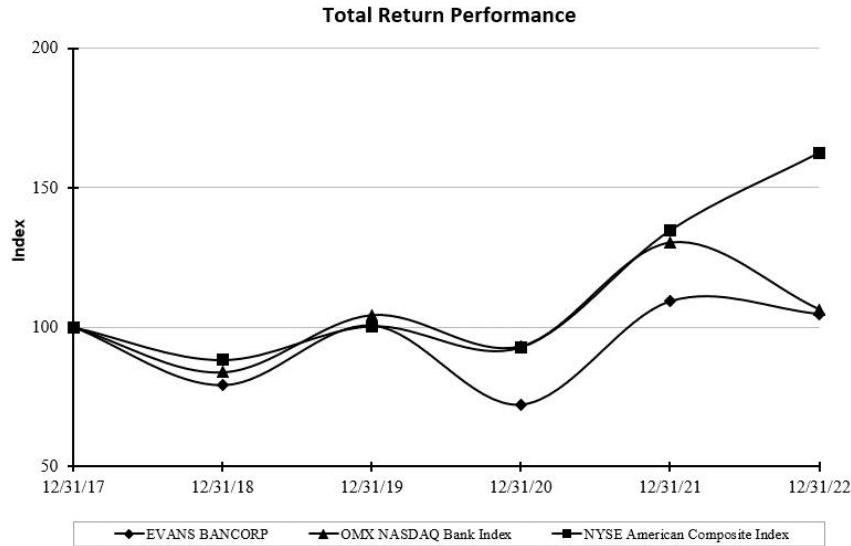
Market Information. The Company’s common stock is listed on the NYSE American under the symbol “EVBN.”

Holders. The approximate number of holders of record of the Company’s common stock as of February 28, 2023 was 1,230.

PERFORMANCE GRAPH

The following Performance Graph compares the Company's cumulative total stockholder return on its common stock for a five-year period (December 31, 2017 to December 31, 2022) with the cumulative total return of the NYSE American Composite Index and NASDAQ Bank Index. The comparison for each of the periods assumes that \$100 was invested on December 31, 2017 in each of the Company's common stock and the stocks included in the NYSE American Composite Index and NASDAQ Bank Index and that all dividends were reinvested without commissions. This table does not forecast future performance of the Company's stock.

**Compare 5-Year Cumulative Total Return Among
Evans Bancorp, Inc., NYSE American - Composite Index,
NASDAQ Bank Index and Peer Group**



| Index | 12/31/17 | 12/31/18 | 12/31/19 | 12/31/20 | 12/31/21 | 12/31/22 |
|---------------------------------|----------|----------|----------|----------|----------|----------|
| Evans Bancorp, Inc. | 100.00 | 79.15 | 100.49 | 72.21 | 109.18 | 104.63 |
| NASDAQ Bank | 100.00 | 83.83 | 104.26 | 93.17 | 130.16 | 106.26 |
| NYSE American - Composite Index | 100.00 | 88.23 | 100.34 | 92.80 | 134.72 | 162.55 |

In accordance with and to the extent permitted by applicable law or regulation, the information set forth above under the heading "Performance Graph" shall not be deemed to be "soliciting material" or to be "filed" with the SEC under the Securities Act or the Exchange Act, or subject to the liabilities of Section 18 of the Exchange Act, except to the extent that we specifically request that such information be treated as soliciting material or specifically incorporate it by reference into such a filing.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers.**Issuer Purchases of Equity Securities**

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs |
|--------------------------------------|---|-------------------------------------|---|---|
| October 1, 2022 - October 31, 2022 | | | | |
| Repurchase program ⁽¹⁾ | - | \$ - | - | 270,731 |
| November 1, 2022 - November 30, 2022 | | | | |
| Repurchase program ⁽¹⁾ | 82,799 | \$ 36.75 | 82,799 | 187,932 |
| December 1, 2022 - December 31, 2022 | | | | |
| Repurchase program ⁽¹⁾ | - | \$ - | - | 187,932 |
| Total: | | | | |
| Repurchase program ⁽¹⁾ | 82,799 | \$ 36.75 | 82,799 | 187,932 |

(1) On February 25, 2021, the Board of Directors authorized the Company to repurchase up to 300,000 shares of the Company's common stock (the "2021 Repurchase Program"). The 2021 Repurchase program does not expire and may be suspended or discontinued by the Board of Directors at any time. The remaining number of shares that may be purchased under the 2021 Repurchase Program as of December 31, 2022 was 187,932.

Item 6. **[RESERVED]**

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

OVERVIEW

This discussion is intended to compare the performance of the Company for the years ended December 31, 2022 and 2021. The review of the information presented should be read in conjunction with Part I, Item 1: "Business" and Part II, Item 8: "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

The Company is a financial holding company registered under the BHCA. The Company currently conducts its business through its two direct wholly-owned subsidiaries: the Bank, and the Bank's subsidiaries, ENL and ENHC; and ENFS and its subsidiary, TEA. The Company does not engage in any other substantial business. Unless the context otherwise requires, the term "Company" refers collectively to Evans Bancorp, Inc. and its subsidiaries.

Selected Financial Data

As of and for the year ended December 31,

| | 2022 | 2021 | 2020 |
|--|---|--------------|--------------|
| | (in thousands, except for per share data) | | |
| Balance Sheet Data | | | |
| Assets | \$ 2,178,510 | \$ 2,210,640 | \$ 2,044,115 |
| Interest-earning assets | 2,043,975 | 2,103,604 | 1,929,674 |
| Investment securities | 371,275 | 309,124 | 166,600 |
| Loans and leases, net | 1,652,931 | 1,553,467 | 1,673,379 |
| Deposits | 1,771,679 | 1,937,037 | 1,771,409 |
| Borrowings | 231,223 | 67,965 | 79,663 |
| Stockholders' equity | 153,993 | 183,892 | 168,905 |
| Income Statement Data | | | |
| Net interest income | \$ 72,955 | \$ 72,785 | \$ 59,782 |
| Non-interest income | 19,271 | 18,847 | 18,237 |
| Non-interest expense | 59,935 | 61,219 | 59,860 |
| Net income | 22,389 | 24,043 | 11,246 |
| Per Share Data | | | |
| Earnings per share - basic | \$ 4.07 | \$ 4.41 | \$ 2.15 |
| Earnings per share - diluted | 4.04 | 4.37 | 2.13 |
| Cash dividends | 1.26 | 1.20 | 1.16 |
| Book value | 28.32 | 33.54 | 31.21 |
| Performance Ratios | | | |
| Return on average assets | 1.02 % | 1.12 % | 0.60 % |
| Return on average equity | 13.49 % | 13.71 % | 7.06 % |
| Return on average tangible common stockholders' equity* | 14.74 % | 14.96 % | 7.77 % |
| Net interest margin | 3.53 % | 3.57 % | 3.37 % |
| Efficiency ratio | 64.99 % | 66.81 % | 76.72 % |
| Efficiency ratio (Non-GAAP) ** | 64.55 % | 66.22 % | 68.45 % |
| Dividend payout ratio | 30.96 % | 27.19 % | 53.95 % |
| Capital Ratios | | | |
| Tier 1 capital to average assets | 9.13 % | 8.57 % | 8.21 % |
| Equity to assets | 7.07 % | 8.32 % | 8.26 % |
| Asset Quality Ratios | | | |
| Total non-performing assets to total assets | 1.14 % | 0.83 % | 1.38 % |
| Total non-performing loans to total loans | 1.48 % | 1.17 % | 1.66 % |
| Net charge-offs to average loans | 0.11 % | 0.03 % | 0.01 % |
| Allowance for loan losses to non-accrual loans | 87.19 % | 106.04 % | 73.21 % |
| Allowance for loan losses to total loans | 1.16 % | 1.17 % | 1.21 % |

* The calculation of the average tangible common stockholders' equity ratio excludes goodwill and intangible assets from average stockholders' equity. See Reconciliation of GAAP to Non-GAAP Financial Measures below.

** The calculation of the non-GAAP efficiency ratio excludes amortization of intangibles, gains and losses from investment securities, merger-related expenses and the impact of historic tax credit transactions. See Reconciliation of GAAP to Non-GAAP Financial Measures below.

[Table of Contents](#)**Reconciliation of GAAP to Non-GAAP Financial Measures**

We believe the non-GAAP financial measures included above provide useful information to management and investors that is supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP; however, we acknowledge that our non-GAAP financial measures have a number of limitations. The following reconciliation table provides a more detailed analysis of the non-GAAP financial measures:

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|---|----------------|-------------|-------------|
| | (in thousands) | | |
| Return on average tangible common stockholders' equity | | | |
| Net income (GAAP) | \$ 22,389 | \$ 24,043 | \$ 11,246 |
| Average shareholders' equity (GAAP) | \$ 165,982 | \$ 175,416 | \$ 159,330 |
| Deduct: Average goodwill and intangible assets | 14,136 | 14,683 | 14,672 |
| Average shareholders' equity (non-GAAP) | \$ 151,846 | \$ 160,733 | \$ 144,658 |
| Return on average tangible common stockholders' equity (non-GAAP) | 14.74% | 14.96% | 7.77% |
| Efficiency ratio | | | |
| Non-interest expense (GAAP) | \$ 59,935 | \$ 61,219 | \$ 59,860 |
| Deduct: Intangible amortization expense | 400 | 537 | 533 |
| Deduct: Merger related expense | - | - | 5,958 |
| Adjusted non-interest expense (non-GAAP) | \$ 59,535 | \$ 60,682 | \$ 53,369 |
| Net interest income (GAAP) | \$ 72,955 | \$ 72,785 | \$ 59,782 |
| Non-interest income (GAAP) | 19,271 | 18,847 | 18,237 |
| Add: Historic tax credit losses, net | - | 9 | 618 |
| Deduct: Gain on sale of securities | - | - | 667 |
| Adjusted total revenue (non-GAAP) | \$ 92,226 | \$ 91,641 | \$ 77,970 |
| Efficiency ratio (non-GAAP) | 64.55% | 66.22% | 68.45% |

See Item 8, "Consolidated Financial Statements and Supplementary Data," of this Report on Form 10-K for further information and analysis of changes in the Company's financial condition and results of operations.

Summary

Net income in 2022 was \$22.4 million, a 7% decrease from 2021 net income of \$24.0 million. The decrease in the Company's net income during 2022 largely reflected a higher provision for loan losses compared with a release of allowance for loan losses during 2021. Net interest income was \$73.0 million in 2022 compared with \$72.8 million in 2021. During 2022, \$0.8 million of PPP fees were recognized and the Company benefited from federal fund rate increases, while 2021 reflected \$8.8 million of PPP fees, \$0.8 million of commercial prepayment fees, and \$0.5 million relating to the amortization of fair value marks on acquired loans. Net interest margin was 3.53% and 3.57% in 2022 and 2021, respectively.

The Company's provision for loan losses was \$2.7 million, which reflected a \$1.5 million charge-off of a single commercial loan and loan growth during 2022, partially offset by a decrease in criticized loans. In 2021, the Company had a \$1.5 million release of allowance for loan losses. The ratio of non-performing loans to total loans was 1.48% compared with 1.17% in 2021.

Non-interest income was \$19.3 million and \$18.8 million in 2022 and 2021, respectively. The largest component of the Company's non-interest income, insurance service and fees, was \$10.5 million in 2022 and 2021. Deposit service

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charges were \$2.9 million in 2022, an increase of \$0.3 million from 2021. Included in the increase of non-interest income during 2022 were increases of \$0.2 million in mortgage servicing rights income, \$0.2 million gain on the sale of other assets, and \$0.1 million from bank-owned life insurance income, partially offset by a decrease of \$0.4 million in loan fees.

Non-interest expense was \$59.9 million, a decrease of \$1.3 million from 2021. Included in the decrease were reductions in charitable contributions of \$0.4 million, marketing expenses of \$0.3 million, loan expenses of \$0.3 million, professional services costs of \$0.2 million, technology and communications expense of \$0.2 million, FDIC insurance expense of \$0.2 million, and amortization of intangible costs of \$0.1 million. The decreases were partially offset by an increase in salaries and benefits expense, the largest component of non-interest expenses, of \$0.2 million.

Strategy

The Company's goal is to continue to increase market share and achieve scale while improving profitability and returning value to shareholders. The Company's biggest strength and earnings driver is commercial and small business lending. The Company expects to continue to focus on building on this competitive advantage by adding personnel in this area. Management has also bolstered its biggest driver of non-interest income, TEA, through both agency and talent acquisition as well as building out its employee benefits and financial services businesses. In addition, management intends to continue to develop strategies to deepen existing customer relationships with tailored product sets that reward the Company's most loyal customers.

The Company's strategies are designed to direct tactical investment decisions supporting its financial objectives. While the Company intends to focus its efforts on the pursuit of these strategies, there can be no assurance that the Company will successfully implement these strategies or that the strategies will produce the desired results. The Company's most significant revenue source continues to be net interest income, defined as total interest income less interest expense. Net interest income accounted for 79% of total revenue in 2022. To produce net interest income and consistent earnings growth over the long-term, the Company must generate loan and deposit growth at acceptable margins within its market area. To generate and grow loans and deposits, the Company must focus on a number of areas including, but not limited to, sales practices, customer and employee satisfaction and retention, competition, evolving customer behavior, technology, product innovation, interest rates, credit performance of its customers and vendor relationships.

The Company also considers non-interest income important to its continued financial success. Fee income generation is partly related to the Company's loan and deposit operations, such as deposit service charges, as well as to its financial products, such as commercial and personal insurance sold through TEA. Improved performance in non-interest income can help increase capital ratios because most of the non-interest income is generated without recording assets on the balance sheet. The Company has and will continue to face challenges in increasing its non-interest income as the regulatory environment changes.

The Company has focused its efforts on targeted groups in its community such as (1) smaller businesses with smaller credit needs but rich in deposits and other service needs; (2) middle market commercial businesses; (3) commercial real estate lending; (4) retail customers; and (5) municipal customers. The overarching goal is to cross-sell between our insurance, financial services and banking lines of business to deepen our relationships with all of our customers.

The Company strives to provide a personal touch to customer service and is committed to maintaining a local, community-based philosophy. The Bank has emphasized hiring local branch and lending personnel with strong ties to the specific local communities it serves.

The Bank serves its market through 18 banking offices in Western New York and the Finger Lakes Region of New York State. The Company's principal source of funding is through deposits, which it reinvests in the community in the form of loans and investments. Deposits are insured up to the maximum permitted by the Deposit Insurance Fund of the FDIC. The Bank is regulated by the OCC.

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The Company's Consolidated Financial Statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the Company's Consolidated Financial Statements and Notes. These estimates, assumptions and

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judgments are based on information available as of the date of the Consolidated Financial Statements. Accordingly, as this information changes, the Consolidated Financial Statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments, and as such, have a greater possibility of producing results that could be materially different than originally reported.

The most significant accounting policies followed by the Company are presented in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. These policies, along with the disclosures presented in the other Notes to the Consolidated Financial Statements contained in this Annual Report on Form 10-K and in this financial review, provide information on how significant assets and liabilities are valued in the Company's Consolidated Financial Statements and how those values are determined.

The more significant areas in which management of the Company applies critical assumptions and estimates include the allowance for loan losses.

Allowance for Loan Losses

The allowance for loan losses ("ALLL") represents management's estimate of probable incurred losses in the Bank's loan portfolio. Determining the amount of the allowance for loan losses requires significant judgment on the part of management and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, consideration of current economic trends and conditions, and other qualitative and quantitative factors, all of which may be susceptible to significant change. Qualitative loss factors are applied to each portfolio segment with the amounts determined by historical loan charge-offs of a peer group of similar-sized regional banks. It is difficult to estimate how potential changes in any one economic factor or input might affect the overall allowance because a wide variety of factors and inputs are considered in estimating the allowance and changes in those factors and inputs considered may not occur at the same rate and may not be consistent across all product types. Additionally, changes in factors and inputs may be directionally inconsistent, such that improvement in one factor may offset deterioration in others.

In estimating the ALLL on loans, management considers the sensitivity of the model and significant judgments and assumptions that could result in an amount that is materially different from management's estimate. Given the concentration of ALLL allocation to the total commercial portfolio and the significant judgments made by management in deriving the qualitative loss factors, management analyzed the impact that changes in judgments could have. The range of impact on the ALLL allocated to the total commercial loan portfolio was between a reduction of \$12.4 million and an increase of \$10.3 million at December 31, 2022. The sensitivity and related range of impact is a hypothetical analysis and is not intended to represent management's judgments or assumptions of qualitative loss factors that were utilized at December 31, 2022 in estimation of the ALLL on loans recognized on the Consolidated Balance Sheet.

If the assumptions underlying the determination of the ALLL prove to be incorrect, the ALLL may not be sufficient to cover actual loan losses and an increase to the ALLL may be necessary to allow for different assumptions or adverse developments. In addition, a problem with one or more loans could require a significant increase to the ALLL.

Management's methodology and policy in determining the allowance for loan losses can be found in Note 1 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K. The activity in the allowance for loan losses is depicted in supporting tables in Note 4 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2022 AND DECEMBER 31, 2021

Net Income

Net income of \$22.4 million in 2022 consisted of \$20.9 million related to the Company's banking activities and \$1.5 million related to the Company's insurance agency activities. Net income of \$22.4 million in 2022, or \$4.04 per diluted share decreased from \$24.0 million, or \$4.37 per diluted share, in 2021.

Net Interest Income

Net interest income, the difference between interest income and fee income on interest earning assets, such as loans and securities, and interest expense on deposits and borrowings, provides the primary basis for the Company's results of operations.

Net interest income is dependent on the amounts of and yields earned on interest earning assets as compared to the amounts of and rates paid on interest bearing liabilities.

AVERAGE BALANCE SHEET INFORMATION

The following table presents the significant categories of the assets and liabilities of the Company, interest income and interest expense, and the corresponding yields earned and rates paid in 2022, 2021, and 2020. The assets and liabilities are presented as daily averages. The average loan balances include both performing and non-performing loans. Interest income on loans does not include interest on loans for which the Bank has ceased to accrue interest. Available-for-sale securities are stated at fair value. Interest and yield are not presented on a tax-equivalent basis.

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| | 2022 | | | 2021 | | | 2020 | | |
|---|-----------------------------|-----------------------|---------------|-----------------------------|-----------------------|---------------|-----------------------------|-----------------------|---------------|
| | Average Outstanding Balance | Interest Earned/ Paid | Yield/ Rate | Average Outstanding Balance | Interest Earned/ Paid | Yield/ Rate | Average Outstanding Balance | Interest Earned/ Paid | Yield/ Rate |
| | (in thousands) | | | (in thousands) | | | (in thousands) | | |
| ASSETS | | | | | | | | | |
| Interest-earning assets: | | | | | | | | | |
| Loans, net (1) | \$ 1,595,944 | \$70,562 | 4.42 % | \$ 1,661,057 | \$72,955 | 4.39 % | \$ 1,526,631 | \$64,753 | 4.24 % |
| Taxable securities | 373,589 | 8,037 | 2.15 % | 221,965 | 4,224 | 1.90 % | 152,456 | 3,587 | 2.35 % |
| Tax-exempt securities | 11,320 | 287 | 2.54 % | 10,489 | 214 | 2.04 % | 10,411 | 246 | 2.36 % |
| Interest bearing deposits at banks | 85,268 | 596 | 0.70 % | 144,944 | 187 | 0.13 % | 82,697 | 247 | 0.30 % |
| Total interest-earning assets | 2,066,121 | \$ 79,482 | 3.85 % | 2,038,455 | \$77,580 | 3.81 % | 1,772,195 | \$68,833 | 3.88 % |
| Non interest-earning assets: | | | | | | | | | |
| Cash and due from banks | | 15,556 | | | 15,197 | | | 14,671 | |
| Premises and equipment, net | | 17,392 | | | 18,963 | | | 16,531 | |
| Other assets | | 88,075 | | | 79,765 | | | 76,911 | |
| Total Assets | | \$ 2,187,144 | | | \$2,152,380 | | | \$1,880,308 | |
| LIABILITIES & STOCKHOLDERS' EQUITY | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| NOW | \$ 261,514 | \$ 427 | 0.16 % | \$ 248,441 | \$ 269 | 0.11 % | \$ 197,113 | \$ 488 | 0.25 % |
| Regular savings | 970,401 | 1,899 | 0.20 % | 932,549 | 1,514 | 0.16 % | 736,558 | 3,120 | 0.42 % |
| Time deposits | 151,719 | 1,263 | 0.83 % | 202,958 | 1,081 | 0.53 % | 312,620 | 4,113 | 1.32 % |
| Other borrowed funds | 48,731 | 1,136 | 2.33 % | 39,478 | 308 | 0.78 % | 35,749 | 304 | 0.85 % |
| Subordinated debt | 31,023 | 1,791 | 5.77 % | 30,922 | 1,616 | 5.23 % | 20,836 | 1,019 | 4.89 % |
| Securities sold U/A to repurchase | 6,827 | 11 | 0.16 % | 4,453 | 7 | 0.16 % | 4,022 | 7 | 0.17 % |
| Total interest-bearing liabilities | 1,470,215 | \$ 6,527 | 0.44 % | 1,458,801 | \$ 4,795 | 0.33 % | 1,306,898 | \$ 9,051 | 0.69 % |
| Noninterest-bearing liabilities: | | | | | | | | | |
| Demand deposits | | 530,879 | | | 494,294 | | | 388,269 | |
| Other | | 20,068 | | | 23,869 | | | 25,811 | |
| Total liabilities | | \$ 2,021,162 | | | \$1,976,964 | | | \$1,720,978 | |
| Stockholders' equity | | 165,982 | | | 175,416 | | | 159,330 | |
| Total Liabilities and Equity | | \$ 2,187,144 | | | \$ 2,152,380 | | | \$ 1,880,308 | |
| Net interest earnings | | <u>\$ 72,955</u> | | | <u>\$ 72,785</u> | | | <u>\$ 59,782</u> | |
| Net interest margin | | | <u>3.53 %</u> | | | <u>3.57 %</u> | | <u>3.37 %</u> | |
| Interest rate spread | | | <u>3.41 %</u> | | | <u>3.48 %</u> | | <u>3.19 %</u> | |

(1) Included in interest earned were PPP loans fees of \$0.8 million, \$8.8 million and \$2.9 million as of December 31, 2022, 2021 and 2020, respectively. Other loan fees included in interest earned were not material during 2022, 2021, and 2020.

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The following table segregates changes in interest earned and paid for the past two years into amounts attributable to changes in volume and changes in rates by major categories of assets and liabilities. The change in interest income and expense due to both volume and rate has been allocated in the table to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each. There are no out-of-period item adjustments included in the following table.

| | 2022 Compared to 2021 Increase (Decrease) Due to | | | 2021 Compared to 2020 Increase (Decrease) Due to | | |
|------------------------------------|---|----------|------------|---|------------|------------|
| | Volume | Rate | Total | (in thousands) | | |
| | | | | Volume | Rate | Total |
| Interest earned on: | | | | | | |
| Loans | \$ (2,876) | \$ 483 | \$ (2,393) | \$ 5,846 | \$ 2,356 | \$ 8,202 |
| Taxable securities | 3,202 | 611 | 3,813 | 1,415 | (778) | 637 |
| Tax-exempt securities | 18 | 55 | 73 | 2 | (34) | (32) |
| Interest-bearing deposits at banks | (106) | 515 | 409 | 126 | (186) | (60) |
| Total interest-earning assets | \$ 238 | \$ 1,664 | \$ 1,902 | \$ 7,389 | \$ 1,358 | \$ 8,747 |
| Interest paid on: | | | | | | |
| NOW accounts | \$ 15 | \$ 143 | \$ 158 | \$ 104 | \$ (323) | \$ (219) |
| Savings deposits | 65 | 320 | 385 | 677 | (2,283) | (1,606) |
| Time deposits | (319) | 501 | 182 | (1,124) | (1,908) | (3,032) |
| Other | 335 | 672 | 1,007 | 345 | 256 | 601 |
| Total interest-bearing liabilities | \$ 96 | \$ 1,636 | \$ 1,732 | \$ 2 | \$ (4,258) | \$ (4,256) |

Net interest income increased by \$0.2 million, or less than 1%, to \$73.0 million in 2022 from \$72.8 million in 2021. This change primarily reflected the benefit from federal fund rate increases during 2022 and an \$152.4 million increase in the average balance of securities, partially offset by an \$8.0 million decrease in PPP fees. Interest expense increased \$1.7 million primarily reflecting competitive pricing on deposits. Overall, the increased volume of interest-earning assets and interest-bearing liabilities positively impacted net interest income by \$0.1 million in 2022, while the rates earned and paid on those respective assets and liabilities were generally flat.

The total commercial loan portfolio average balance, including commercial real estate and C&I loans, decreased \$95.0 million, or 9%, from a \$1.20 billion average balance in 2021 to a \$1.1 billion average balance in 2022. This decrease was primarily the result of reduced volume of SBA loans due to PPP forgiveness. Average consumer loans, including residential mortgages and home equity lines of credit, increased 7% from \$476.2 million in 2021 to \$511.2 million in 2022. The increase was primarily due to higher levels of residential mortgage originations.

On the funding side, average interest bearing deposits were consistent with the prior year, while average overnight borrowings increased \$24.5 million.

The Company's net interest margin decreased from 3.57% in 2021 to 3.53% in 2022. The net interest spread, or the difference between yield on interest-earning assets and rate on interest-bearing liabilities, decreased from 3.48% in 2021 to 3.40% in 2022. These changes are primarily reflective of increases in loan yields and deposit rates. The yield on interest-earning assets increased 4 basis points to 3.85% during 2022, as higher loan yields was partially offset by a \$8.0 million decrease in PPP fees. Cost of interest-bearing liabilities increased 11 basis points to 0.44% during 2022. The increase in the cost of interest-bearing liabilities is the result of higher rates as the Company continues to provide competitive pricing on deposits. The rate paid on average time deposits increased from 0.53% in 2021 to 0.83% in 2022. Average time deposits were 10% of total interest-bearing liabilities in 2022, compared with 14% in the prior year period.

The Bank regularly monitors its exposure to interest rate risk. Management believes that the proper management of interest-sensitive funds will help protect the Bank's earnings against changes in interest rates. The Bank's Asset/Liability Management Committee ("ALCO") meets monthly for the purpose of evaluating the Bank's short-term and long-term liquidity position and the potential impact on capital and earnings of changes in interest rates. The Bank has adopted an asset/liability policy that specifies minimum limits for liquidity and capital ratios. This policy

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includes setting ranges for the negative impact acceptable on net interest income and on the fair value of equity as a result of a shift in interest rates. The asset/liability policy also includes guidelines for investment activities and funds management. At its monthly meetings, ALCO reviews the Bank's status and formulates its strategies based on current economic conditions, interest rate forecasts, loan demand, deposit volatility and the Bank's earnings objectives.

Provision for Loan Losses

The Company's provision for allowance for loan losses of \$2.7 million during 2022, compared with a release of the allowance for loan losses of \$1.5 million in 2021 reflects an increase in non-performing and criticized loans as well as improvements in economic trends and conditions related to the COVID-19 pandemic. The Company identified a well-defined weakness in the hotel industry and classified the \$81 million of loans to clients within that industry as criticized during 2020. More than half of this portfolio has since been upgraded or paid off. Currently, \$30 million of the hotel portfolio remains in criticized status at December 31, 2022 compared with \$111 million at December 31, 2021. The ratio of non-performing loans to total loans was 1.48% at December 31, 2022 compared with 1.17% at the end of 2021. The Company records a specific reserve on impaired loans and a higher reserve percentage on criticized loan balances, or those loans risk-rated special mention or worse, which are collectively evaluated for impairment. At December 31, 2022, criticized loans that were collectively evaluated for impairment totaled \$75 million, compared with \$97 million at December 31, 2021. Total loans collectively evaluated for impairment were \$1.6 billion at December 31, 2022, an increase of \$95 million from December 31, 2021.

A description of how the allowance for loan losses is determined along with tabular data depicting the key factors in calculating the allowance is set forth in Notes 1 and 4 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Non-accrual, Past Due and Restructured Loans

Non-performing loans increased \$6.3 million from \$18.4 million at December 31, 2021 to \$24.7 million at December 31, 2022. The increase in 2022 was primarily driven by one commercial real estate loan totaling \$7 million that moved to non-accrual status during 2022. Non-performing loans included \$22.3 million of non-accruing loans at December 31, 2022 compared with \$17.4 million at December 31, 2021. Total non-accrual loans to total loans was 1.33% and 1.11% at December 31, 2022 and 2021, respectively. There were \$2.4 million of accruing loans categorized as 90 days past due at December 31, 2022 compared with \$1.0 million at December 31, 2021.

Total non-performing loans to total assets was 1.14% at December 31, 2022 compared with 0.83% at December 31, 2021. Total non-performing loans to total loans and leases at December 31, 2022 and 2021 was 1.48% and 1.17%, respectively.

The Company had \$4.9 million in loans that were restructured and deemed to be TDRs at December 31, 2022 with \$1.3 million of those balances in non-accrual status, compared with \$5.7 million and \$1.5 million, respectively, at December 31, 2021. Any TDR that is placed on non-accrual is not returned to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the restructurings were completed in an effort to maximize the Company's ability to collect on loans where borrowers were experiencing financial difficulty. Modifications made to loans in a troubled debt restructuring did not have a material impact on the Company's net income for the years ended December 31, 2022 and 2021. The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan's original effective rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired. In accordance with the CARES Act and federal banking regulators issued guidance, modifications made to a borrower affected by the COVID-19 pandemic did not result in a TDR classification if the loan were current as of December 31, 2019. This COVID-19 related TDR exception expired on January 1, 2022.

See Note 4 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for further information about the Company's non-accrual, past due and restructured loans.

Allowance for Loan and Lease Losses

The following table summarizes the Bank's allocation of the allowance for loan losses by portfolio type for years 2022 and 2021.

| | <u>Balance at 12/31/2022</u> | <u>Percent of loans to total loans</u> | <u>Balance at 12/31/2021</u> | <u>Percent of loans to total loans</u> |
|---------------------------|------------------------------|--|------------------------------|--|
| | (in thousands) | | | |
| Residential mortgages* | \$ 2,102 | 26 % | \$ 2,127 | 27 % |
| Commercial mortgages* | 11,595 | 54 % | 12,367 | 53 % |
| Home equities | 608 | 5 % | 581 | 5 % |
| Commercial and industrial | 4,980 | 15 % | 3,309 | 15 % |
| Consumer loans** | 153 | - % | 54 | - % |
| Total | \$ 19,438 | 100 % | \$ 18,438 | 100 % |

* includes construction loans

** includes other loans

During 2022, the Company had net loan charge-offs of \$1.7 million, compared with of \$0.5 million in 2021. The ratio of net loan charge-offs to average net loans outstanding was 0.11% in 2022 compared with 0.03% in 2021. Charge-offs during 2022 included \$1.5 million related to a single commercial loan. There were no significant charge-offs or recoveries during 2021. The following table presents by loan category net loan charge-offs to average loans outstanding ratios for 2022 and 2021.

| | <u>2022</u> | <u>2021</u> |
|------------------------|-------------|-------------|
| Residential mortgages* | 0.03 % | -% |
| Commercial mortgages* | - % | -% |
| Home equities | 0.04 % | -% |
| Commercial loans | 0.59 % | 0.10 % |
| Consumer loans** | 5.54 % | 1.27 % |

* includes construction loans

** includes other loans

Commercial mortgages comprised 60% of the allowance for loan losses, and correspondingly, the commercial mortgage portfolio made up the largest proportion, or 54%, of the total loan portfolio as of December 31, 2022, as compared with 67% of the allowance and 53% of the total loan portfolio at December 31, 2021. The commercial mortgage percentage of the allowance as it compares to the percentage of total loans primarily reflects the impact of the COVID-19 pandemic on the Company's hotel loan portfolio.

C&I loans comprised 26% of the allowance for loan losses and 15% of the loan portfolio as of December 31, 2022, as compared with 18% of the allowance and 15% of the total loan portfolio at December 31, 2021.

Residential mortgages comprised 11% of the allowance for loan losses and 26% of the loan portfolio as of December 31, 2022, as compared with 12% of the allowance and 26% of the total loan portfolio at December 31, 2021. Loans acquired in a business combination are recorded at fair value with no carry-over of an acquired entity's previously established allowance for credit losses. Acquired residential mortgages that were not included in the allowance for loan losses were \$104 million and \$120 million at December 31, 2022 and 2021, respectively.

In addition to acquired loans, PPP loans are excluded from the calculation of the allowance for loan losses because they are 100% guaranteed by the SBA. Total loans excluded from the calculation of the allowance for loan losses were \$130 million and \$180 million at December 31, 2022 and 2021, respectively. Overall, the ratio of the allowance for loan losses to total loans decreased from 1.17% at December 31, 2021 to 1.16% on December 31, 2022. The non-performing loans to total loans ratio increased from 1.17% at the end of 2021, to 1.48% at the conclusion of 2022.

The Company evaluates the loan portfolio to ensure that specific credits are appropriately graded and reserved. At least annually, borrowers' financial information is reviewed by the individual relationship managers. Independent of the individual relationship managers, the credit department performs annual reviews on all requisite relationships within the loan portfolio. In addition to the credit department, the Company has engaged an independent vendor to monitor the management of the Company's commercial loan portfolio. The Company's loan review function reviews a percentage of the commercial loan portfolio based on an annual risk assessment, typically ranging from 40% to 50%. The Company believes that the allowance for loan losses is reflective of a fair assessment of the current environment and credit quality trends.

Non-Interest Income

Total non-interest income increased from \$18.8 million in 2021 to \$19.3 million in 2022. Deposit service charges were up \$0.3 million to \$2.9 million at December 31, 2022. In addition to the increase in deposit service charges, mortgage servicing rights increased \$0.2 million, and a gain on sale of other real estate owned of \$0.2 million during 2022. These increases were partially offset by lower loan fees of \$0.4 million. Insurance services fees of \$10.5 million remained relatively flat compared to 2021. Insurance revenue remains the largest component of non-interest income at 54% of total non-interest income. TEA is a source of diversification in the earnings of the Company and helps generate income not directly impacted by difficult credit or interest rate environments.

Non-Interest Expense

Total non-interest expense decreased \$1.3 million, or 2%, from \$61.2 million in 2021 to \$59.9 million in 2022. The largest decreases in non-interest expense in 2022 when compared with 2021 were charitable contributions of \$0.4 million, marketing expenses of \$0.3 million, loan expenses of \$0.3 million, technology and communications expense of \$0.2 million, FDIC insurance expense of \$0.1 million, and amortization of intangibles costs of \$0.1 million. These decreases were partially offset by an in salaries and employee benefits of \$0.3 million.

The efficiency ratio expresses the relationship of operating expenses to revenues. The Company's GAAP efficiency ratio, or non-interest operating expenses divided by the sum of net interest income and non-interest income, was 64.99% in 2022 compared with 66.8% in 2021. The Company's non-GAAP efficiency ratio, which excludes amortization expense, gains and losses from investment securities, merger-related expenses and the impact of historic tax credit transactions, was 64.6% in 2022 compared with 66.2% in 2021.

Taxes

Income tax expense for the year was \$7.2 million, representing an effective tax rate of 24.2% compared with an effective tax rate of 24.7% in 2021. For further discussion of the Company's income taxes, including a reconciliation from the statutory rate to the actual rate for 2022 and 2021, see Note 14 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

FINANCIAL CONDITION

The Company had total assets of \$2.2 billion at December 31, 2022, a decrease of \$32 million, or 1% from December 31, 2021. Net loans of \$1.7 billion at the most recent year end were \$99 million, or 6%, higher than at December 31, 2021. Total investment securities increased \$62 million, or 20%, from \$309 million at December 31, 2021 to \$371 million at December 31, 2022. Deposits decreased by \$165 million, or 9%, to \$1.8 billion as of the end of 2022. Stockholders' equity was \$154 million at the conclusion of 2022, a \$30 million, or 16% decrease from \$184 million at the previous year end.

Securities Activities

The primary objectives of the Bank's securities portfolio are to provide liquidity and maximize income while preserving safety of principal. Secondary objectives include: providing collateral to secure local municipal deposits, the investment of funds during periods of decreased loan demand, interest rate sensitivity considerations, supporting local communities through the purchase of tax-exempt securities and tax planning considerations. The Bank's Board of Directors is responsible for establishing overall policy and reviewing performance of the Bank's investments.

Under the Bank's policy, acceptable portfolio investments include: United States Government obligations, obligations of federal agencies or U.S. Government-sponsored enterprises, mortgage-backed securities, municipal obligations (general obligations, revenue obligations, school districts and non-rated issues from the Bank's general market area), banker's acceptances, certificates of deposit, Industrial Development Authority Bonds, Public Housing Authority Bonds, corporate bonds (each corporation limited to the Bank's legal lending limit), collateralized mortgage obligations, Small Business Investment Companies (SBIC), Federal Reserve stock and Federal Home Loan Bank stock.

In regard to municipal securities, the Company's general investment policy is that in-state securities must be rated at least Moody's Baa (or equivalent) at the time of purchase. The Company reviews the ratings report and municipality financial statements and prepares a pre-purchase analysis report before the purchase of any municipal securities. Out-of-state issues must be rated by Moody's at least Aa (or equivalent) at the time of purchase. The Company did not own any out-of-state municipal bonds at December 31, 2022 or December 31, 2021. Bonds rated below A are reviewed periodically to ensure their continued creditworthiness. While purchase of non-rated municipal securities is permitted, such purchases are limited to bonds issued by municipalities in the Company's general market area. Those municipalities are typically customers of the Bank whose financial situation is familiar to management. The financial statements of the issuers of non-rated securities are reviewed by the Bank and a credit file of the issuers is kept on each non-rated municipal security with relevant financial information.

The Company has not experienced any credit troubles in its municipal bond portfolio and does not believe any credit troubles are imminent. Aside from the non-rated municipal securities to local municipalities discussed above that are considered held-to-maturity, all of the Company's available-for-sale municipal bonds are investment-grade government obligation ("G.O.") bonds. G.O. bonds are generally considered safer than revenue bonds because they are backed by the full faith and credit of the government while revenue bonds rely on the revenue produced by a particular project. All of the Company's municipal bonds are to municipalities in New York State. To the Company's knowledge, there has never been a default on a NY G.O. bond in the history of the state. The Company believes that its risk of loss on default of a G.O. municipal bond for the Company is relatively low. However, historical performance does not guarantee future performance.

All fixed and adjustable rate mortgage pools backing the Company's mortgage-backed securities contain a certain amount of risk related to the uncertainty of prepayments of the underlying mortgages. Interest rate changes have a direct impact on prepayment rates. The Company uses a third-party developed model to monitor the average life and yield volatility of mortgage pools under various interest rate assumptions.

The Company designates all securities at the time of purchase as either "held to maturity" or "available for sale." Securities designated as held to maturity are reported at amortized cost and consist of municipal investments that the Bank has made in its local market area. At December 31, 2022, \$6.9 million in securities were designated as held to maturity. Debt and mortgage backed securities designated as available for sale are reported at fair market value.

Fair values for available for sale securities are determined using independent pricing services and market-participating brokers. The Company utilizes a third-party for these pricing services. The third-party utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, the third-party service provider's evaluated pricing applications apply information as applicable through processes, such as benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, our third-party pricing service provider uses model processes, such as the Option Adjusted Spread model, to assess interest rate impact and develop prepayment scenarios. The models and the process take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models. The third party, at times, may determine that it does not have sufficient verifiable information to value a particular security. In these cases the Company will utilize valuations from another pricing service.

Management believes that it has a sufficient understanding of the third party service's valuation models, assumptions and inputs used in determining the fair value of securities to enable management to maintain an appropriate system of internal control. On a quarterly basis the Company reviews changes, as submitted by our third-party pricing service provider, in the market value of its securities portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on a quarterly basis the Company has its entire securities portfolio priced by a second pricing service to determine

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consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company may submit an inquiry to our third party pricing service provider regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than our third-party pricing service provider's evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in 2022 or 2021.

The available for sale portfolio totaled \$364 million or approximately 98% of the Company's securities portfolio at December 31, 2021. Net unrealized gains and losses on available for sale securities resulted in an unrealized loss of \$63.9 million at December 31, 2022, as compared with \$4.3 million at December 31, 2021. The change in the net unrealized position of the portfolio in 2022 was due to the increase in market interest rates during the year and the increase in total securities resulting from elevated purchase activity a year earlier. Unrealized gains and losses on available-for-sale securities are reported, net of taxes, as a separate component of stockholders' equity. For the year ended December 31, 2022, the impact of net unrealized losses, net of taxes, on stockholders' equity was \$44 million.

Certain securities available for sale were in an unrealized loss position at December 31, 2022. Management assessed those securities available for sale in an unrealized loss position at December 31, 2022 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, the financial condition of the issuer (primarily government or government-sponsored enterprises) and the Company's ability and intent to hold these securities until their fair value recovers to their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuer.

The Company's securities portfolio outstanding balances increased from \$309 million at December 31, 2021 to \$371 million at December 31, 2022 and the Company's interest-bearing deposits at banks decreased from \$235 million to \$6 million over the same time period. The interest-bearing deposits are liquid interest-bearing cash accounts at correspondent banks. The decrease in interest-bearing deposits and the increase in securities reflects the use of excess liquidity and a reduction in customer deposits. At December 31, 2022, the Company's concentration in U.S. government-sponsored agency bonds was 38% of the total securities balance versus 31% at December 31, 2021. Government-sponsored mortgage-backed securities comprised 54% of the portfolio at December 31, 2022, compared with 66% of the portfolio at December 31, 2021, and tax-advantaged municipal bonds made up 8% of the portfolio at December 31, 2022 versus 3% of the portfolio at December 31, 2021.

Income from securities held in the Bank's investment portfolio represented 10% and 6% of total interest income of the Company in 2022 and 2021, respectively. Taxable securities yields increased to 2.15% in 2022 from 1.90% in 2021, while tax-exempt yields were 2.54% in 2022 and 2.04% in 2021.

As a member of both the Federal Reserve System and the FHLB, the Bank is required to hold stock in those entities. The Bank held \$10.4 million and \$3.0 million in FHLB stock as of December 31, 2022 and 2021, respectively, and \$3.1 million and \$3.0 million in FRB stock at December 31, 2022 and 2021, respectively.

Available for sale securities with a total fair value of \$226 million at December 31, 2022 were pledged as collateral to secure public deposits and for other purposes required or permitted by law.

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The following table sets forth the contractual maturities and weighted average interest yields of the Bank's securities portfolio that are not carried at fair value through earnings (yields on tax-exempt obligations are not presented on a tax-equivalent basis) as of December 31, 2022. Expected maturities will differ from contracted maturities since issuers may have the right to call or prepay obligations without penalties.

| | Maturing | | | | | | | |
|---|--------------------|-------|------------------------------------|-------|------------------------------------|-------|--------------------|-------|
| | Within One Year | | After One But Within Five Years | | After Five But Within Ten Years | | After Ten Years | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | (\$ in thousands) | | | | | | | |
| Available for Sale: | | | | | | | | |
| Debt Securities | | | | | | | | |
| U.S. treasuries and government agencies | \$ 5,941 | 2.09% | \$ 61,545 | 1.81% | \$ 53,146 | 1.79% | \$ 20,050 | 1.73% |
| States and political subdivisions | 839 | 1.77% | 19,223 | 2.18% | 1,760 | 3.12% | - | - |
| Total debt securities | <u>\$ 6,780</u> | 2.05% | <u>\$ 80,768</u> | 1.90% | <u>\$ 54,906</u> | 1.83% | <u>\$ 20,050</u> | 1.73% |
| Mortgage-backed securities | | | | | | | | |
| FNMA | \$ - | - | \$ 5,953 | 2.67% | \$ 17,022 | 2.05% | \$ 40,127 | 2.04% |
| FHLMC | - | - | 7,769 | 3.39% | 9,647 | 1.93% | 22,811 | 1.79% |
| GNMA | - | - | 65 | 3.73% | - | - | 33,394 | 1.94% |
| SBA | - | - | - | - | 3,625 | 2.90% | 16,512 | 2.67% |
| CMO | - | - | 118 | 2.77% | 345 | 1.66% | 44,434 | 2.19% |
| Total mortgage-backed securities | <u>\$ -</u> | - | <u>\$ 13,905</u> | 3.08% | <u>\$ 30,639</u> | 2.11% | <u>\$ 157,278</u> | 2.09% |
| Total securities designated as available for sale | <u>\$ 6,780</u> | 2.05% | <u>\$ 94,673</u> | 2.18% | <u>\$ 85,545</u> | 1.93% | <u>\$ 177,328</u> | 2.05% |
| Held to Maturity: | | | | | | | | |
| Debt Securities | | | | | | | | |
| States and political subdivisions | \$ 6,096 | 3.34% | \$ 441 | 3.25% | \$ 412 | 3.03% | \$ - | - |
| Total securities designated as held to maturity | <u>\$ 6,096</u> | 3.34% | <u>\$ 441</u> | 3.25% | <u>\$ 412</u> | 3.03% | <u>\$ -</u> | - |
| Total securities | <u>\$ 12,876</u> | 2.66% | <u>\$ 95,114</u> | 2.07% | <u>\$ 85,957</u> | 1.94% | <u>\$ 177,328</u> | 2.05% |

LENDING ACTIVITIES

The Bank has a loan policy which is approved by its Board of Directors on an annual basis. The loan policy governs the conditions under which loans may be made, addresses the lending authority of Bank officers, documentation requirements, appraisal policy, charge-off policies and desired portfolio mix. The Bank's lending limit to any one borrower is subject to regulation by the OCC. The Bank continually monitors its loan portfolio to review compliance with new and existing regulations.

The Bank offers a variety of loan products to its customers, including residential and commercial real estate mortgage loans, commercial loans, and installment loans. The Bank primarily extends loans to customers located within the Company's footprint. Interest income on loans represented 89% of the total interest income of the Company in 2022 compared with 94% in 2021. The Bank's loan portfolio, net of the allowances for loan losses, totaled \$1.7 billion and \$1.6 billion at December 31, 2022 and December 31, 2021, respectively. The net loan portfolio represented 77% and 81% of the Company's average interest-earning assets during 2022 and 2021, respectively.

Real Estate Loans

Approximately 85% of the Bank's total loan portfolio at December 31, 2022 consisted of real estate loans or loans collateralized by mortgages on real estate, including residential mortgages, commercial mortgages and other types of real estate loans. The Bank's real estate loan portfolio was \$1.42 billion at December 31, 2022, compared with \$1.34 billion at December 31, 2021. The real estate loan portfolio increased by 7% in 2022 over 2021, primarily as a result of higher commercial real estate loans.

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The Bank offers fixed rate residential mortgage loans with terms of 10 to 30 years with, typically, up to an 80% loan-to-value (“LTV”) ratio. Fixed rate residential mortgage loans outstanding totaled \$431 million at December 31, 2022 compared with \$400 million at December 31, 2021, which was 30% and 25% of total loans outstanding, respectively. This balance did not include any construction residential mortgage loans, which are discussed below. Residential mortgage originations in 2022 were \$70 million compared with \$121 million in 2021. The decrease was primarily the result of a decline in new mortgages and customer refinancings resulting from higher interest rates.

The Bank has a contractual arrangement with FNMA, pursuant to which the Bank sells certain mortgage loans to FNMA and the Bank retains the servicing rights to those loans. The Bank determines with each origination of residential real estate loans which desired maturities, within the context of overall maturities in the loan portfolio, provide the appropriate mix to optimize the Bank’s ability to absorb the corresponding interest rate risk within the Company’s tolerance ranges. In 2022, the Bank sold \$4.8 million in mortgages to FNMA under this arrangement, compared with \$1 million in mortgages sold in 2021.

At December 31, 2022, the Company had approximately \$59 million in unpaid principal balances of loans that it services for FHLMC, compared with \$70 million at December 31, 2021. No loans were sold to FHLMC by the Company during the years 2022 and 2021.

At December 31, 2022, the Bank had retained the servicing rights on \$57 million in mortgages sold to FNMA, compared with a \$61 million servicing portfolio of loans sold to FNMA at December 31, 2021. The Company recorded a net servicing asset for such loans of \$1.4 million at December 31, 2022 and 2021.

The Bank offers adjustable rate residential mortgage loans with terms of up to 30 years. Rates on these mortgage loans remain fixed for a predetermined time and are adjusted annually thereafter. The Bank’s outstanding adjustable rate residential mortgage loans were \$10 million at December 31, 2022 compared with \$11 million at December 31, 2021. At each respective time period adjustable rate residential mortgage loans represented less than 1% of total loans outstanding.

Overall, residential real estate loans increased from \$411 million at December 31, 2021 to \$440 million at December 31, 2022.

The Bank also offers commercial mortgage loans with up to an 80% LTV ratio for up to 20 years on a variable and fixed rate basis. Many of these mortgage loans either mature or are subject to a rate call after three to five years. To the extent required, loans exceeding an 80% LTV are reported on an exception report to the Board of Directors. The Bank’s outstanding commercial mortgage loans were \$779 million at December 31, 2022, which was 47% of total loans outstanding, and 5% higher than the \$740 million balance at December 31, 2021. The balance at December 31, 2022 included \$713 million in fixed rate and \$66 million in variable rate commercial mortgage loans, which include interest rate calls.

The Bank also offers other types of loans collateralized by real estate, such as home equity loans. The Bank offers home equity loans at variable and fixed interest rates with terms of up to 15 years and up to an 85% combined LTV ratio. At December 31, 2022, the real estate loan portfolio included \$82 million of home equity loans, which represented 5% of total loans outstanding, compared with \$81 million and 5% at December 31, 2021, respectively. The total home equity portfolio included \$74 million in variable rate loans and \$8 million in fixed rate loans.

The Bank also offers both residential and commercial real estate construction loans at up to an 80% LTV ratio at fixed interest or adjustable interest rates and multiple maturities. At December 31, 2022, adjustable rate construction loans outstanding totaled \$103 million, or 6% of total loans outstanding, and fixed rate real estate construction loans outstanding totaled \$18 million, or 1% of total loans outstanding. At December 31, 2021, adjustable rate construction loans outstanding totaled \$84 million, or 5% of total loans outstanding, and fixed rate real estate construction loans outstanding totaled \$19 million, or 1% of total loans outstanding.

Commercial and Industrial Loans

The Bank offers C&I loans on a secured and unsecured basis, including lines of credit and term loans at fixed and variable interest rates and multiple maturities. The Bank’s C&I loan portfolio totaled \$250 million at December 31, 2022, compared with \$237 million at December 31, 2021, a 5% increase. The increase in 2022 is attributable to the SBA forgiveness of PPP loans during 2021. At December 31, 2022 there were \$0.9 million in PPP loans outstanding compared to \$25 million at December 31, 2021. At December 31, 2022 commercial lines of credit increased \$25

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million since the end of 2021. Loan growth was muted due to economic factors, including the contraction in economic activity resulting from the pandemic and the reduced demand resulting from the availability of PPP loans. C&I loans represented 15% of the Bank's total loans at the end of 2022 and 2021.

Collateral for C&I loans, where applicable, may consist of inventory, receivables, equipment and other business assets. At December 31, 2022, 7% of the Bank's C&I loans were at variable rates which are tied to the prime rate or LIBOR.

Consumer Loans

The Bank's consumer installment and other loan portfolio totaled \$0.6 million at December 31, 2022 compared with \$0.7 million at December 31, 2021, representing less than 1% of the Bank's total loans outstanding at those dates. Traditional installment loans are offered at fixed interest rates with various maturities of up to 60 months, on a secured and unsecured basis. This segment of the portfolio is done on an accommodation basis for customers. The Company does not actively try to grow the portfolio in a significant way. Other loans consisted primarily of cash reserves, overdrafts, and loan clearing accounts.

Loan Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table shows the maturities of loans outstanding as of December 31, 2022 and the classification of those loans according to sensitivity to changes in interest rates.

| (in thousands) | Within 1 Year | After 1 - 5 Years | After 5 - 15 Years | After 15 Years | Total |
|-----------------------------------|------------------|-------------------|--------------------|-------------------|-------------------|
| Commercial and Industrial | | | | | |
| Interest rates: | | | | | |
| Fixed Rate | \$ 824 | \$ 54,739 | \$ 63,737 | \$ - | \$ 119,300 |
| Variable Rate | 82,078 | 37,172 | 11,452 | 67 | 130,769 |
| Total | \$ 82,902 | \$ 91,911 | \$ 75,189 | \$ 67 | \$ 250,069 |
| Commercial Real Estate * | | | | | |
| Interest rates: | | | | | |
| Fixed Rate | \$ 18,116 | \$ 213,859 | \$ 476,577 | \$ 7,616 | \$ 716,168 |
| Variable Rate | 17,913 | 60,456 | 101,472 | 108 | 179,949 |
| Total | \$ 36,029 | \$ 274,315 | \$ 578,049 | \$ 7,724 | \$ 896,117 |
| Residential Real Estate ** | | | | | |
| Interest rates: | | | | | |
| Fixed Rate | \$ 196 | \$ 5,730 | \$ 82,244 | \$ 345,981 | \$ 434,151 |
| Variable Rate | - | 35 | 453 | 9,110 | 9,598 |
| Total | \$ 196 | \$ 5,765 | \$ 82,697 | \$ 355,091 | \$ 443,749 |
| Home Equity | | | | | |
| Interest rates: | | | | | |
| Fixed Rate | \$ 11 | \$ 1,106 | \$ 6,874 | \$ 591 | \$ 8,582 |
| Variable Rate | 48 | 146 | 8,822 | 64,816 | 73,832 |
| Total | \$ 59 | \$ 1,252 | \$ 15,696 | \$ 65,407 | \$ 82,414 |
| Consumer and other loans | | | | | |
| Interest rates: | | | | | |
| Fixed Rate | \$ 8 | \$ 317 | \$ 100 | \$ 16 | \$ 441 |
| Variable Rate | 30 | - | - | 101 | 131 |
| Total | \$ 38 | \$ 317 | \$ 100 | \$ 117 | \$ 572 |

*Includes commercial real estate construction loans

**Includes residential real estate construction loans

SOURCES OF FUNDS

General

Customer deposits represent the primary source of the Bank's funds for lending and other investment purposes. In addition to deposits, other sources of funds include loan repayments, loan sales on the secondary market, interest and dividend income from investments, matured investments, borrowings from the FHLB and from correspondent banks, and issuance of securities.

Deposits

The Bank offers a variety of deposit products, including checking, savings, NOW accounts, certificates of deposit and jumbo certificates of deposit. Bank deposits are insured up to the limits provided by the FDIC.

As of December 31, 2022 the amount of total uninsured deposits, deposits that exceed the limits provided by the FDIC, was \$0.7 billion.

The following schedule indicates the amount of time deposits in uninsured accounts by time remaining until maturity at December 31, 2022:

| | <u>Dollar Amount</u> |
|--------------------------------|----------------------|
| At December 31, 2022: | (in thousands) |
| Three months or less | \$ 3,464 |
| Over three through six months | 5,567 |
| Over six through twelve months | 26,706 |
| Over twelve months | <u>5,005</u> |
| Total | <u>\$ 40,742</u> |

Total deposits at December 31, 2022 decreased \$165 million or 9% from the end of 2021. The change from the prior year reflects movement of deposits of interest rate sensitive customers.

Included in the decrease was total savings of \$218 million. Offsetting the decrease were increases in time deposits of \$38 million and non-interest-bearing demand deposits and NOW deposits of \$14 million. Competitive deposit pricing within the current market played a role in the changes in deposit mix from prior year.

Time deposits were \$203 million as of December 31, 2022, a \$38 million or 23% increase from December 31, 2021. Consumer time deposits increased \$41 million or 26% from previous year end. Brokered time deposits, included in other time deposits, provide an additional funding source for loan growth. Brokered time deposits decreased \$2 million from December 31, 2021 to December 31, 2022.

Federal Funds Purchased and Other Borrowed Funds

Another source of the Bank's funds for lending and investing activities is borrowings from the FHLB. The Bank had \$173.2 million outstanding on its overnight line of credit with the FHLB as of December 31, 2022. The Bank did not have an outstanding balance on its overnight line of credit with the FHLB as of December 31, 2021. The Company's use of its overnight line of credit with FHLBNY varies depending on its ability to fund investment and loan growth with deposits along with the line usage's impact on interest rate risk. At December 31, 2022, the Bank had \$20 million in FHLB borrowings compared with \$33 million at December 31, 2021. The FHLB borrowings as of December 31, 2022 have various maturity dates through 2024 and a weighted average rate of 4.42%.

Subordinated Debt

On October 1, 2004, Evans Capital Trust I, a statutory business trust wholly-owned by the Company (the "Trust"), issued \$11.0 million in aggregate principal amount of floating rate preferred capital securities due November 23, 2034 to investors (the "Capital Securities") and \$0.3 million of common securities to the Company (the "Common Securities"). The Capital Securities represent preferred undivided interests in the assets of the Trust. The Common Securities are wholly-owned by the Company and are the only class of the Trust's securities possessing general voting

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powers. In connection with the issuance and sale of the Capital Securities, the Company issued an \$11.3 million floating rate junior subordinated debt security, due October 1, 2037, to the Trust. Payments from the Company under the junior subordinated debt security are the sole source of cash flow for the Trust and fund the Trust's payments on its Capital Securities. The interest rate payable to holders of the Capital Securities was 7.42% at December 31, 2022.

On July 9, 2020, the Company issued and sold \$20 million in aggregate principal amount of its 6.00% Fixed-to-Floating Rate Subordinated Notes due July 15, 2030.

Securities Sold Under Agreements to Repurchase

The Bank enters into agreements with certain customers to sell securities owned by the Bank to those customers and repurchase the identical security within one day. No physical movement of the securities is involved. The customer is informed that the securities are held in safekeeping by the Bank on behalf of the customer. Securities sold under agreements to repurchase totaled \$7.1 and \$4.1 million at December 31, 2022 and 2021, respectively. Balances can vary day to day based on customer needs.

Liquidity

The Company utilizes cash flows from its investment portfolio and federal funds sold balances to manage the liquidity requirements it experiences due to loan demand and deposit fluctuations. The Bank also has many borrowing options. As a member of the FHLB, the Bank is able to borrow funds at competitive rates. Given the current collateral available, advances of up to \$320 million can be drawn on the FHLB via the Bank's Overnight Line of Credit Agreement. The Bank also has the ability to purchase up to \$18 million in federal funds from its correspondent banks. By placing sufficient collateral in safekeeping at the Federal Reserve Bank, the Bank could also borrow at the FRB's discount window. The Company's liquidity needs also can be met by more aggressively pursuing time deposits, accessing the brokered time deposit market, including the Certificate of Deposit Account Registry Service ("CDARS") network. Additionally, the Company has access to capital markets as a funding source.

The cash flows from the Company's investment portfolio are laddered, so that securities mature at regular intervals, to provide funds from principal and interest payments at various times as liquidity needs may arise. Contractual maturities are also laddered, with consideration as to the volatility of market prices, so that securities are available for sale from time-to-time without the need to incur significant losses. At December 31, 2022, approximately 3% of the Company's debt securities had maturity dates of one year or less, and approximately 29% had maturity dates of five years or less. In addition, the Company receives regular cash flows on its mortgage-backed securities.

The Company, on an ongoing basis, closely monitors the Company's liquidity position for compliance with internal policies, and believes that available sources of liquidity are adequate to meet funding needs in the normal course of business. As part of that monitoring process, management calculates the 90-day liquidity each month by analyzing the cash needs of the Bank. Included in the calculation are liquid assets and potential liabilities. The Company stresses the potential liabilities calculation to ensure a strong liquidity position. Included in the calculation are assumptions of some significant deposit run-off as well as funds needed for loan closing and investment purchases. At December 31, 2022, in the stress test, the Bank had net short-term liquidity available of \$209 million as compared with \$724 million at December 31, 2021. Available assets of \$377 million divided by public and purchased funds of \$506 million resulted in a long-term liquidity ratio of 75% at December 31, 2022, compared with 153% at December 31, 2021.

The Company does not anticipate engaging in any activities, either currently or over the long-term, for which adequate funding would not be available and which would therefore result in significant pressure on liquidity. However, an economic recession could negatively impact the Company's liquidity. The Bank relies heavily on FHLB as a source of funds, particularly with its overnight line of credit. In past economic recessions, some FHLB branches have suspended dividends, cut dividend payments, and not bought back excess FHLB stock that members hold in an effort to conserve capital. FHLB has stated that it expects to be able to continue to pay dividends, redeem excess capital stock, and provide competitively priced advances in the future. The 11 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt, other FHLB branches can be called upon to make the payment.

Systemic weakness in the FHLB could result in higher costs of FHLB borrowings and increased demand for alternative sources of liquidity that are more expensive, such as brokered time deposits, the discount window at the Federal Reserve, or lines of credit with correspondent banks.

Contractual Obligations

The Company is party to contractual financial obligations, including repayment of borrowings, operating lease payments, commitments to extend credit, and purchase agreements.

At December 31, 2022, the Company had commitments to extend credit of \$387 million, compared with \$395 million at December 31, 2021. For additional information regarding future financial commitments, this disclosure should be read in conjunction with Note 17 to the Company's Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Capital

Total Company stockholders' equity was \$154 million at December 31, 2022, a decrease from \$184 million at December 31, 2021. Equity as a percentage of assets was 7.07% and 8.3% at December 31, 2022 and 2021, respectively. Book value per share of common stock decreased to \$28.32 at December 31, 2022 from \$33.54 at December 31, 2021. Reflected in the book value changes are the Federal Reserve's aggressive interest rate hikes that have resulted in significant unrealized losses on investment securities, which reduced book value per share at December 31, 2022 by \$8.13 when compared with the last year. The decrease in stockholders' equity and book value per share was primarily the result of \$44.2 million net of tax unrealized losses on available for sale investment securities, and \$6.9 million in dividends paid to common stockholders, partially offset by \$22.4 million of net income in 2022.

The aggregate dividend payment of \$1.26 per share in 2022 was \$0.06, or 5% higher per share than dividends paid in 2021. The Company typically pays a semi-annual dividend in April and October of each year. Management and the Board of Directors of the Company believe that the dividend level is prudent to maintain available capital to support the continued growth of the Company, as well as to manage the Company's and the Bank's capital ratios, while providing a dividend yield (dividend per share divided by stock price) competitive with peers in the industry at an annualized rate of 3.37% at December 31, 2022.

Included in stockholders' equity is accumulated other comprehensive income/(loss) which includes the net after-tax impact of unrealized gains or losses on investment securities classified as available for sale. Net unrealized losses after tax were \$47.3 million at December 31, 2022, compared with \$3.2 million at December 31, 2021. Such unrealized gains and losses are generally due to changes in interest rates and represent the difference, net of applicable income tax effect, between the estimated fair value and amortized cost of investment securities classified as available-for-sale. The Company had no other-than-temporary impairment charges in its investment portfolio in 2022 or 2021.

The Company and the Bank have consistently maintained regulatory capital ratios above well capitalized standards. For further detail on capital and capital ratios, see Note 21 to the Company's Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and/or interest rates of the Bank's financial instruments. The primary market risk the Company is exposed to is interest rate risk. The core banking activities of lending and deposit-taking expose the Bank to interest rate risk, which occurs when assets and liabilities re-price at different times and by different amounts as interest rates change. As a result, net interest income earned by the Bank is subject to the effects of changing interest rates. The Bank measures interest rate risk by calculating the variability of net interest income in the future periods under various interest rate scenarios using projected balances for interest-earning assets and interest-bearing liabilities. Management's philosophy toward interest rate risk management is to limit the variability of net interest income. The balances of financial instruments used in the projections are based on expected growth from forecasted business opportunities, anticipated prepayments of loans and investment securities and expected maturities of investment securities, loans and deposits. Management supplements the modeling technique described above with the analysis of market values of the Bank's financial instruments and changes to such market values given changes in interest rates.

ALCO, which includes members of the Bank's senior management, monitors the Bank's interest rate sensitivity with the aid of a model that considers the impact of ongoing lending and deposit gathering activities, as well as the interrelationships between the magnitude and timing of the re-pricing of financial instruments, including the effect of changing interest rates on expected prepayments and maturities. When deemed prudent, the Bank's management has

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taken actions and intends to do so in the future, to mitigate the Bank's exposure to interest rate risk through the use of on or off-balance sheet financial instruments. Possible actions include, but are not limited to, changes in the pricing of loan and deposit products, modifying the composition of interest-earning assets and interest-bearing liabilities, and the purchase of other financial instruments used for interest rate risk management purposes. In 2022 and 2021, the Bank did not use off-balance sheet financial instruments to manage interest rate risk.

SENSITIVITY OF NET INTEREST INCOME TO CHANGES IN INTEREST RATES

| | Calculated increase in projected annual net interest income | |
|---------------------------|--|--------------------------|
| | (in thousands) | |
| | December 31, 2022 | December 31, 2021 |
| Changes in interest rates | | |
| +200 basis points | \$ (2,867) | \$ 1,375 |
| +100 basis points | 770 | 3,569 |
| -100 basis points | (962) | (2,183) |
| -200 basis points | (2,661) | NM |

Many assumptions are utilized by the Bank to calculate the impact that changes in interest rates may have on net interest income. The more significant assumptions relate to the rate of prepayments of mortgage-related assets, loan and deposit volumes and pricing, and deposit maturities. The Bank also assumes immediate changes in rates, including 100 and 200 basis point rate changes. In the event that a 100 or 200 basis point rate change cannot be achieved, the applicable rate changes are limited to lesser amounts, such that interest rates cannot be less than zero. These assumptions are inherently uncertain and, as a result, the Bank cannot precisely predict the impact of changes in interest rates on net interest income. Actual results may differ significantly due to the timing, magnitude, and frequency of interest rate changes in market conditions and interest rate differentials (spreads) between maturity/re-pricing categories, as well as any actions, such as those previously described, which management may take to counter such changes. At each of December 31, 2022 and December 31, 2021, the Bank's projected net interest income benefitted more from a 100 basis point increase in market rates compared with lower net interest income resulting from a 200 basis point increase in rates. This relationship was due in part to expected increases in deposit rates needed to retain deposit customers if rates moved up 200 basis points but were not required if rates only moved 100 basis points higher. In light of the uncertainties and assumptions associated with the process, the amounts presented in the table, and changes in such amounts, are not considered significant to the Bank's projected net interest income.

Financial instruments with off-balance sheet risk at December 31, 2022 included \$348 million in undisbursed lines of credit at an average interest rate of 6.83%; \$0.3 million in fixed rate loan origination commitments at 6.10%; and \$4 million in adjustable rate letters of credit, which if drawn upon, would typically earn an interest rate equal to the prime lending rate plus 2%. Unused overdraft protection lines totaled \$22 million.

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The following table represents expected maturities of interest-bearing assets and liabilities and their corresponding average interest rates.

Expected maturity year ended December 31,

| | 2023 | 2024 | 2025 | 2026 | 2027 | Thereafter | Total | Fair Value |
|-------------------------------------|----------------|-----------|-----------|-----------|------------|--------------|--------------|--------------|
| | (in thousands) | | | | | | | |
| Interest-bearing Assets | | | | | | | | |
| Gross loan and lease | | | | | | | | |
| receivables | \$ 56,659 | \$ 67,828 | \$ 75,075 | \$ 84,568 | \$ 144,570 | \$ 1,244,221 | \$ 1,672,921 | \$ 1,564,641 |
| Average interest | 6.88% | 5.96% | 5.64% | 4.76% | 4.97% | 4.80% | 4.97% | 4.97% |
| Investment securities | | | | | | | | |
| | \$ 12,876 | \$ 8,592 | \$ 25,451 | \$ 32,507 | \$ 28,565 | \$ 263,284 | \$ 371,275 | \$ 371,135 |
| Average interest | 2.66% | 3.00% | 2.20% | 1.86% | 1.93% | 2.01% | 2.05% | 2.05% |
| Interest-bearing Liabilities | | | | | | | | |
| Interest-bearing | | | | | | | | |
| deposits | | | | | | | | |
| | \$ 1,239,756 | \$ 23,743 | \$ 9,332 | \$ 2,831 | \$ 2,307 | \$ - | \$ 1,277,969 | \$ 1,275,212 |
| Average interest | 0.70% | 2.41% | 1.73% | 0.11% | 0.10% | - | 0.74% | 0.74% |
| Other borrowed funds | | | | | | | | |
| | \$ 186,443 | \$ 6,304 | \$ - | \$ - | \$ - | \$ - | \$ 192,747 | \$ 180,843 |
| Average interest | 4.47% | 3.08% | - | - | - | - | 4.42% | 4.42% |
| Securities sold under | | | | | | | | |
| agreements to repurchase | | | | | | | | |
| | \$ 7,147 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 7,147 | \$ 7,147 |
| Average interest | 0.16% | - | - | - | - | - | 0.16% | 0.16% |
| Subordinated debt | | | | | | | | |
| | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 31,330 | \$ 31,330 | \$ 30,263 |
| Average interest | - | - | - | - | - | 4.86% | 4.86% | 4.86% |
| Operating lease | | | | | | | | |
| obligations | | | | | | | | |
| | \$ 1,055 | \$ 919 | \$ 744 | \$ 672 | \$ 419 | \$ 1,374 | \$ 5,183 | \$ 4,723 |
| Average interest | 3.08% | 3.02% | 2.84% | 2.78% | 2.83% | 3.37% | 3.05% | 3.05% |

The amounts in the above table exclude acquisition fair value adjustments and debt issuance costs.

When rates rise or fall, the market value of the Company's rate-sensitive assets and liabilities increases or decreases. As a part of the Company's asset/liability policy, the Company has set limitations on the acceptable level of the negative impact of such rate fluctuations on the market value of the Company's balance sheet. On a quarterly basis, the balance sheet is shocked for immediate rate movement of 200 basis points. At December 31, 2022, the Company determined it would take an immediate movement in rates in excess of 200 basis points to eliminate the current capital cushion in excess of regulatory requirements. The Company's and the Bank's capital ratios are also reviewed by management on a quarterly basis.

Capital Expenditures

Significant planned expenditures for 2023 include the purchase of technology to improve workflow automation and operational efficiency. The Company believes it has a sufficient capital base to support these known and potential capital expenditures, currently expected to total approximately \$0.8 million, with current assets.

Impact of Inflation and Changing Prices

There will continually be economic events, such as changes in the economic policies of the FRB, which will have an impact on the profitability of the Company. Inflation may result in impaired asset growth, reduced earnings and substandard capital ratios. The net interest margin can be adversely impacted by the volatility of interest rates throughout the year. Since these factors are unknown, management attempts to structure the balance sheet and re-pricing frequency of assets and liabilities to avoid a significant concentration that could result in a negative impact on earnings.

Segment Information

The Company's operating segments have been determined based upon its internal profitability reporting. The Company's operating segments consist of banking activities and insurance agency activities.

The banking activities segment includes all of the activities of the Bank in its function as a full-service commercial bank. Net income from banking activities was \$20.9 million in 2022 compared with \$22.7 million in 2021. The decrease in net income from banking activities was driven by \$2.7 million of provision for loan losses in 2022 compared with a credit for loan losses of \$1.5 million in 2021. Net interest income increased \$0.2 million from \$72.8 million in 2021 to \$73.0 million in 2022. Non-interest expense decreased \$0.7 million to \$52.1 million in 2022. Total assets of the banking activities segment were \$2.2 billion at December 31, 2022, an decrease of \$32 million or 1.5% from December 31, 2021.

The insurance activities segment includes activities of TEA, a property and casualty insurance agency with locations in the Western New York area. Net income from insurance activities was \$1.5 million in 2022, an increase from \$1.3 million in 2021. TEA's total assets were \$18.0 million at December 31, 2022 and \$18.3 million at December 31, 2021.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this Item is incorporated by reference to the discussion of "Liquidity" and "Market Risk", including the discussion under the caption "Sensitivity of Net Interest Income to Changes in Interest Rates" included in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statements and Supplementary Data consist of the financial statements as indexed and presented below.

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Stockholders and the Board of Directors
Evans Bancorp, Inc.
Williamsville, New York

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Evans Bancorp, Inc. (the "Company") as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income (loss), changes in stockholders' 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"). In our opinion, the financial statements 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.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our 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. We believe that our audits provide a reasonable basis for our opinion.

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 – Allowance for Loans Collectively Evaluated for Impairment.

As described in Notes 1 and 4 to the consolidated financial statements, the Company's allowance for loan losses is management's best estimate of probable incurred losses inherent in the loan portfolio as of the balance sheet date. The allowance for loan losses was \$19.4 million as of December 31, 2022, which consists of two components: the allowance related to loans individually evaluated for impairment, representing \$0.4 million and the allowance related to loans collectively evaluated for impairment, representing \$19.1 million.

The general portfolio allocation is segmented into homogeneous pools of loans with similar characteristics. Separate pools of loans include loans pooled by loan grade and by portfolio segment for pass and watch loans. An average historical loss rate over the past ten years multiplied by the loss emergence period factor is applied against these loans. For both the criticized and non-criticized loan pools in the general portfolio allocation, additional qualitative factors are applied. The qualitative factors applied to the general portfolio allocation reflect management's evaluation of various conditions. The conditions evaluated include the following: levels and trends in delinquencies, non-accruals, and criticized loans; trends in volume and terms of loans; effects of any changes in lending policies and credit quality underwriting standards; experience, ability, and depth of management; national and economic trends and conditions;

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changes in the quality of the loan review system; concentrations of credit risk; changes in collateral value; and large loan risk. The total possible qualitative allocation is determined by comparing peer bank historical charge-off rates to the Bank's historical charge-off rate. The actual qualitative allocation is determined by qualitative factor by loan type based on metrics that management believes are appropriate indicators of whether the Bank is in a low, moderate, or high risk range relative to historical experience for each qualitative factor.

We identified the allowance for loans collectively evaluated for impairment as a critical audit matter because of the necessary judgment applied by us to evaluate management's significant estimates and subjective assumptions relating to 1) the determination of the loss emergence period factor by segment, 2) the determination of additional qualitative factors for criticized loans, 3) the determination of aggregate qualitative allocation, and 4) the classification of commercial loans as criticized or impaired. Changes in these assumptions could have a material effect on the Company's financial results.

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

- Testing the effectiveness of controls over the evaluation of the allowance related to loans collectively evaluated for impairment, including controls addressing:
 - Data inputs, judgments and calculations used to determine the loss emergence period factor and additional qualitative factors for criticized assets.
 - Problem loan identification and delinquency monitoring.
 - Management's review of the qualitative and quantitative analysis related to the qualitative factors.
 - Independent loan review and independent annual credit reviews of the commercial portfolios.
- Substantively testing management's process, including evaluating their judgments and assumptions, for developing the allowance for loans collectively evaluated for impairment, which included:
 - Testing the data input and mathematical accuracy of the calculation, including historical losses, loss emergence period factors and additional qualitative factors for criticized loans.
 - Evaluation of the reasonableness of management's judgments related to the historical loss experience and estimated loss emergence period, including the evaluation of triggering events related to default and actual losses. The evaluation of triggering events included evaluation of management's assessment of problem loan identification and delinquencies.
 - Evaluation of reasonableness of management's judgments related to qualitative factors to determine if they are calculated to conform with management's policies and were consistently applied period over period. Our evaluation considered the weight of evidence from internal and external sources and loan portfolio performance.
 - Analytically evaluating the allowance related to loans collectively evaluated for impairment by loan segment year over year for reasonableness.
 - Testing the loan grades of the commercial portfolios.

/s/ Crowe LLP

We have served as the Company's auditor since 2020.

Grand Rapids, Michigan
March 3, 2023

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2022 AND DECEMBER 31, 2021
(in thousands, except share and per share amounts)

| | December 31, 2022 | December 31, 2021 |
|--|----------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 16,796 | \$ 9,856 |
| Interest-bearing deposits at banks | 6,258 | 234,929 |
| Securities: | | |
| Available for sale, at fair value (amortized cost: \$428,216 at December 31, 2022; \$310,228 at December 31, 2021) | 364,326 | 305,959 |
| Held to maturity, at amortized cost (fair value: \$6,809 at December 31, 2022; \$3,179 at December 31, 2021) | 6,949 | 3,165 |
| Federal Home Loan Bank common stock, at cost | 10,437 | 3,045 |
| Federal Reserve Bank common stock, at cost | 3,074 | 3,039 |
| Loans, net of allowance for loan losses of \$19,438 at December 31, 2022 and \$18,438 at December 31, 2021 | 1,652,931 | 1,553,467 |
| Properties and equipment, net of accumulated depreciation of \$11,596 at December 31, 2022 and \$10,283 at December 31, 2021 | 16,999 | 17,789 |
| Goodwill | 12,702 | 12,702 |
| Intangible assets | 1,227 | 1,627 |
| Bank-owned life insurance | 41,826 | 34,295 |
| Operating lease right-of-use asset | 4,392 | 4,826 |
| Other assets | 40,593 | 25,941 |
| TOTAL ASSETS | \$ 2,178,510 | \$ 2,210,640 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits: | | |
| Demand | \$ 493,710 | \$ 492,864 |
| NOW | 273,359 | 259,908 |
| Savings | 801,943 | 1,019,925 |
| Time | 202,667 | 164,340 |
| Total deposits | 1,771,679 | 1,937,037 |
| Securities sold under agreement to repurchase | 7,147 | 4,112 |
| Other borrowings | 193,001 | 32,879 |
| Operating lease liability | 4,723 | 5,210 |
| Other liabilities | 16,892 | 16,536 |
| Subordinated debt | 31,075 | 30,974 |
| Total liabilities | 2,024,517 | 2,026,748 |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, \$.50 par value, 10,000,000 shares authorized; 5,544,339 and 5,482,756 shares issued at December 31, 2022 and December 31, 2021, respectively, and 5,437,048 and 5,482,756 outstanding at December 31, 2022 and December 31, 2021, respectively | 2,775 | 2,744 |
| Capital surplus | 81,031 | 78,795 |
| Treasury stock, at cost, 107,291 and 0 shares at December 31, 2022 and December 31, 2021, respectively | (3,891) | - |
| Retained earnings | 123,356 | 108,024 |
| Accumulated other comprehensive loss, net of tax | (49,278) | (5,671) |
| Total stockholders' equity | 153,993 | 183,892 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 2,178,510 | \$ 2,210,640 |

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2022, 2021, AND 2020
(in thousands, except share and per share amounts)

| | 2022 | 2021 | 2020 |
|---|-----------|-----------|-----------|
| INTEREST INCOME | | | |
| Loans | \$ 70,562 | \$ 72,955 | \$ 64,753 |
| Interest bearing deposits at banks | 596 | 187 | 247 |
| Securities: | | | |
| Taxable | 8,037 | 4,224 | 3,587 |
| Non-taxable | 287 | 214 | 246 |
| Total interest income | 79,482 | 77,580 | 68,833 |
| INTEREST EXPENSE | | | |
| Deposits | 3,589 | 2,864 | 7,721 |
| Other borrowings | 1,147 | 315 | 311 |
| Subordinated debt | 1,791 | 1,616 | 1,019 |
| Total interest expense | 6,527 | 4,795 | 9,051 |
| NET INTEREST INCOME | 72,955 | 72,785 | 59,782 |
| PROVISION (CREDIT) FOR LOAN LOSSES | 2,739 | (1,513) | 5,351 |
| NET INTEREST INCOME AFTER PROVISION (CREDIT) FOR LOAN LOSSES | 70,216 | 74,298 | 54,431 |
| NON-INTEREST INCOME | | | |
| Deposit service charges | 2,861 | 2,531 | 2,242 |
| Insurance service and fees | 10,453 | 10,457 | 10,610 |
| Gain on loans sold | 95 | 11 | 383 |
| Bank-owned life insurance | 707 | 853 | 680 |
| Loss on tax credit investments | - | (30) | (2,475) |
| Refundable state historic tax credit | - | 21 | 1,857 |
| Gain on sale of securities | - | - | 667 |
| Interchange fee income | 2,071 | 2,116 | 1,755 |
| Other | 3,084 | 2,888 | 2,518 |
| Total non-interest income | 19,271 | 18,847 | 18,237 |
| NON-INTEREST EXPENSE | | | |
| Salaries and employee benefits | 38,854 | 38,612 | 32,990 |
| Occupancy | 4,619 | 4,698 | 4,296 |
| Advertising and public relations | 1,159 | 1,427 | 1,128 |
| Professional services | 3,425 | 3,587 | 3,544 |
| Technology and communications | 5,187 | 5,376 | 5,234 |
| Amortization of intangibles | 400 | 537 | 533 |
| Merger-related expenses | - | - | 5,958 |
| FDIC insurance | 1,025 | 1,133 | 1,090 |
| Other | 5,266 | 5,849 | 5,087 |
| Total non-interest expense | 59,935 | 61,219 | 59,860 |
| INCOME BEFORE INCOME TAXES | 29,552 | 31,926 | 12,808 |
| INCOME TAX PROVISION | 7,163 | 7,883 | 1,562 |
| NET INCOME | \$ 22,389 | \$ 24,043 | \$ 11,246 |
| Net income per common share-basic | \$ 4.07 | \$ 4.41 | \$ 2.15 |
| Net income per common share-diluted | \$ 4.04 | \$ 4.37 | \$ 2.13 |
| Weighted average number of common shares outstanding | 5,495,044 | 5,447,057 | 5,232,881 |
| Weighted average number of diluted shares outstanding | 5,536,375 | 5,501,511 | 5,268,560 |

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2022, 2021, AND 2020
(in thousands)

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|--|--------------------|------------------|------------------|
| NET INCOME | \$ 22,389 | \$ 24,043 | \$ 11,246 |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX: | | | |
| Unrealized (loss) gain on available-for-sale securities: | | | |
| Unrealized (loss) gain on available-for-sale securities | (44,188) | (5,557) | 2,369 |
| Reclassification of gain on sale of securities | - | - | (494) |
| Total | <u>(44,188)</u> | <u>(5,557)</u> | <u>1,875</u> |
| Defined benefit pension plans: | | | |
| Amortization of prior service cost | 22 | 23 | 23 |
| Amortization of actuarial loss | 200 | 280 | 330 |
| Actuarial gains (losses) | 359 | 302 | (364) |
| Total | <u>581</u> | <u>605</u> | <u>(11)</u> |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX | <u>(43,607)</u> | <u>(4,952)</u> | <u>1,864</u> |
| COMPREHENSIVE INCOME (LOSS) | <u>\$ (21,218)</u> | <u>\$ 19,091</u> | <u>\$ 13,110</u> |

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2022, 2021, AND 2020
(in thousands, except share and per share amounts)

| | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total |
|--|-----------------|--------------------|----------------------|--|-------------------|-------------------|
| Balance, December 31, 2019 | \$ 2,467 | \$ 63,302 | \$ 85,267 | \$ (2,583) | \$ - | \$ 148,453 |
| Net Income | | | 11,246 | | | 11,246 |
| Other comprehensive income | | | | 1,864 | | 1,864 |
| Cash dividends (\$1.16 per common share) | | | (5,991) | | | (5,991) |
| Stock compensation expense | | 883 | | | | 883 |
| Reissued 310 restricted shares | | | | | | - |
| Issued 23,338 restricted shares, net of forfeitures | 12 | (12) | | | | - |
| Issued 6,813 shares under Dividend Reinvestment Plan | 3 | | 148 | | | 151 |
| Issued 19,434 shares in Employee Stock Purchase Plan | 9 | | 407 | | | 416 |
| Issued 9,230 shares in stock option exercises | 5 | | 145 | | | 150 |
| Issued 422,475 shares in stock consideration | 212 | 11,521 | | | | 11,733 |
| Reissued 501 shares in stock option exercises | | | | | | - |
| Balance, December 31, 2020 | <u>\$ 2,708</u> | <u>\$ 76,394</u> | <u>\$ 90,522</u> | <u>\$ (719)</u> | <u>\$ -</u> | <u>\$ 168,905</u> |
| Net Income | | | 24,043 | | | 24,043 |
| Other comprehensive income | | | | (4,952) | | (4,952) |
| Cash dividends (\$1.20 per common share) | | | (6,541) | | | (6,541) |
| Stock compensation expense | | 947 | | | | 947 |
| Issued 18,181 restricted shares, net of forfeitures | 9 | (9) | | | | - |
| Issued 8,293 shares under Dividend Reinvestment Plan | 4 | | 290 | | | 294 |
| Issued 12,166 shares in Employee Stock Purchase Plan | 6 | | 393 | | | 399 |
| Issued 19,715 shares in stock option exercises | 10 | | 187 | | | 197 |
| Issued 13,017 shares for earnout | 7 | | 593 | | | 600 |
| Balance, December 31, 2021 | <u>\$ 2,744</u> | <u>\$ 78,795</u> | <u>\$ 108,024</u> | <u>\$ (5,671)</u> | <u>\$ -</u> | <u>\$ 183,892</u> |
| Net Income | | | 22,389 | | | 22,389 |
| Other comprehensive income | | | | (43,607) | | (43,607) |
| Cash dividends (\$1.26 per common share) | | | (6,942) | | | (6,942) |
| Stock compensation expense | | 1,206 | | | | 1,206 |
| Repurchased 112,068 shares of Common Stock | | | | | (4,140) | (4,140) |
| Issued 18,844 restricted shares | 9 | (9) | | | | - |
| Reissued 7,244 restricted shares in stock option exercises | | 10 | (115) | | 249 | 144 |
| Forfeitures 2,467 shares of restricted stock | | | | | | - |
| Issued 7,738 shares under Dividend Reinvestment Plan | 4 | | 291 | | | 295 |
| Issued 12,731 shares in Employee Stock Purchase Plan | 7 | | 377 | | | 384 |
| Issued 22,270 shares in stock option exercises | 11 | | 361 | | | 372 |
| Balance, December 31, 2022 | <u>\$ 2,775</u> | <u>\$ 81,031</u> | <u>\$ 123,356</u> | <u>\$ (49,278)</u> | <u>\$ (3,891)</u> | <u>\$ 153,993</u> |

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2022, 2021, AND 2020

(in thousands)

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|---|------------------|-------------------|------------------|
| OPERATING ACTIVITIES: | | | |
| Interest received | \$ 76,390 | \$ 71,457 | \$ 63,677 |
| Fees received | 17,958 | 19,197 | 17,240 |
| Interest paid | (6,513) | (5,997) | (10,830) |
| Cash paid to employees and vendors | (58,294) | (58,267) | (59,312) |
| Income tax paid | (3,327) | (5,790) | (2,953) |
| Proceeds from sale of loans held for resale | 4,897 | 949 | 15,408 |
| Originations of loans held for resale | (4,704) | (1,037) | (15,443) |
| Net cash provided by operating activities | <u>26,407</u> | <u>20,512</u> | <u>7,787</u> |
| INVESTING ACTIVITIES: | | | |
| Available for sales securities: | | | |
| Purchases | (144,413) | (189,838) | (91,504) |
| Proceeds from sales | - | - | 25,553 |
| Proceeds from maturities, calls, and payments | 19,066 | 37,928 | 55,892 |
| Held to maturity securities: | | | |
| Purchases | (6,651) | (3,845) | (5,361) |
| Proceeds from maturities, calls, and payments | 2,867 | 4,884 | 3,543 |
| Cash paid for bank owned life insurance | (6,830) | - | - |
| Proceeds from bank-owned life insurance claims | 378 | - | - |
| Additions to properties and equipment | (1,008) | (1,033) | (5,822) |
| Proceeds from sales of assets | - | 581 | 1,500 |
| Proceeds (purchase) of tax credit investment | 191 | (1,913) | - |
| Sale of other real estate | 1,380 | 129 | 982 |
| Net cash used in acquisitions | - | (900) | (6,490) |
| Net (increase) decrease in loans | (101,555) | 131,387 | (191,684) |
| Net cash used in investing activities | <u>(236,575)</u> | <u>(22,620)</u> | <u>(213,391)</u> |
| FINANCING ACTIVITIES: | | | |
| Proceeds (repayments) of short-term borrowings, net | 176,236 | (675) | (16,329) |
| (Repayments of) proceeds from long-term borrowings | (12,598) | (10,454) | 20,693 |
| Debt issuance cost of long term borrowings | - | - | (509) |
| Net (decrease) increase in deposits | (165,314) | 166,069 | 265,770 |
| Dividends paid | (6,942) | (6,541) | (5,991) |
| Repurchase of treasury stock | (4,140) | - | - |
| Issuance of common stock | 1,051 | 890 | 717 |
| Reissuance of treasury stock | 144 | - | - |
| Net cash (used in) provided by financing activities | <u>(11,563)</u> | <u>149,289</u> | <u>264,351</u> |
| Net (decrease) increase in cash and equivalents | (221,731) | 147,181 | 58,747 |
| CASH AND CASH EQUIVALENTS: | | | |
| Beginning of year | <u>244,785</u> | <u>97,604</u> | <u>38,857</u> |
| End of year | <u>\$ 23,054</u> | <u>\$ 244,785</u> | <u>\$ 97,604</u> |

See Notes to Consolidated Financial Statements

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EVANS BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2022, 2021, AND 2020
(in thousands)

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|---|------------------|------------------|-----------------|
| RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Net income | \$ 22,389 | \$ 24,043 | \$ 11,246 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 1,647 | 1,260 | 1,205 |
| Deferred tax expense (benefit) | 251 | 1,520 | (1,852) |
| Provision (credit) for loan losses | 2,739 | (1,513) | 5,351 |
| Loss on tax credit investment | - | 30 | 2,475 |
| Changes in refundable state historic tax credits | - | (21) | (1,857) |
| Net (gain) loss on sales of assets and other real estate owned | (196) | 135 | (702) |
| Gain on sales of securities | - | - | (667) |
| Gain on loans sold | (95) | (11) | (383) |
| Stock compensation expense | 1,206 | 947 | 883 |
| Proceeds from sale of loans held for resale | 4,897 | 949 | 15,408 |
| Originations of loans held for resale | (4,704) | (1,037) | (15,443) |
| Changes in assets and liabilities affecting cash flow: | | | |
| Other assets | 2,914 | (8,679) | (5,745) |
| Other liabilities | (4,641) | 2,889 | (2,132) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ 26,407 | \$ 20,512 | \$ 7,787 |

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

| | | | |
|---|------|------|------------|
| Fair value of assets acquired in acquisition (non-cash) | \$ - | \$ - | \$ 311,847 |
| Fair value of liabilities assumed in acquisition | \$ - | \$ - | \$ 296,076 |

12, 2011 AND 2010
EVANS BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2022, 2021 AND 2020

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and General

Evans Bancorp, Inc. (the “Company”) was organized as a New York business corporation and incorporated under the laws of the State of New York on October 28, 1988 for the purpose of becoming a bank holding company. Through August 2004, the Company was registered with the Federal Reserve Board (“FRB”) as a bank holding company under the Bank Holding Company Act of 1956, as amended. In August 2004, the Company filed for, and was approved as, a Financial Holding Company under the Bank Holding Company Act. The Company currently conducts its business through its two subsidiaries: Evans Bank, N.A. (the “Bank”), a nationally chartered bank, and its subsidiary, Evans National Holding Corp. (“ENHC”); and Evans National Financial Services, LLC (“ENFS”) and its subsidiary, The Evans Agency LLC (“TEA”). Unless the context otherwise requires, the term “Company” refers collectively to Evans Bancorp, Inc. and its subsidiaries. The Company conducts its business through its subsidiaries. It does not engage in any other substantial business.

Regulatory Requirements

The Company is subject to the rules, regulations, and reporting requirements of various regulatory bodies, including the FRB, the Federal Deposit Insurance Corporation (“FDIC”), the Office of the Comptroller of the Currency (“OCC”), the New York State Department of Financial Services (“NYDFS”), and the Securities and Exchange Commission (“SEC”).

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, the Bank, ENFS and their subsidiaries. All material inter-company accounts and transactions are eliminated in consolidation.

Accounting Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and disclosure of contingent assets and liabilities in order to prepare these consolidated financial statements in conformity with U.S. generally accepted accounting principles. These estimates and assumptions are based on management’s best estimates and judgment and management evaluates them on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. We adjust our estimates and assumptions when facts and circumstances dictate. As future events cannot be determined with precision, actual results could differ significantly from our estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the consolidated financial statements in periods as they occur.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks and interest-bearing deposits at banks.

Securities

Securities which the Bank has the positive intent and ability to hold to maturity are classified as held to maturity and are stated at cost, adjusted for discounts and premiums that are recognized in interest income over the period to the earlier of the call date or maturity using the level yield method. These securities represent debt issuances of local municipalities in the Bank’s market area for which market prices are not readily available. Management periodically evaluates the financial condition of the municipalities for any indication that the Bank does not expect to recover the entire amortized cost basis of their bonds.

Securities classified as available for sale are stated at fair value with unrealized gains and losses excluded from earnings and reported, net of deferred income taxes, in accumulated other comprehensive income or loss, a component of stockholders’ equity. Gains and losses on sales of securities are computed using the specific identification method.

Declines in the fair value of investment securities (with certain exceptions for debt securities noted below) that are deemed to be other-than-temporary are charged to earnings as a realized loss and a new cost basis for the securities is established. Declines in the fair value of debt securities below amortized cost are deemed to be other-than-temporary in circumstances where: (1) the Bank has the intent to sell a security; (2) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis; or (3) the Bank does not expect to recover the entire amortized cost basis of the security. If the Bank intends to sell a security or if it is

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more likely than not that the Bank will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the difference between the security's amortized cost basis and its fair value. If the Bank does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income or loss.

The Bank does not engage in securities trading activities.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") System. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are recorded as a component of interest income.

Federal Reserve Bank Stock

The Bank is a member of the FRB. FRB stock is carried at cost, classified as a restricted security. Both cash and stock dividends are recorded as a component of interest income.

Loan Servicing Assets

Servicing assets are related to residential mortgage loans sold and are recognized at the time of sale when servicing is retained with the income statement effect recorded in gains on loans sold. Servicing assets are initially recorded at fair value based on the present value of the contractually specified servicing fee, net of estimated servicing costs, over the estimated life of the loan. The servicing assets are subsequently amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. The Company periodically evaluates servicing assets for impairment based upon the fair value of the assets as compared to their carrying amount.

Loans

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for unamortized deferred fees or costs. Interest income is accrued on the unpaid principal balance and is recognized using the interest method. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the effective yield method of accounting for amortizing loans and straight line over an estimated life for lines of credit.

Loans become past due when the payment date has been missed. If payment has not been received within 30 days, then the loan is delinquent. Delinquent loans are placed into three categories; 30-59 days past due, 60-89 days past due, or 90+ days past due. Loans 90 or more days past due are considered non-performing.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well secured and in process of collection. If the credit is not well secured and in the process of collection, the loan is placed on non-accrual status and is subject to charge-off if collection of principal or interest is considered doubtful. A loan can also be placed on nonaccrual before it is 90 days delinquent if management determines that it is probable that the Bank will be unable to collect principal or interest due according to the contractual terms of the loan.

All interest due but not collected for loans that are placed on non-accrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cost-recovery method, until it again qualifies for an accrual basis. Any cash receipts on non-accrual loans reduce the carrying value of the loans. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current, the adverse circumstances which resulted in the delinquent payment status are resolved, and payments are made in a timely manner for a period of time sufficient to reasonably assure their future dependability.

The Bank considers a loan impaired when, based on current information and events, it is probable that it will be unable to collect principal or interest due according to the contractual terms of the loan. These loans are individually assessed for any impairment. Loan impairment is measured based on the present value of expected cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business. The Company has an appraisal policy in which appraisals are obtained upon a loan being downgraded on the Company's internal loan rating scale to special mention or substandard depending on the amount of the loan, the type of loan and the type of collateral. All impaired

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nonaccrual loans are either graded special mention or substandard on the internal loan rating scale. Subsequent to the downgrade, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers.

The Bank monitors the credit risk in its loan portfolio by reviewing certain credit quality indicators (“CQI”). The primary CQI for its commercial mortgage and commercial and industrial (“C&I”) portfolios is the individual loan’s credit risk rating. The following list provides a description of the credit risk ratings that are used internally by the Bank when assessing the adequacy of its allowance for loan losses:

- *Acceptable or better:* Credits with a slight risk of loss. The loan is secured by collateral of sufficient value to cover the loan by an acceptable margin. The financial statements of the company demonstrate sufficient net worth and repayment ability. The company has established an acceptable credit history with the bank and typically has a proven track record of performance. Management is experienced, and has an at least average ability to manage the company. The industry has an average or less than average susceptibility to wide fluctuations in business cycles.
- *Watch:* Credits are generally acceptable but warrant greater attention than those rated acceptable or better. Temporary performance issues, if left unresolved, may result in above average risk. The borrower’s financial position is not typically strong. Earnings, while still positive, may be inconsistent. Industry issues or external events (such as possible litigation exposure) may cause concern. Although ability to repay is not an immediate concern, more regular monitoring may be necessary as a result of the short-term performance issues or sensitivities to external events that may result in a weakening condition. Any perceived weaknesses are acceptable when viewed against the overall credit and collateral risks assumed. Borrowers are likely fully leveraged when compared to others in a similar industry and their ability to raise capital may be limited.
- *Special Mention:* Credits that have potential weaknesses that warrant management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Borrowers in this category may be experiencing adverse operating trends (declining revenues or margins) or an ill proportioned balance sheet. Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a special mention rating. Nonfinancial reasons for rating a credit exposure as special mention include management problems, pending litigation, stale financial statements, an ineffective loan agreement or other material structural weakness, and any other significant deviation from prudent lending practices.

Potential weaknesses in commercial real estate loans may include, construction delays, changes in concept or project plan, slow leasing, rental concessions, deteriorating market conditions, impending expiry of a major lease, or other adverse events that do not currently jeopardize repayment.

- *Substandard:* Credits that are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Substandard assets have a high probability of payment default, or they have other well-defined weaknesses. They are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigates. Although substandard assets in the aggregate will have distinct potential for loss, an individual asset’s loss potential does not have to be distinct for the asset to be rated substandard.

A well-defined weakness may manifest itself via:

- significant deterioration in financial condition of the borrower;
- impairment of primary repayment source;
- material deviation from planned absorption of rental or sales units; or
- material deterioration in market conditions.

Commercial real estate credits evidencing one or more of the following characteristics are evaluated for a possible substandard classification:

- slower than projected leasing or sales activity that threatens to result in protracted repayment or default;
- lower than projected lease rates or sales prices that jeopardize repayment capacity;
- changes in concept or plan due to unfavorable market conditions;
- construction or tax liens;
- inability to obtain necessary zoning or permits necessary to develop the project as planned;
- a diversion of needed cash from an otherwise viable property to satisfy the demands of a troubled borrower or guarantor;
- material imbalances in the construction budget;
- significant construction delays;
- expiration of a major lease or default by a major tenant;
- poorly structured or overly liberal repayment terms.

When a project has slowed or stalled and the guarantor is providing some support but the loan has not been restructured, unless the guarantor is providing support of principal payments sufficient to retire the debt under reasonable terms, a substandard classification is typically warranted. If the guarantor is keeping interest payments current and shows a documented willingness and capacity to do so in the future, and collateral values protect against loss, the loan should generally be left on accrual. This level of support, however, does not fully mitigate the well-defined weaknesses in the credit and does not preclude a substandard classification.

- *Doubtful*: Credits that have all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. A doubtful asset has a high probability of total or substantial loss but because of specific pending events that may strengthen the assets, its classification as loss is deferred. Borrowers in this category are usually in default, lack adequate liquidity or capital and lack the resources necessary to remain an operating entity. Because of high probability of loss, nonaccrual accounting treatment is required for doubtful assets.

Circumstances that might warrant a doubtful classification for commercial real estate loans could include collateral values that are uncertain due to a lack of comparisons in an inactive market, impending changes such as zoning classification, environmental issues, or the pending resolution of legal issues that may affect the realization of value in a sale.

- *Loss*: Credits that are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Borrowers in this category are often in bankruptcy, have formally suspended debt repayments, or have otherwise ceased normal business operations. The Company does not maintain an asset on the balance sheet if realizing its value would require long-term litigation or other lengthy recovery efforts.

The Company's consumer loans, including residential mortgages and home equities, are not individually risk rated or reviewed in the Company's loan review process. Consumers are not required to provide the Company with updated financial information as is a commercial customer. Consumer loans also carry smaller balances. Given the lack of updated information since the initial underwriting of the loan and small size of individual loans, the Company does not have credit risk ratings for consumer loans and instead uses delinquency status as the credit quality indicator for consumer loans. However, once a consumer loan is identified as impaired, it is individually evaluated for impairment.

Loans acquired in a business combination are recorded at fair value with no carry-over of an acquired entity's previously established allowance for credit losses. Purchased impaired loans represent specifically identified loans with evidence of credit deterioration for which it was probable at acquisition that the Company would be unable to collect all contractual principal and interest payments. For purchased impaired loans, the excess of cash flows expected at acquisition over the estimated fair value of acquired loans is 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 Company's allowance for credit losses. Subsequent improvements in expected cash flows result first in the recovery of any related allowance for credit losses and then in recognition of additional interest income over the then remaining lives of the loans. For all other acquired loans, the difference between the fair value and outstanding principal balance of the loans is recognized as an adjustment to interest income over the lives of those loans.

Allowance for Loan Losses

The provision for loan losses represents the amount charged against the Bank's earnings to maintain an allowance for probable incurred loan losses inherent in the portfolio based on management's evaluation of the loan portfolio at the balance sheet date. Factors considered by the Bank's management in establishing the allowance include: the collectability of individual loans, current loan concentrations, charge-off history, loss emergence period, delinquent loan percentages, the fair value of the collateral, input from regulatory agencies, and general economic conditions.

On a quarterly basis, management of the Bank meets to review and determine the adequacy of the allowance for loan losses. In making this determination, the Bank's management analyzes the ultimate collectability of the loans in its portfolio by incorporating feedback provided by the Bank's internal loan staff, an independent internal loan review function and information provided by examinations performed by regulatory agencies.

The analysis of the allowance for loan losses is composed of two components: specific credit allocation and general portfolio allocation. The specific credit allocation includes a detailed review of each impaired loan and allocation is made based on this analysis. Factors may include the appraisal value of the collateral, the age of the appraisal, the type of collateral, the performance of the loan to date, the performance of the borrower's business based on financial statements, and legal judgments involving the borrower. The general portfolio allocation consists of an assigned reserve percentage based on the historical loss experience, the loss emergence period, and other qualitative factors of the loan category.

The general portfolio allocation is segmented into homogeneous pools of loans with similar characteristics. Separate pools of loans include loans pooled by loan grade and by portfolio segment. An average historical loss rate over the past ten years multiplied by the loss emergence period factor is applied against these loans.

For both the criticized and non-criticized loan pools in the general portfolio allocation, additional qualitative factors are applied. The qualitative factors applied to the general portfolio allocation reflect management's evaluation of various conditions. The conditions evaluated include the following: levels and trends in delinquencies, non-accruals, and criticized loans; trends in volume and terms of loans; effects of any changes in lending policies and credit quality underwriting standards; experience, ability, and depth of management; national and economic trends and conditions; changes in the quality of the loan review system; concentrations of credit risk; changes in collateral value; and large loan risk. The total possible qualitative allocation is determined by comparing peer bank historical charge-off rates to the Bank's historical charge-off rate. The actual qualitative allocation is determined by qualitative factor by loan type based on metrics that management believes are appropriate indicators of whether the Bank is in a low, moderate, or high risk range relative to historical experience for each qualitative factor.

A loan for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, is considered to be a Troubled Debt Restructuring ("TDR"). The allowances for credit losses on loans on a TDR is measured using the specific credit allocation. On April 7, 2020, federal banking regulators issued a revised Interagency Statement on Loan Modifications and Reporting for Financial Institutions, which, among other things, encouraged financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19, and stated that institutions generally do not need to categorize COVID-19-related modifications as TDRs and that the agencies will not direct supervised institutions to automatically categorize all COVID-19 related loan modifications as TDRs. Similarly, under the CARES Act, provisions were included that allow for loan modifications to not be classified as TDRs if certain criteria were met. The TDR exemption expired on January 1, 2022.

Foreclosed Real Estate

Foreclosed real estate is initially recorded at fair value (net of costs of disposal) at the date of foreclosure. Costs relating to development and improvement of property are capitalized, whereas costs relating to the holding of property are expensed. Assessments are periodically performed by management, and an allowance for losses is established through a charge to operations if the carrying value of a property exceeds fair value.

Operating Leases

The Company determines if an arrangement is a lease at inception by assessing whether there is an identified asset and whether the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration. Operating leases with a term of more than one year are included in operating lease Right-of-Use ("ROU") assets and operating lease liabilities. The Company made a policy election to apply the short-term lease exemption to any operating leases with an original term of less than 12 months, therefore no ROU asset or lease liability is recorded for these operating leases.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized on the lease commencement date

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based on the present value of lease payments over the lease term. The Company uses the incremental borrowing rate commensurate with the lease term based on the information available at the lease commencement date in determining the present value of lease payments.

Insurance Service and Fees

Commission revenue from selling commercial and personal property and casualty insurance on behalf of the insurance carriers is recognized at the time of the sale of the policy or when a policy renews. Commission revenue from selling benefit plans to commercial customers on behalf of the insurance carriers is recognized each month when the customer continues with the benefit plan. The Company also receives contingent commissions from insurance companies which are based on the overall profitability of their relationship based primarily on the loss experience of the insurance placed by the Company. Contingent commissions from insurance companies are accrued throughout the year based on recent historical results. As loss events occur and overall performance becomes known, accrual adjustments are recorded until the cash is ultimately received. Financial services commissions and insurance claims services revenue are recognized when the services are rendered. Information on insurance service and fee revenue is included in Note 15 to these Consolidated Financial Statements, "Revenue Recognition of Non-interest Income."

Goodwill and Other Intangible Assets

The Company records the excess of the cost of acquired entities over the fair value of identifiable tangible and intangible assets acquired, less liabilities assumed, as goodwill. The Company does not amortize goodwill and any acquired intangible asset with an indefinite useful economic life, but reviews them for impairment at a reporting unit level on an annual basis, or when events or changes in circumstances indicate that the carrying amounts may be impaired. The Company has selected December 31 as the date to perform the annual impairment test. A reporting unit is defined as any distinct, separately identifiable component of one of our operating segments for which complete, discrete financial information is available and reviewed regularly by the segment's management. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet. The Company amortizes acquired intangible assets with definite useful economic lives, consisting of core deposit intangibles, customer relationships and trade names, over their useful economic lives, which range from 5 to 10 years, utilizing the straight-line method.

Business Combinations

The company accounts for business combinations under the acquisition method of accounting. Upon obtaining control of the acquired entity, the Company records all identifiable assets and liabilities at their estimated fair values. Goodwill is recorded when the consideration paid for an acquired entity exceeds the estimated fair value of the net assets acquired. Changes to the acquisition date fair values of assets acquired and liabilities assumed may be made as adjustments to goodwill over a 12-month measurement period following the date of acquisition. Such adjustments are attributable to additional information obtained related fair value estimates of the assets acquired and liabilities assumed. Certain costs associated with business combinations are expensed as incurred.

Subordinated Debt

Long-term borrowings are carried at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized in interest expense using the interest method. Debt issuance costs are recognized in interest expense over the life of the instrument.

Bank-Owned Life Insurance

The Bank has purchased insurance on the lives of Company directors and certain members of the Company's management. The policies accumulate asset values to meet future liabilities, including the payment of employee benefits, such as retirement benefits. Increases in the cash surrender value are recorded as other income in the Company's Consolidated Statements of Income.

Properties and Equipment

Land is carried at cost. Properties and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 39 years. Impairment losses on properties and equipment are realized if the carrying amount is not recoverable from its undiscounted cash flows and exceeds its fair value.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax effects attributable to differences between the financial statement value of existing assets and liabilities and their respective tax bases and carryforwards. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the periods in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense.

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The Bank has invested in partnerships that incur expenses related to the rehabilitation of a certified historic structure located in New York State. At the time the historic structure is placed in service, the Bank is eligible for a federal and New York State tax credit. At the same time, the Bank evaluates its investment, which is valued at the present value of the expected cash flows from its partnership interest. If the investment is determined to be impaired, the Bank will record that impairment loss on its income statement in non-interest income. The federal tax credit impact is included in the Company's estimated effective tax rate calculation and recorded in income tax expense. For New York State, any new credit earned from rehabilitated historic properties placed in service on or after January 1, 2015 not used in the current tax year will be treated as a refund or overpayment of tax to be credited to the next year's tax. Since the realization of the tax credit does not depend on the Bank's generation of future taxable income or the Bank's ongoing tax status or tax position, the refund is not considered an element of income tax accounting. In such cases, the Bank would not record the credit as a reduction of income tax expense; rather, the Bank includes the refundable New York State tax credit in non-interest income with a corresponding receivable recorded in other assets.

Earnings Per Share

Earnings per common share is determined by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per common share is based on increasing the weighted-average number of shares of common stock by the number of shares of common stock that would be issued assuming the exercise of stock options. Such adjustments to weighted-average number of shares of common stock outstanding are made only when such adjustments are expected to dilute earnings per common share. Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and are not included in calculating diluted earnings per share. There were 55,555, 57,322 and 81,770 anti-dilutive shares in 2022, 2021 and 2020, respectively.

Comprehensive Income (Loss)

Comprehensive income (loss) includes both net income and other comprehensive income (loss), including the change in unrealized gains and losses on securities available for sale, and the change in the liability related to pension costs, net of tax.

Employee Benefits

The Bank maintains a non-contributory, qualified, defined benefit pension plan (the "Pension Plan") that covered substantially all employees before it was frozen on January 31, 2008. All benefits eligible participants had accrued in the Pension Plan until the freeze date have been retained. Employees have not accrued additional benefits in the Pension Plan from that date. The actuarially determined pension benefit in the form of a life annuity is based on the employee's combined years of service, age and compensation. The Bank's policy is to fund the minimum amount required by government regulations. Employees are eligible to receive these benefits at normal retirement age.

The Bank maintains a defined contribution 401(k) plan and accrues contributions due under this plan as earned by employees. In addition, the Bank maintains a non-qualified Supplemental Executive Retirement Plan for certain members of senior management, a non-qualified Deferred Compensation Plan for directors and certain members of management, and a non-qualified Executive Incentive Retirement Plan for certain members of management, as described more fully in Note 12 to these Consolidated Financial Statements, "Employee Benefits and Deferred Compensation Plans."

Stock-based Compensation

Stock-based compensation expense is recognized over the requisite service period of the stock-based grant based on the estimated grant date value of the stock-based compensation that is expected to vest. The Company accounts for forfeitures of stock awards when they occur. When stock awards are granted, the Company assumes that the service condition will be achieved when determining the initial amount of compensation cost recognized. Information on the determination of the estimated value of stock-based awards used to calculate stock-based compensation expense is included in Note 13 to these Consolidated Financial Statements, "Stock-Based Compensation."

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.

Financial Instruments with Off-Balance Sheet Risk

In the ordinary course of business, the Bank has entered into off-balance sheet financial arrangements consisting of commitments to extend credit and standby letters of credit. The Bank provides guarantees in the form of standby letters of credit, which represent an irrevocable obligation to make payments to a third party if the borrower defaults on its obligation under a borrowing or other contractual

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arrangement with the third party. The Bank could potentially be required to make payments to the extent of the amount guaranteed by the standby letters of credit based on the terms of the agreement. There were no liabilities recorded on the Consolidated Balance Sheets related to standby letters of credit as of December 31, 2022 and 2021, reflecting management's assessment of the value of the guarantee given the lack of historical activity and the likelihood of current customers to draw on the letters of credit. The Bank has not incurred any losses on its commitments during the past three years and has not recorded a reserve for its commitments.

Fair Value of Assets and Liabilities

Fair value estimates involve uncertainties and matters of significant judgement regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Advertising Costs

Advertising costs are expensed as incurred.

RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

The FASB establishes changes to U.S. GAAP in the form of accounting standards updates ("ASUs") to the FASB Accounting Standards Codification. The Company considers the applicability and impact of all ASUs when they are issued by FASB. ASUs adopted by the Company during its current fiscal year did not have a material impact on the Company's consolidated financial position, results of operations, cash flows or disclosures. Accounting standards that have been recently issued but not yet required to be adopted as of December 31, 2022, to the extent management believes their adoption will have a material impact on the Company's financial condition, results of operations, cash flows or disclosures, are discussed below.

ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments* – The Company adopted ASU 2016-13 on January 1, 2023. ASU 2016-13 replaces the "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Both financial institutions and users of their financial statements expressed concern that current GAAP restricts the ability to record credit losses that are expected, but do not yet meet the "probable" threshold. The main objective of this ASU (commonly known as the Current Expected Credit Loss Impairment Model, or CECL, in the industry) is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in CECL replace the incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The Company has finalized the methodology determination, software models, quantitative framework, and policies and procedures for how to determine expected credit losses under the new guidance. Management is finalizing the qualitative component of the CECL calculation and is working with an independent third-party consultant to review internal procedures, policies, assumptions, and validate system models.

2. ACQUISITIONS

The Company did not have any acquisitions during 2022 or 2021. On May 1, 2020, the Company completed the acquisition of FSB Bancorp, Inc., a Maryland corporation and the parent holding company of Fairport Savings Bank ("FSB"). On that date, FSB was merged into Evans Bank, a wholly owned banking subsidiary of the Company.

There were no merger-related expenses recorded in 2022 or 2021. Direct acquisition and other charges incurred in connection with the FSB merger were expensed as incurred and totaled \$6.0 million for the year ended December 31, 2020. These expenses were recorded in merger-related expense on the consolidated statements of income.

The following table presents selected unaudited pro forma financial information reflecting the FSB merger assuming it was completed as of January 1, 2020. The unaudited pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the financial results of the combined companies had the FSB merger actually been completed at the beginning of the period presented, nor does it indicate future results for any other interim or full year period. The unaudited pro forma information is based on the actual financial statements of the Company for the period presented, and on the actual financial statements of FSB for the year ended December 31, 2020 until the date of the FSB merger, at which time FSB's results of operations were included in the Company's financial statements.

| | 2020 | |
|-------------------------------------|----------------|--------|
| | (in thousands) | |
| Net interest income after provision | \$ | 56,090 |
| Non-interest income | | 18,826 |
| Non-interest expense | | 57,409 |
| Net income | | 14,723 |

The unaudited supplemental pro forma information for the year ended December 31, 2020 set forth above reflects adjustments related to (a) purchase accounting fair value adjustments; (b) amortization of core deposit; and (c) adjustments to interest income and expense due to amortization of premiums and accretion of discounts. Furthermore, the unaudited supplemental pro forma information does not reflect management's estimate of any revenue enhancement opportunities or anticipated potential cost savings for periods that include data as of May 1, 2020 or earlier. The disclosures regarding the results of operations for FSB subsequent to its acquisition date are omitted as this information is not practical to obtain.

3. SECURITIES

The amortized cost of securities and their approximate fair value at December 31 were as follows:

| | 2022 | | | |
|---|-------------------|------------|-------------|---------------|
| | (in thousands) | | | |
| | Amortized Cost | Unrealized | | Fair Value |
| | | Gains | Losses | |
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. treasuries and government agencies | \$ 165,495 | \$ 1 | \$ (24,814) | \$ 140,682 |
| States and political subdivisions | 23,480 | 4 | (1,662) | 21,822 |
| Total debt securities | \$ 188,975 | \$ 5 | \$ (26,476) | \$ 162,504 |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 75,921 | \$ - | \$ (12,819) | \$ 63,102 |
| FHLMC | 46,922 | - | (6,695) | 40,227 |
| GNMA | 40,039 | - | (6,580) | 33,459 |
| SBA | 22,556 | - | (2,419) | 20,137 |
| CMO | 53,803 | - | (8,906) | 44,897 |
| Total mortgage-backed securities | \$ 239,241 | \$ - | \$ (37,419) | \$ 201,822 |
| Total securities designated as available for sale | \$ 428,216 | \$ 5 | \$ (63,895) | \$ 364,326 |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 6,949 | \$ - | \$ (140) | \$ 6,809 |
| Total securities designated as held to maturity | \$ 6,949 | \$ - | \$ (140) | \$ 6,809 |

| | 2021 | | | |
|---|---------------------------|-------------------|-------------------|-----------------------|
| | (in thousands) | | | |
| | <u>Amortized Cost</u> | <u>Unrealized</u> | | <u>Fair Value</u> |
| | | <u>Gains</u> | <u>Losses</u> | |
| Available for Sale: | | | | |
| Debt securities: | | | | |
| U.S. government agencies | \$ 99,005 | \$ 199 | \$ (2,386) | \$ 96,818 |
| States and political subdivisions | 6,150 | 96 | - | 6,246 |
| Total debt securities | <u>\$ 105,155</u> | <u>\$ 295</u> | <u>\$ (2,386)</u> | <u>\$ 103,064</u> |
| Mortgage-backed securities: | | | | |
| FNMA | \$ 64,056 | \$ 222 | \$ (1,068) | \$ 63,210 |
| FHLMC | 38,796 | 62 | (424) | 38,434 |
| GNMA | 31,814 | 15 | (615) | 31,214 |
| SBA | 17,919 | 343 | (54) | 18,208 |
| CMO | 52,488 | 175 | (834) | 51,829 |
| Total mortgage-backed securities | <u>\$ 205,073</u> | <u>\$ 817</u> | <u>\$ (2,995)</u> | <u>\$ 202,895</u> |
| Total securities designated as available for sale | <u>\$ 310,228</u> | <u>\$ 1,112</u> | <u>\$ (5,381)</u> | <u>\$ 305,959</u> |
| Held to Maturity: | | | | |
| Debt securities | | | | |
| States and political subdivisions | \$ 3,165 | \$ 17 | \$ (3) | \$ 3,179 |
| Total securities designated as held to maturity | <u>\$ 3,165</u> | <u>\$ 17</u> | <u>\$ (3)</u> | <u>\$ 3,179</u> |

Available for sale securities with a total fair value of \$226 million and \$207 million were pledged as collateral to secure public deposits and for other purposes required or permitted by law at December 31, 2022 and 2021, respectively.

The scheduled maturity of debt and mortgage-backed securities at December 31, 2022 is summarized below. All maturity amounts are contractual maturities. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call premiums.

| | <u>December 31, 2022</u> | |
|--|---------------------------|---------------------------------|
| | <u>Amortized cost</u> | <u>Estimated fair value</u> |
| | (in thousands) | |
| Debt securities available for sale: | | |
| Due in one year or less | \$ 6,849 | \$ 6,780 |
| Due after one year through five years | 87,550 | 80,768 |
| Due after five years through ten years | 65,586 | 54,906 |
| Due after ten years | 28,990 | 20,050 |
| | <u>188,975</u> | <u>162,504</u> |
| Mortgage-backed securities available for sale | <u>239,241</u> | <u>201,822</u> |
| Total | <u>\$ 428,216</u> | <u>\$ 364,326</u> |
| Debt securities held to maturity: | | |
| Due in one year or less | \$ 6,096 | \$ 6,061 |
| Due after one year through five years | 441 | 407 |
| Due after five years through ten years | 412 | 341 |
| Due after ten years | - | - |
| Total | <u>\$ 6,949</u> | <u>\$ 6,809</u> |

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Contractual maturities of the Company's mortgage-backed securities generally exceed ten years; however, the effective lives may be significantly shorter due to prepayments of the underlying loans and due to the nature of these securities.

There were no realized gains or losses from sales of securities in 2022 or 2021. Gross realized gains and gross realized losses on sales of investment securities were \$0.7 million and less than \$0.1 million, respectively, in 2020.

Information regarding unrealized losses within the Company's available for sale securities at December 31, 2022 and 2021 is summarized below. The securities are primarily U.S. government sponsored entities securities or municipal securities. All unrealized losses are considered temporary and related to market interest rate fluctuations.

| | | 2022 | | | | | |
|---------------------------------------|----|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | | Less than 12 months | | 12 months or longer | | Total | |
| | | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | | (in thousands) | | | | | |
| Available for Sale: | | | | | | | |
| Debt securities: | | | | | | | |
| U.S. government agencies | \$ | 68,292 | \$ (5,929) | \$ 71,389 | \$ (18,885) | \$ 139,681 | \$ (24,814) |
| States and political subdivisions | | 19,540 | (1,645) | 418 | (17) | 19,958 | (1,662) |
| Total debt securities | \$ | 87,832 | \$ (7,574) | \$ 71,807 | \$ (18,902) | \$ 159,639 | \$ (26,476) |
| Mortgage-backed securities: | | | | | | | |
| FNMA | \$ | 23,242 | \$ (3,081) | \$ 39,860 | \$ (9,738) | \$ 63,102 | \$ (12,819) |
| FHLMC | | 11,927 | (790) | 28,300 | (5,905) | 40,227 | (6,695) |
| GNMA | | 10,763 | (1,298) | 22,696 | (5,282) | 33,459 | (6,580) |
| SBA | | 16,996 | (1,971) | 3,141 | (448) | 20,137 | (2,419) |
| CMO | | 11,288 | (673) | 33,609 | (8,233) | 44,897 | (8,906) |
| Total mortgage-backed securities | \$ | 74,216 | \$ (7,813) | \$ 127,606 | \$ (29,606) | \$ 201,822 | \$ (37,419) |
| Held to Maturity: | | | | | | | |
| Debt securities: | | | | | | | |
| States and political subdivisions | \$ | 6,627 | \$ (118) | \$ 182 | \$ (22) | \$ 6,809 | \$ (140) |
| Total temporarily impaired securities | \$ | 168,675 | \$ (15,505) | \$ 199,595 | \$ (48,530) | \$ 368,270 | \$ (64,035) |
| | | 2021 | | | | | |
| | | Less than 12 months | | 12 months or longer | | Total | |
| | | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | | (in thousands) | | | | | |
| Available for Sale: | | | | | | | |
| Debt securities: | | | | | | | |
| U.S. government agencies | \$ | 50,381 | \$ (884) | \$ 27,488 | \$ (1,502) | \$ 77,869 | \$ (2,386) |
| States and political subdivisions | | - | - | - | - | - | - |
| Total debt securities | \$ | 50,381 | \$ (884) | \$ 27,488 | \$ (1,502) | \$ 77,869 | \$ (2,386) |
| Mortgage-backed securities: | | | | | | | |
| FNMA | \$ | 48,008 | \$ (903) | \$ 2,941 | \$ (165) | \$ 50,949 | \$ (1,068) |
| FHLMC | | 35,851 | (423) | 76 | (1) | 35,927 | (424) |
| GNMA | | 30,252 | (615) | 143 | - | 30,395 | (615) |
| SBA | | 2,824 | (25) | 1,218 | (29) | 4,042 | (54) |
| CMO | | 38,313 | (833) | 25 | (1) | 38,338 | (834) |
| Total mortgage-backed securities | \$ | 155,248 | \$ (2,799) | \$ 4,403 | \$ (196) | \$ 159,651 | \$ (2,995) |
| Held to Maturity: | | | | | | | |
| Debt securities: | | | | | | | |
| States and political subdivisions | \$ | 1,782 | \$ (3) | \$ - | \$ - | \$ 1,782 | \$ (3) |
| Total temporarily impaired securities | \$ | 207,411 | \$ (3,686) | \$ 31,891 | \$ (1,698) | \$ 239,302 | \$ (5,384) |

Management has assessed the securities available for sale in an unrealized loss position at December 31, 2022 and 2021 and determined the decline in fair value below amortized cost to be temporary. In making this determination, management considered the period of time the securities were in a loss position, the percentage decline in comparison to the securities' amortized cost, and the financial condition of the issuer (primarily government or government-sponsored enterprises). In addition, management does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost. Management believes the decline in fair value is primarily related to market interest rate fluctuations and not to the credit deterioration of the individual issuers. The Company holds no securities backed by sub-prime or Alt-A residential mortgages or commercial mortgages and also does not hold any trust-preferred securities.

The Company did not record any other-than-temporary impairment charges in 2022, 2021, or 2020. The creditworthiness of the Company's portfolio is largely reliant on the ability of U.S. government agencies such as the Federal Home Loan Bank ("FHLB"), Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"), and municipalities throughout New York State to meet their obligations. In addition, dysfunctional markets could materially alter the liquidity, interest rate, and pricing risk of the portfolio. The stable past performance is not a guarantee for similar performance going forward.

4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Major categories of loans at December 31, 2022 and 2021 are summarized as follows:

| | <u>December 31, 2022</u> | <u>December 31, 2021</u> |
|---------------------------------|--------------------------|--------------------------|
| Mortgage loans on real estate: | | (in thousands) |
| Residential mortgages | \$ 440,123 | \$ 411,060 |
| Commercial and multi-family | 778,714 | 739,761 |
| Construction-Residential | 3,626 | 5,109 |
| Construction-Commercial | 117,403 | 98,012 |
| Home equities | 82,414 | 81,238 |
| Total real estate loans | <u>1,422,280</u> | <u>1,335,180</u> |
| Commercial and industrial loans | 250,069 | 237,077 |
| Consumer and other loans | 572 | 719 |
| Unaccreted yield adjustments* | (552) | (1,071) |
| Total gross loans | <u>1,672,369</u> | <u>1,571,905</u> |
| Allowance for loan losses | (19,438) | (18,438) |
| Loans, net | <u>\$ 1,652,931</u> | <u>\$ 1,553,467</u> |

*Includes net premiums and discounts on acquired loans and net deferred fees and costs on loans originated.

At December 31, 2022, the outstanding principal balance and the carrying amount of acquired credit-impaired loans totaled \$0.8 million and \$0.7 million, respectively, relatively consistent with an outstanding principal balance and carrying amount of \$0.8 million at December 31, 2021. There were no valuation allowances for specifically identified impairment attributable to acquired credit-impaired loans at December 31, 2022 or 2021.

There were \$495 million and \$619 million in residential and commercial mortgage loans pledged to FHLB NY to serve as collateral for potential borrowings as of December 31, 2022 and 2021, respectively.

Residential Mortgages: The Company originates adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase, or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area and are amortized over a period of 10 to 30 years. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of the property's appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling.

The Company, in its normal course of business, sells certain residential mortgages which it originates to FNMA. The Company maintains servicing rights on the loans that it sells to FNMA and earns a fee thereon. The Bank determines with each origination of residential real estate loans which desired maturities, within the context of overall maturities in the loan portfolio, provide the appropriate mix to optimize the Bank's ability to absorb the corresponding interest rate risk within the Company's tolerance ranges. This practice allows the Company to manage interest rate risk, liquidity risk, and credit risk. At December 31, 2022 and 2021, the Company had

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approximately \$57 million and \$61 million, respectively, in unpaid principal balances of loans that it services for FNMA. For the years ended December 31, 2022 and 2021, the Company sold \$4.5 million and \$1 million, respectively, in loans to FNMA and realized gains on those sales of \$0.1 million and less than \$0.1 million, respectively. Gains or losses recognized upon the sale of loans are determined on a specific identification basis.

At December 31, 2022, the Company also had approximately \$59 million in unpaid principal balances of loans that it services for FHLMC, compared with \$70 million at December 31, 2021. No loans were sold to FHLMC by the Company during the years 2022 and 2021.

The Company had a related asset carried at fair value of approximately \$1.1 million and \$0.9 million for the servicing portfolio rights at December 31, 2022 and 2021, respectively. At December 31, 2022 no residential mortgages were held for sale, compared to \$0.1 million in loans held for sale at December 31, 2021. The carrying value approximates fair value.

Commercial and Multi-Family Mortgages and Commercial Construction Loans: Commercial real estate loans are made to finance the purchases of real estate with completed structures or in the midst of being constructed. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, hotels, retail stores or plazas, healthcare facilities, and other non-owner-occupied facilities. These loans are generally less risky than commercial and industrial loans since they are secured by real estate and buildings. The Company offers commercial mortgage loans with up to an 80% LTV ratio for up to 20 years on a variable and fixed rate basis. Many of these mortgage loans either mature or are subject to a rate call after three to five years. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and the underlying cash flows. Construction loans have a unique risk, because they are secured by an incomplete dwelling.

Home Equities: The Company originates home equity lines of credit and second mortgage loans (loans secured by a second lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans because they are in a second position with respect to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Commercial and Industrial Loans: These loans generally include term loans and lines of credit. Such loans are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion, and improvements) and equipment purchases. As a general practice, a collateral lien is placed on equipment or other assets owned by the borrower. These loans generally carry a higher risk than commercial real estate loans based on the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers. To further reduce risk and enhance liquidity, these loans generally carry variable rates of interest, re-pricing in three- to five-year periods, and have a maturity of five years or less. Lines of credit generally carry floating rates of interest (e.g. prime plus a margin).

Consumer Loans: The Company funds a variety of consumer loans, including direct automobile loans, recreational vehicle loans, boat loans, home improvement loans, and personal loans (collateralized and uncollateralized). Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging up to five years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed. A minimal amount of loans are unsecured, which carry a higher risk of loss. These loans included overdrawn deposit accounts classified as loans of \$0.1 million at December 31, 2022 and 2021.

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The following tables summarize the allowance for loan losses, as of December 31, 2022 and 2021, respectively, by portfolio segment. The segments presented are at the level management uses to assess and monitor the risk and performance of the portfolio.

| 2022 | | | | | | |
|---|------------------------------|--------------------------------------|-----------------------|---------------------------|------------------|---------------------|
| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 3,309 | \$ 12,367 | \$ 54 | \$ 2,127 | \$ 581 | \$ 18,438 |
| Charge-offs | (1,546) | - | (170) | (125) | (30) | (1,871) |
| Recoveries | 114 | - | 18 | - | - | 132 |
| Provision (Credit) | 3,103 | (772) | 251 | 100 | 57 | 2,739 |
| Ending balance | <u>\$ 4,980</u> | <u>\$ 11,595</u> | <u>\$ 153</u> | <u>\$ 2,102</u> | <u>\$ 608</u> | <u>\$ 19,438</u> |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Individually evaluated for impairment | - | 251 | - | 28 | 77 | 356 |
| Collectively evaluated for impairment | 4,980 | 11,344 | 153 | 2,074 | 531 | 19,082 |
| Total | <u>\$ 4,980</u> | <u>\$ 11,595</u> | <u>\$ 153</u> | <u>\$ 2,102</u> | <u>\$ 608</u> | <u>\$ 19,438</u> |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ 687 | \$ - | \$ 687 |
| Individually evaluated for impairment | 2,697 | 18,144 | - | 4,020 | 949 | 25,810 |
| Collectively evaluated for impairment | 247,372 | 877,973 | 572 | 439,042 | 81,465 | 1,646,424 |
| Total | <u>\$ 250,069</u> | <u>\$ 896,117</u> | <u>\$ 572</u> | <u>\$ 443,749</u> | <u>\$ 82,414</u> | <u>\$ 1,672,921</u> |

Note: Loan balances do not include \$(0.6) million of unaccreted yield adjustments as of December 31, 2022.

* includes construction loans

2021

| (in thousands) | Commercial and Industrial | Commercial Real Estate Mortgages* | Consumer and Other | Residential Mortgages* | Home Equities | Total |
|---|---------------------------|-----------------------------------|--------------------|------------------------|------------------|---------------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 4,882 | \$ 13,249 | \$ 45 | \$ 1,658 | \$ 581 | \$ 20,415 |
| Charge-offs | (424) | (1) | (147) | - | - | (572) |
| Recoveries | 76 | - | 30 | - | 2 | 108 |
| Provision (Credit) | (1,225) | (881) | 126 | 469 | (2) | (1,513) |
| Ending balance | <u>\$ 3,309</u> | <u>\$ 12,367</u> | <u>\$ 54</u> | <u>\$ 2,127</u> | <u>\$ 581</u> | <u>\$ 18,438</u> |
| Allowance for loan losses: | | | | | | |
| Ending balance: | | | | | | |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Individually evaluated for impairment | \$ 100 | 345 | - | 9 | 41 | 495 |
| Collectively evaluated for impairment | 3,209 | 12,022 | 54 | 2,118 | 540 | 17,943 |
| Total | <u>\$ 3,309</u> | <u>\$ 12,367</u> | <u>\$ 54</u> | <u>\$ 2,127</u> | <u>\$ 581</u> | <u>\$ 18,438</u> |
| Loans: | | | | | | |
| Ending balance: | | | | | | |
| Loans acquired with deteriorated credit quality | \$ - | \$ - | \$ - | \$ 803 | \$ - | \$ 803 |
| Individually evaluated for impairment | \$ 5,028 | 11,925 | - | 2,598 | 1,236 | 20,787 |
| Collectively evaluated for impairment | 232,049 | 825,848 | 719 | 412,768 | 80,002 | 1,551,386 |
| Total | <u>\$ 237,077</u> | <u>\$ 837,773</u> | <u>\$ 719</u> | <u>\$ 416,169</u> | <u>\$ 81,238</u> | <u>\$ 1,572,976</u> |

Note: Loan balances do not include \$(1.1) million of unaccreted yield adjustments as of December 31, 2021.

* includes construction loans

A description of the Company's accounting policies and the methodology used to estimate the allowance for loan losses, including a description of the factors considered in determining the allowance for loan losses, such as historical losses and existing economic conditions, is included in Note 1 to these Consolidated Financial Statements.

The following table provides data, at the class level, of credit quality indicators of certain loans, as of December 31, 2022 and 2021, respectively:

| 2022 | | | | | |
|--|-------------------------------------|---------------------------------------|------------------------------|---------------------------|----------------|
| (in thousands) | | | | | |
| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial | |
| Acceptable or better | \$ 77,378 | \$ 567,112 | \$ 644,490 | \$ | 177,278 |
| Watch | 22,639 | 168,626 | 191,265 | \$ | 40,603 |
| Special Mention | 4,979 | 17,965 | 22,944 | \$ | 25,316 |
| Substandard | 12,407 | 25,011 | 37,418 | \$ | 6,872 |
| Doubtful/Loss | - | - | - | \$ | - |
| Total | <u>\$ 117,403</u> | <u>\$ 778,714</u> | <u>\$ 896,117</u> | <u>\$</u> | <u>250,069</u> |

| 2021 | | | | | |
|--|-------------------------------------|---------------------------------------|------------------------------|---------------------------|----------------|
| (in thousands) | | | | | |
| Corporate Credit Exposure – By Credit Rating | Commercial Real Estate Construction | Commercial and Multi-Family Mortgages | Total Commercial Real Estate | Commercial and Industrial | |
| Acceptable or better | \$ 65,211 | \$ 480,159 | \$ 545,370 | \$ | 152,675 |
| Watch | 19,108 | 182,502 | 201,610 | \$ | 64,406 |
| Special Mention | 7,045 | 33,219 | 40,264 | \$ | 10,200 |
| Substandard | 6,648 | 43,881 | 50,529 | \$ | 9,796 |
| Doubtful/Loss | - | - | - | \$ | - |
| Total | <u>\$ 98,012</u> | <u>\$ 739,761</u> | <u>\$ 837,773</u> | <u>\$</u> | <u>237,077</u> |

The Company continues to evaluate its portfolio of loans to clients within the hotel industry for residual impacts of the COVID-19 pandemic. Loans that have returned to compliance with contractual payment terms for a sustained period have been upgraded out of the watch or criticized categories. The Company identified a well-defined weakness in the hotel industry and classified the \$81 million of loans to clients within that industry during 2020. Subsequently, more than half of this portfolio has been upgraded or paid off. Currently, \$30 million of the hotel portfolio remains in criticized status at the end of 2022. Total criticized assets decreased to \$93 million at December 31, 2022 compared with \$111 million at the end of 2021.

The Company evaluates the loan portfolio to ensure that specific credits are appropriately graded and reserved. At least annually, borrowers' financial information is reviewed by the individual relationship managers. Independent of the individual relationship managers, the credit department performs annual reviews on all requisite relationships within the loan portfolio. In addition to the credit department, the Company has engaged an independent vendor to monitor the management of the Company's commercial loan portfolio. The Company's loan review function reviews a percentage of the commercial loan portfolio based on an annual risk assessment, typically ranging from 40% to 50%. The Company believes that the allowance for loan losses is reflective of a fair assessment of the current environment and credit quality trends.

The Company's consumer loans, including residential mortgages and home equity loans and lines of credit, are not individually risk rated or reviewed as part of the Company's loan review process. Unlike commercial customers, consumer loan customers are not required to provide the Company with updated financial information. Consumer loans also carry smaller dollar balances. Given the lack of updated information since the initial underwriting of the loan and the small size of individual loans, the Company uses delinquency status as the primary credit quality indicator for consumer loans. Once a consumer loan reaches 60 days past due, management orders an independent appraisal of the underlying collateral and produces a credit report on the borrower. After discounting for potential selling costs and other factors specific to the property or borrower, the book value of the loan is then compared to the collateral value as determined by the appraisal. In situations where the Company holds a junior lien, management accounts for the amount of the senior liens held by other lenders, and the collateral value is more heavily discounted to account for the increased risk. If the loan is ultimately determined to be impaired, it is placed in non-accrual status. Unless the loan is well secured and in the process of collection, all consumer loans that are more than 90 days past due are placed in non-accrual status.

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A summary of current, past due, and nonaccrual loans as of December 31, 2022 and 2021 follows:

| 2022 | | | | | | |
|---------------------------|---------------------|-----------------|---------------|-----------------|-----------------------|---------------------|
| (in thousands) | | | | | | |
| | Current Balance | 30-59 days | 60-89 days | 90+ days | Non-accruing Loans | Total Balance |
| Commercial and industrial | \$ 246,393 | \$ 235 | \$ 684 | \$ 139 | \$ 2,618 | \$ 250,069 |
| Residential real estate: | | | | | | |
| Residential | 434,773 | 1,111 | - | 472 | 3,767 | 440,123 |
| Construction | 3,626 | - | - | - | - | 3,626 |
| Commercial real estate: | | | | | | |
| Commercial | 770,911 | 1,079 | - | 75 | 6,649 | 778,714 |
| Construction | 107,063 | - | - | 1,648 | 8,692 | 117,403 |
| Home equities | 80,797 | 752 | 198 | 100 | 567 | 82,414 |
| Consumer and other | 567 | 3 | 1 | 1 | - | 572 |
| Total Loans | \$ 1,644,130 | \$ 3,180 | \$ 883 | \$ 2,435 | \$ 22,293 | \$ 1,672,921 |

| 2021 | | | | | | |
|---------------------------|---------------------|------------------|-----------------|-----------------|-----------------------|---------------------|
| (in thousands) | | | | | | |
| | Current Balance | 30-59 days | 60-89 days | 90+ days | Non-accruing Loans | Total Balance |
| Commercial and industrial | \$ 229,724 | \$ 1,336 | \$ 568 | \$ 548 | \$ 4,901 | \$ 237,077 |
| Residential real estate: | | | | | | |
| Residential | 402,992 | 3,466 | 1,563 | - | 3,039 | 411,060 |
| Construction | 5,109 | - | - | - | - | 5,109 |
| Commercial real estate: | | | | | | |
| Commercial | 711,481 | 16,451 | 6,073 | - | 5,756 | 739,761 |
| Construction | 93,842 | 757 | - | 480 | 2,933 | 98,012 |
| Home equities | 79,644 | 627 | 209 | - | 758 | 81,238 |
| Consumer and other | 706 | 9 | 4 | - | - | 719 |
| Total Loans | \$ 1,523,498 | \$ 22,646 | \$ 8,417 | \$ 1,028 | \$ 17,387 | \$ 1,572,976 |

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The following table provides data, at the class level, of impaired loans:

| | At December 31, 2022 | | | 2022 | |
|--|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded: | (in thousands) | | | | |
| Commercial and industrial | \$ 2,697 | \$ 3,334 | \$ - | \$ 2,654 | \$ 82 |
| Residential real estate: | | | | | |
| Residential | 4,607 | 5,109 | - | 4,522 | 57 |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | 9,453 | 9,778 | - | 7,928 | 288 |
| Construction | 7,360 | 7,500 | - | 3,715 | 282 |
| Home equities | 813 | 885 | - | 778 | 24 |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 24,930 | \$ 26,606 | \$ - | \$ 19,597 | \$ 733 |

| | At December 31, 2022 | | | 2022 | |
|---|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | |
| Commercial and industrial | \$ - | \$ - | \$ - | \$ - | \$ - |
| Residential real estate: | | | | | |
| Residential | 59 | 59 | 28 | 59 | - |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | - | - | - | - | - |
| Construction | 1,331 | 1,499 | 251 | 1,360 | - |
| Home equities | 136 | 153 | 77 | 58 | 2 |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 1,526 | \$ 1,711 | \$ 356 | \$ 1,477 | \$ 2 |

| | At December 31, 2022 | | | 2022 | |
|-----------------------------|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| Total: | (in thousands) | | | | |
| Commercial and industrial | \$ 2,697 | \$ 3,334 | \$ - | \$ 2,654 | \$ 82 |
| Residential real estate: | | | | | |
| Residential | 4,666 | 5,168 | 28 | 4,581 | 57 |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | 9,453 | 9,778 | - | 7,928 | 288 |
| Construction | 8,691 | 8,999 | 251 | 5,075 | 282 |
| Home equities | 949 | 1,038 | 77 | 836 | 26 |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 26,456 | \$ 28,317 | \$ 356 | \$ 21,074 | \$ 735 |

| | At December 31, 2021 | | | 2021 | |
|--|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With no related allowance recorded: | (in thousands) | | | | |
| Commercial and industrial | \$ 4,874 | \$ 5,712 | \$ - | \$ 5,126 | \$ 22 |
| Residential real estate: | | | | | |
| Residential | 3,297 | 3,654 | - | 3,602 | 27 |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | 8,821 | 9,338 | - | 11,223 | 270 |
| Construction | 1,395 | 1,499 | - | 1,144 | - |
| Home equities | 1,127 | 1,324 | - | 1,319 | 12 |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 19,514 | \$ 21,527 | \$ - | \$ 22,414 | \$ 331 |

| | At December 31, 2021 | | | 2021 | |
|---|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With a related allowance recorded: | (in thousands) | | | | |
| Commercial and industrial | \$ 154 | \$ 158 | \$ 100 | \$ 159 | \$ 4 |
| Residential real estate: | | | | | |
| Residential | 60 | 60 | 9 | 59 | 1 |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | 171 | 717 | 16 | 191 | - |
| Construction | 1,538 | 1,555 | 329 | 1,642 | - |
| Home equities | 109 | 109 | 41 | 109 | - |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 2,032 | \$ 2,599 | \$ 495 | \$ 2,160 | \$ 5 |

| | At December 31, 2021 | | | 2021 | |
|-----------------------------|----------------------|--------------------------|-------------------|-----------------------------|----------------------------|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| Total: | (in thousands) | | | | |
| Commercial and industrial | \$ 5,028 | \$ 5,870 | \$ 100 | \$ 5,285 | \$ 26 |
| Residential real estate: | | | | | |
| Residential | 3,357 | 3,714 | 9 | 3,661 | 28 |
| Construction | - | - | - | - | - |
| Commercial real estate: | | | | | |
| Commercial | 8,992 | 10,055 | 16 | 11,414 | 270 |
| Construction | 2,933 | 3,054 | 329 | 2,786 | - |
| Home equities | 1,236 | 1,433 | 41 | 1,428 | 12 |
| Consumer and other | - | - | - | - | - |
| Total impaired loans | \$ 21,546 | \$ 24,126 | \$ 495 | \$ 24,574 | \$ 336 |

2020

| | Average Recorded Investment | | | Interest Income Recognized | | |
|---------------------------|-------------------------------------|----------------------------------|------------------|-------------------------------------|----------------------------------|---------------|
| | With no related allowance recorded: | With related allowance recorded: | Total | With no related allowance recorded: | With related allowance recorded: | Total |
| Commercial and industrial | \$ 1,952 | \$ 4,938 | \$ 6,890 | \$ 8 | \$ 25 | \$ 33 |
| Residential real estate: | | | | | | |
| Residential | 3,754 | - | 3,754 | 60 | - | 60 |
| Construction | - | - | - | - | - | - |
| Commercial real estate: | | | | | | |
| Commercial | 12,397 | 2,943 | 15,340 | 209 | 10 | 219 |
| Construction | 1,315 | 1,556 | 2,871 | - | 53 | 53 |
| Home equities | 1,565 | 109 | 1,674 | 23 | 1 | 24 |
| Consumer and other | - | 3 | 3 | - | - | - |
| Total impaired loans | <u>\$ 20,983</u> | <u>\$ 9,549</u> | <u>\$ 30,532</u> | <u>\$ 300</u> | <u>\$ 89</u> | <u>\$ 389</u> |

As management identifies impaired loans that are collateral dependent, new appraisals are ordered to determine the fair value of the collateral. It should also be noted that when estimating the fair value of collateral for the purpose of performing an impairment test, management further reduces the appraised value of the collateral to account for estimated selling or carrying costs, age of the appraisal, if applicable, or any other perceived market or borrower-specific risks to the value of the collateral.

The interest income in the preceding table was interest income recognized on accruing TDRs and interest paid prior to loans being identified as non-accrual. Cash basis income on impaired loans is the same as interest income recognized for all periods presented in the preceding table.

The Bank had no loan commitments to borrowers in non-accrual status at December 31, 2022 and 2021.

Troubled debt restructurings (“TDRs”)

The following tables summarize the loans that were classified as troubled debt restructurings as of the dates indicated:

| | December 31, 2022 | | | |
|-----------------------------|-------------------|-----------------|-----------------|-------------------|
| | (in thousands) | | | |
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 814 | \$ 735 | \$ 79 | \$ - |
| Residential real estate: | | | | |
| Residential | 875 | 530 | 345 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 2,803 | - | 2,803 | - |
| Construction | - | - | - | - |
| Home equities | 387 | 5 | 382 | - |
| Consumer and other | - | - | - | - |
| Total TDR loans | <u>\$ 4,879</u> | <u>\$ 1,270</u> | <u>\$ 3,609</u> | <u>\$ -</u> |

| | December 31, 2021 | | | |
|-----------------------------|-------------------|-----------------|-----------------|-------------------|
| | (in thousands) | | | |
| | Total | Nonaccruing | Accruing | Related Allowance |
| Commercial and industrial | \$ 1,003 | \$ 876 | \$ 127 | \$ - |
| Residential real estate: | | | | |
| Residential | 989 | 627 | 362 | - |
| Construction | - | - | - | - |
| Commercial real estate: | | | | |
| Commercial and multi-family | 3,236 | - | 3,236 | - |
| Construction | - | - | - | - |
| Home equities | 490 | 12 | 478 | - |
| Consumer and other | - | - | - | - |
| Total TDR loans | <u>\$ 5,718</u> | <u>\$ 1,515</u> | <u>\$ 4,203</u> | <u>\$ -</u> |

Any TDR that is placed on non-accrual is not reverted back to accruing status until the borrower makes timely payments as contracted for at least six months and future collection under the revised terms is probable. All of the Company’s restructurings were allowed in an effort to maximize its ability to collect on loans where borrowers were experiencing financial difficulty.

The reserve for a TDR is based upon the present value of the future expected cash flows discounted at the loan’s original effective interest rate or upon the fair value of the collateral less costs to sell, if the loan is deemed collateral dependent. This reserve methodology is used because all TDR loans are considered impaired.

The Company’s TDRs have various agreements that involve deferral of principal payments, or interest-only payments, for a period (usually 12 months or less) to allow the borrower time to improve cash flow or sell the property. Other common concessions leading to the designation of a TDR are lines of credit that are termed-out and/or extensions of maturities at rates that are less than the prevailing market rates given the risk profile of the borrower.

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The following tables show the data for TDR activity by type of concession granted to the borrower during 2022 and 2021:

| Troubled Debt Restructurings by Type of Concession | Year ended December 31, 2022 | | | Year ended December 31, 2021 | | |
|--|------------------------------|--|---|------------------------------|--|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial and Industrial: | | | | | | |
| Extension of maturity | 1 | \$ 461 | \$ 461 | - | \$ - | \$ - |
| Residential Real Estate & Construction | | | | | | |
| Commercial Real Estate & Construction | | | | | | |
| Home Equities: | | | | | | |
| Extension of maturity and interest rate reduction | 1 | 38 | 38 | - | - | - |
| Consumer and other loans | - | - | - | - | - | - |

Modifications made to loans in a troubled debt restructuring did not have a material impact on the Company's net income for the years ended December 31, 2022 and 2021. All of the C&I and commercial real estate TDRs were already considered impaired and sufficiently reserved for prior to being identified as a TDR.

The general practice of the Bank is to work with borrowers so that they are able to repay their loan in full. If a borrower continues to be delinquent or cannot meet the terms of a TDR and the loan is determined to be uncollectible, the loan will be charged-off to its collateral value. A loan is considered in default when the loan is 90 days past due. Loans which were classified as TDRs during the preceding twelve months and which subsequently defaulted during the twelve-month periods ended December 31, 2022 and 2021 were not material. Commitments to lend additional amounts on loans classified as TDRs were not material as of December 31, 2022 and 2021.

5. PROPERTIES AND EQUIPMENT

Properties and equipment at December 31 were as follows:

| | 2022 | 2021 |
|------------------------------------|----------------|-----------|
| | (in thousands) | |
| Land | \$ 845 | \$ 845 |
| Buildings and improvements | 18,815 | 18,563 |
| Furniture, fixtures, and equipment | 8,935 | 8,664 |
| | 28,595 | 28,072 |
| Less accumulated depreciation | (11,596) | (10,283) |
| Properties and equipment, net | \$ 16,999 | \$ 17,789 |

Depreciation expense totaled \$1.7 million in 2022, \$1.8 million in 2021, and \$1.6 million in 2020.

6. LEASES

The Company's leases, consisting of property leases for certain of our bank branches and insurance agency offices, are classified as operating leases. Operating lease Right of Use ("ROU") assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. ROU assets were \$4.4 million and \$4.8 million as of December 31, 2022 and 2021, respectively. Lease liabilities were \$4.7 million and \$5.2 million as of December 31, 2022 and 2021, respectively. As these leases do not provide an implicit rate, we use our incremental borrowing rate in determining the present value of lease payments. Our lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Leases with an initial term of 12 months or less are not recorded on the balance sheet.

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Lease expense is recognized on a straight-line basis over the lease term. Operating lease expenses were \$1.1 million during the years ended December 31, 2022 and 2021, respectively, and are included in occupancy expense on the consolidated statement of income. Cash paid for amounts included in the measurement of lease liabilities were \$1.0 million and \$1.1 million during the years ended December 31, 2022 and 2021, respectively, and are included in cash flows from operating activities on the consolidated statement of cash flows. The weighted average discount rate related to the Company's leases was 3.0% as of December 31, 2022 and 2.8% as of December 31, 2021. The weighted average remaining lease term related to the Company's leases was 6.7 years and 7.4 years as of December 31, 2022 and 2021, respectively. Future minimum lease payments under non-cancellable leases as of December 31, 2022 were as follows:

| | Year Ending December 31, | |
|--|--------------------------|--------------|
| | (in thousands) | |
| | 2023 | \$ 1,055 |
| | 2024 | 919 |
| | 2025 | 744 |
| | 2026 | 672 |
| | 2027 | 419 |
| | Thereafter | 1,374 |
| Total future minimum lease payments | | 5,183 |
| Less imputed interest | | 460 |
| Total | \$ | 4,723 |

ROU assets obtained in exchange for lease obligations were \$0.5 million during the years ended December 31, 2022 and 2021.

7. GOODWILL AND INTANGIBLE ASSETS

Assets and liabilities acquired in a business combination are recorded at their estimated fair values as of the acquisition date. The excess of the purchase price of the acquisition over the fair value of net assets acquired is recorded as goodwill. The Company had \$12.7 million in goodwill at December 31, 2022 and 2021, including \$10.9 million in the insurance agency activities segment and \$1.8 million in the banking activities segment. There were no additions to goodwill during 2022 or 2021.

Goodwill is evaluated for impairment on an annual basis, or whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying value. The Company measures the fair value of the banking and insurance agency reporting units annually, as of December 31. There was no impairment of goodwill recognized during 2022. An \$11 thousand impairment of goodwill was recognized in 2021 related to the discontinued operations of a business within the insurance agency reporting unit.

There were no additions to intangible assets during 2022 or 2021. The gross carrying amount and accumulated amortization of other intangible assets at December 31, 2022 and December 31, 2021 were as follows:

| | 2022 | | 2021 | |
|-----------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| | (in thousands) | | (in thousands) | |
| Amortized intangible asset: | | | | |
| Other insurance intangibles | \$ 3,325 | (2,210) | \$ 3,325 | (1,828) |
| Core deposit intangibles | 166 | (54) | 166 | (36) |
| Total | \$ 3,491 | (2,264) | \$ 3,491 | (1,864) |

Total intangible assets have an estimated weighted average remaining life of 4.1 years. Core deposit intangibles have an estimated weighted average remaining life of 7.3 years. Other insurance intangibles have an estimated weighted average remaining life of 3.8 years. Amortization expense related to intangibles for the years ended December 31, 2022, 2021, and 2020 was \$0.4 million, \$0.5 million, and \$0.5 million, respectively. During 2021, the Company recorded less than \$0.1 million of impairment related to an other insurance intangible asset that was determined to be valueless. There was no impairment of intangible assets recognized during 2022.

Estimated amortization expense for each of the five succeeding fiscal years is as follows:

| Year Ending December 31 | Amount |
|-------------------------|-----------------|
| (in thousands) | |
| 2023 | \$ 389 |
| 2024 | 378 |
| 2025 | 218 |
| 2026 | 60 |
| 2027 | 60 |
| Thereafter | 122 |
| | <u>\$ 1,227</u> |

8. DEPOSITS

Time deposits of \$250 thousand and over, excluding brokered deposits, totaled \$40.7 million and \$25.3 million at December 31, 2022 and 2021, respectively. Brokered time deposits totaled \$6.5 million and \$8.7 million at December 31, 2022 and 2021, respectively.

At December 31, 2022, the scheduled maturities of all time deposits were as follows:

| (in thousands) | |
|----------------|-------------------|
| 2023 | \$ 164,447 |
| 2024 | 23,750 |
| 2025 | 9,332 |
| 2026 | 2,831 |
| 2027 | 2,307 |
| | <u>\$ 202,667</u> |

9. BORROWED FUNDS AND SUBORDINATED DEBT

Other borrowings at December 31, 2022 consisted of various FHLB advances with fixed interest rate terms ranging from 1.66% to 3.34% and a FHLB overnight line of credit advance of \$173 million.

The maturities and weighted average rates of other borrowed funds, excluding purchased discounts of \$0.3 million, at December 31, 2022 are as follows:

| | <u>Maturities</u> | <u>Weighted Average Rate</u> |
|-------|-------------------|------------------------------|
| | (in thousands) | |
| 2023 | \$ 186,443 | 4.47 % |
| 2024 | 6,304 | 3.08 % |
| Total | <u>\$ 192,747</u> | 4.42 % |

The Bank has the ability to borrow additional funds from the FHLB based on the securities or real estate loans that can be used as collateral and to purchase additional federal funds through one of the Bank's correspondent banks. Given the current collateral available, additional advances of up to \$320 million can be drawn on the FHLB via the Bank's Overnight Line of Credit Agreement. The Bank also has the ability to purchase up to \$18 million in federal funds from its correspondent banks. There were \$495 million and \$619 million in residential and commercial mortgage loans pledged to FHLB NY to serve as collateral for potential borrowings as of December 31, 2022 and 2021, respectively.

As a member of the Federal Home Loan Bank System, the Bank is required to hold stock in FHLB NY. The Bank held FHLB NY stock with a carrying value of \$10.4 million and \$3.0 million as of December 31, 2022 and December 31, 2021, respectively.

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The amounts and interest rates of other borrowed funds, excluding purchased discounts of \$0.3 million, \$0.7 million and \$1.4 million at December 31, 2022, 2021 and 2020, respectively, were as follows:

| | FHLB Overnight Line of Credit | | FHLB Advances | | FRB Borrowings | | Total Other Borrowings |
|--------------------------------------|--------------------------------------|---------|----------------------|--------|-----------------------|-------|-------------------------------|
| | | | (in thousands) | | | | |
| At December 31, 2022 | | | | | | | |
| Amount outstanding | \$ | 173,200 | \$ | 19,547 | \$ | - | \$ 192,747 |
| Weighted-average interest rate | | 4.61% | | 2.77% | | - | 4.42% |
| For the year ended December 31, 2022 | | | | | | | |
| Highest amount at a month end | \$ | 173,200 | \$ | 31,756 | \$ | - | |
| Daily average amount outstanding | \$ | 24,519 | \$ | 23,721 | \$ | - | \$ 48,240 |
| Weighted-average interest rate | | 3.96% | | 2.72% | | - | 3.35% |
| At December 31, 2021 | | | | | | | |
| Amount outstanding | \$ | - | \$ | 32,145 | \$ | - | \$ 32,145 |
| Weighted-average interest rate | | - | | 2.64% | | - | 2.64% |
| For the year ended December 31, 2021 | | | | | | | |
| Highest amount at a month end | \$ | - | \$ | 42,434 | \$ | - | |
| Daily average amount outstanding | \$ | - | \$ | 38,378 | \$ | 24 | \$ 38,403 |
| Weighted-average interest rate | | - | | 2.55% | | 0.35% | 2.55% |
| At December 31, 2020 | | | | | | | |
| Amount outstanding | \$ | - | \$ | 42,600 | \$ | 693 | \$ 43,293 |
| Weighted-average interest rate | | - | | 2.51% | | 0.35% | 2.47% |
| For the year ended December 31, 2020 | | | | | | | |
| Highest amount at a month end | \$ | - | \$ | 50,597 | \$ | 693 | |
| Daily average amount outstanding | \$ | - | \$ | 35,625 | \$ | 451 | \$ 35,625 |
| Weighted-average interest rate | | - | | 2.35% | | 0.35% | 2.33% |

Subordinated debt comprised \$20.0 million of subordinated notes and \$11.3 million of trust preferred capital securities at December 31, 2022 and 2021.

On July 9, 2020, the Company issued \$20.0 million of fixed to floating rate subordinated notes. The subordinated notes have an initial fixed interest rate of 6.00% to, but excluding, July 15, 2025, payable semi-annually in arrears. From and including July 15, 2025 to but excluding the maturity date or early redemption date, the interest rate will reset quarterly to an interest rate per annum initially equal to the then-current three-month Secured Overnight Financing Rate provided by the Federal Reserve Bank of New York plus 590 basis points, payable quarterly in arrears. The subordinated notes mature on July 15, 2030. The Company is entitled to redeem the notes, in whole or in part, at any time on or after July 15, 2025, and to redeem the subordinated notes at any time in whole upon certain other events.

On October 1, 2004, Evans Capital Trust I, a statutory business trust wholly-owned by the Company (the "Trust"), issued \$11.0 million in aggregate principal amount of floating rate preferred capital securities due November 23, 2034 to various investors (the "Capital Securities") and \$0.3 million of common securities to the Company (the "Common Securities"). The Capital Securities represent preferred undivided interests in the assets of the Trust. The Common Securities represent the initial capital contribution of the Company to the Trust, which have not been consolidated and are included in "Other Assets" on the Company's consolidated balance sheet. Under the Federal Reserve Board's current risk-based capital guidelines, the Capital Securities are includable in the Company's Tier 1 (Core) capital. The Common Securities are wholly-owned by the Company and are the only class of the Trust's securities possessing general voting powers.

The Capital Securities have a distribution rate of three-month LIBOR plus 2.65%, and the distribution dates are February 23, May 23, August 23, and November 23. The distribution rate was 7.42% at December 31, 2022.

The proceeds from the issuances of the Capital Securities and Common Securities were used by the Trust to purchase \$11.3 million in aggregate liquidation amount of floating rate junior subordinated deferrable interest debentures ("Junior Subordinated Debentures") of the Company, due October 1, 2037.

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The Junior Subordinated Debentures represent the sole assets of the Trust, and payments under the Junior Subordinated Debentures are the sole source of cash flow for the Trust. The interest rate payable on the Junior Subordinated Debentures was 7.42% at December 31, 2022.

Holders of the Capital Securities receive preferential cumulative cash distributions on each distribution date at the stated distribution rate, unless the Company exercises its right to extend the payment of interest on the Junior Subordinated Debentures for up to twenty quarterly periods, in which case payment of distributions on the respective Capital Securities will be deferred for comparable periods. During an extended interest period, in accordance with terms as defined in the indenture relating to the Capital Securities, the Company may not pay dividends or distributions on, or repurchase, redeem, or acquire any shares of its capital stock. The agreements governing the Capital Securities, in the aggregate, provide a full, irrevocable, and unconditional guarantee by the Company of the payment of distributions on, the redemption of, and any liquidation distribution with respect to the Capital Securities. The obligations under such guarantee and the Capital Securities are subordinate and junior in right of payment to all senior indebtedness of the Company.

The Capital Securities will remain outstanding until the Junior Subordinated Debentures are repaid at maturity, are redeemed prior to maturity, or are distributed in liquidation to the Trust. The Capital Securities are mandatorily redeemable in whole, but not in part, upon repayment at the stated maturity dates of the Junior Subordinated Debentures or the earlier redemption of the Junior Subordinated Debentures in whole upon the occurrence of one or more events (“Events”) set forth in the indentures relating to the Capital Securities, and in whole or in part at any time contemporaneously with the optional redemption of the related Junior Subordinated Debentures in whole or in part. The Junior Subordinated Debentures are redeemable prior to their stated maturity dates at the Company’s option: (i) on or after the stated optional redemption dates, in whole at any time, or in part from time to time; or (ii) in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of one or more of the Events, in each case subject to possible regulatory approval. The redemption price of the Capital Securities and the related Junior Subordinated Debentures upon early redemption would be at the liquidation amount plus accumulated but unpaid distributions.

10. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank enters into agreements with customers to sell securities owned by the Bank to the customers and repurchase the identical security, within one business day. No physical movement of the securities is involved. The Bank had \$7.1 million and \$4.1 million in securities sold under agreement to repurchase at December 31, 2022 and December 31, 2021, respectively.

11. COMPREHENSIVE INCOME (LOSS)

The following tables display the components of other comprehensive income (loss), net of tax:

| | Balance at December 31, 2021 | Net Change (in thousands) | Balance at December 31, 2022 |
|--|---------------------------------|------------------------------|---------------------------------|
| Net unrealized loss on investment securities | \$ (3,160) | \$ (44,188) | \$ (47,348) |
| Net defined benefit pension plan adjustments | (2,511) | 581 | (1,930) |
| Total | <u>\$ (5,671)</u> | <u>\$ (43,607)</u> | <u>\$ (49,278)</u> |

| | Balance at December 31, 2020 | Net Change (in thousands) | Balance at December 31, 2021 |
|---|---------------------------------|------------------------------|---------------------------------|
| Net unrealized gain (loss) on investment securities | \$ 2,397 | \$ (5,557) | \$ (3,160) |
| Net defined benefit pension plan adjustments | (3,116) | 605 | (2,511) |
| Total | <u>\$ (719)</u> | <u>\$ (4,952)</u> | <u>\$ (5,671)</u> |

| | Balance at December 31, 2019 | Net Change (in thousands) | Balance at December 31, 2020 |
|--|---------------------------------|------------------------------|---------------------------------|
| Net unrealized gain on investment securities | \$ 522 | \$ 1,875 | \$ 2,397 |
| Net defined benefit pension plan adjustments | (3,105) | (11) | (3,116) |
| Total | <u>\$ (2,583)</u> | <u>\$ 1,864</u> | <u>\$ (719)</u> |

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| | 2022 | | |
|--|--------------------|--|--------------------|
| | Before-Tax Amount | Income Tax (Provision) Benefit (in thousands) | Net-of-Tax Amount |
| Unrealized loss on investment securities: | | | |
| Unrealized loss on investment securities | \$ (59,621) | \$ 15,433 | \$ (44,188) |
| Defined benefit pension plans adjustments: | | | |
| Net actuarial gain (loss) | \$ 481 | \$ (122) | \$ 359 |
| Reclassifications from accumulated other comprehensive income for gains (losses) | | | |
| Amortization of prior service cost | 31 | (9) | 22 |
| Amortization of actuarial loss | 274 | (74) | 200 |
| Net change | <u>786</u> | <u>(205)</u> | <u>581</u> |
| Other Comprehensive Income (Loss) | <u>\$ (58,835)</u> | <u>\$ 15,228</u> | <u>\$ (43,607)</u> |

| | 2021 | | |
|--|-------------------|--|-------------------|
| | Before-Tax Amount | Income Tax (Provision) Benefit (in thousands) | Net-of-Tax Amount |
| Unrealized loss on investment securities: | | | |
| Unrealized loss on investment securities | \$ (7,508) | \$ 1,951 | \$ (5,557) |
| Defined benefit pension plans adjustments: | | | |
| Net actuarial gain (loss) | \$ 404 | \$ (102) | \$ 302 |
| Reclassifications from accumulated other comprehensive income for gains (losses) | | | |
| Amortization of prior service cost | 31 | (8) | 23 |
| Amortization of actuarial loss | 383 | (103) | 280 |
| Net change | <u>818</u> | <u>(213)</u> | <u>605</u> |
| Other Comprehensive Income (Loss) | <u>\$ (6,690)</u> | <u>\$ 1,738</u> | <u>\$ (4,952)</u> |

| | 2020 | | |
|--|-------------------|--|-------------------|
| | Before-Tax Amount | Income Tax (Provision) Benefit (in thousands) | Net-of-Tax Amount |
| Unrealized gain on investment securities: | | | |
| Unrealized gain on investment securities | \$ 3,201 | \$ (832) | \$ 2,369 |
| Reclassification from accumulated other comprehensive income for losses | (667) | 173 | (494) |
| Net change | 2,534 | (659) | 1,875 |
| Defined benefit pension plans adjustments: | | | |
| Net actuarial (loss) gain | \$ (492) | \$ 128 | \$ (364) |
| Reclassifications from accumulated other comprehensive income for gains (losses) | | | |
| Amortization of prior service cost | 31 | (8) | 23 |
| Amortization of actuarial loss | 446 | (116) | 330 |
| Net change | <u>(15)</u> | <u>4</u> | <u>(11)</u> |
| Other Comprehensive Income (Loss) | <u>\$ 2,519</u> | <u>\$ (655)</u> | <u>\$ 1,864</u> |

12. EMPLOYEE BENEFITS AND DEFERRED COMPENSATION PLANS

Employees' Pension Plan

The Bank has a defined benefit pension plan that covered substantially all employees of the Company and its subsidiaries (the "Pension Plan"). The Pension Plan provides benefits that are based on the employees' compensation and years of service. The Bank uses an actuarial method of amortizing prior service cost and unrecognized net gains or losses which result from actual experience and assumptions being different than those that are projected. The amortization method the Bank uses recognizes the prior service cost and net gains or losses over the average remaining service period of active employees which exceeds the required amortization. The Pension Plan was frozen effective January 31, 2008. Under the freeze, eligible employees will receive the benefits already earned through January 31, 2008 at retirement, but will not be able to accrue any additional benefits. As a result, service cost will no longer be incurred.

Selected Financial Information for the Pension Plan is as follows:

| | <u>2022</u> | <u>2021</u> |
|--|-----------------|-----------------|
| Change in benefit obligation: | | (in thousands) |
| Benefit obligation at the beginning of the year | \$ 6,551 | \$ 6,837 |
| Service cost | - | - |
| Interest cost | 179 | 165 |
| Assumption change | (1,613) | (297) |
| Actuarial loss | 49 | 85 |
| Benefits paid | (254) | (239) |
| Benefit obligation at the end of the year | <u>4,912</u> | <u>6,551</u> |
| Change in plan assets: | | |
| Fair value of plan assets at the beginning of year | 6,536 | 6,583 |
| Actual return on plan assets | (1,284) | 192 |
| Employer contributions | - | - |
| Benefits paid | (254) | (239) |
| Fair value of plan assets at the end of year | <u>4,998</u> | <u>6,536</u> |
| Funded status | \$ 86 | \$ (15) |
| Amount recognized in the Consolidated Balance Sheets consist of: | | |
| Accrued benefit liabilities | <u>\$ 86</u> | <u>\$ (15)</u> |
| Amount recognized in the Accumulated Other Comprehensive Loss consists of: | | |
| Net actuarial loss | \$ 2,229 | \$ 2,254 |
| Prior service cost | - | - |
| Net amount recognized in equity - pre-tax | <u>\$ 2,229</u> | <u>\$ 2,254</u> |
| Accumulated benefit obligation at year end | <u>\$ 4,912</u> | <u>\$ 6,551</u> |

Assumptions used by the Bank in the determination of Pension Plan information consisted of the following:

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|--|-------------|-------------|-------------|
| Discount rate for projected benefit obligation | 5.22 % | 2.77 % | 2.42 % |
| Discount rate for net periodic pension cost | 2.77 % | 2.42 % | 3.20 % |
| Rate of increase in compensation levels | - % | - % | - % |
| Expected long-term rate of return of plan assets | 5.50 % | 5.50 % | 5.50 % |

The components of net periodic benefit cost consisted of the following:

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|--------------------------------|----------------|----------------|----------------|
| | | (in thousands) | |
| Service cost | \$ - | \$ - | \$ - |
| Interest cost | 179 | 165 | 200 |
| Expected return on plan assets | (353) | (356) | (325) |
| Net amortization and deferral | 97 | 100 | 96 |
| Net periodic benefit cost | <u>\$ (77)</u> | <u>\$ (91)</u> | <u>\$ (29)</u> |

The components of net periodic benefit cost other than the service cost component are included in the line item “other expense” in the income statement.

The Company did not contribute to the Pension Plan in 2022 and expects that it will not contribute to the Pension Plan in 2023.

The expected long-term rate of return on Pension Plan assets assumption was determined based on historical returns earned by equity and fixed income securities, adjusted to reflect future return expectations based on plan targeted asset allocation. Equity and fixed income securities were assumed to earn returns in the ranges of 4.5% to 11% and 4% to 5%, respectively. When these overall return expectations are applied to the Pension Plan’s targeted allocation, the expected rate of return was determined to be 5.50%, which is within the range of expected return. The Company’s management will continue to evaluate its actuarial assumptions, including the expected rate of return, at least annually, and will adjust as necessary.

The weighted average asset allocation of the Pension Plan at December 31, 2022 and 2021, the Pension Plan measurement date, was as follows:

| Asset Category: | <u>2022</u> | <u>2021</u> |
|-----------------------------|-----------------|-----------------|
| Equity mutual funds | 35.29 % | 33.81 % |
| Fixed income mutual funds | 63.70 % | 63.40 % |
| Cash/Short-term investments | 1.01 % | 2.79 % |
| | <u>100.00 %</u> | <u>100.00 %</u> |

The portfolio is invested in accordance with sound investment practices. Consistent with this approach, the investment strategy is to diversify the portfolio in order to reduce risk and to maintain sufficient liquidity to meet the obligations of the Plan. The Plan’s long-term asset allocation under normal market conditions is 34% equity investment and 66% fixed income assets and other short term investments and cash equivalents. The investment objective of the allocation in equity investments emphasizes long term capital appreciation. These equity investments are diversified across market capitalization, industries, style and geographical location. The investment objective of the fixed income allocation is to generally provide a diversified source of income with an awareness of capital preservation. The primary objective of the investment philosophy is capital preservation.

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The major categories of assets in the Bank's Pension Plan as of year-end are presented in the following table. Assets are segregated according to their investment objective by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (see Note 20 – Fair Value of Financial Instruments).

| | 2022 | 2021 |
|-------------------------|-----------------|-----------------|
| | (in thousands) | |
| Level 1: | | |
| Cash | \$ - | \$ 22 |
| Mutual funds: | | |
| Short-term investments: | | |
| Money market | 50 | 160 |
| Fixed Income: | 3,314 | 4,144 |
| Equities: | | |
| Small cap | 255 | - |
| Mid-Cap | 151 | - |
| Large cap | 794 | 920 |
| International large cap | 434 | 1,290 |
| | <u>\$ 4,998</u> | <u>\$ 6,536</u> |

The mutual funds are actively traded with market quotes available on at least a daily basis. Therefore, they are Level 1 assets.

The discount rate utilized by the Company for determining future pension obligations is based on a review of long-term bonds that receive one of the two highest ratings given by a recognized rating agency. The discount rate determined on this basis increased from 2.77% at December 31, 2021 to 5.22% at December 31, 2022 for the Company's Pension Plan.

Expected benefit payments under the Pension Plan over the next ten years at December 31, 2022 are as follows:

| | (in thousands) |
|------------------|----------------|
| 2023 | \$ 302 |
| 2024 | 336 |
| 2025 | 337 |
| 2026 | 342 |
| 2027 | 337 |
| Year 2028 - 2032 | 1,728 |

Supplemental Executive Retirement Plans

The Bank also maintains a non-qualified supplemental executive retirement plan (the "SERP") covering certain members of the Company's senior management. The SERP was amended during 2003 to provide a benefit based on a percentage of final average earnings, as opposed to the fixed benefit that was provided for in the superseded plan.

On April 8, 2010, the Compensation Committee of the Board of Directors of the Company approved the adoption of the Evans Bank, N.A. Supplemental Executive Retirement Plan for Senior Executives ("the Senior Executive SERP"). The "old" SERP plan will keep its participants at the time of the creation of the Senior Executive SERP, but any future executives identified by the Board of Directors as eligible for SERP benefits will participate in the Senior Executive SERP. A participant is generally entitled to receive a benefit under the Senior Executive SERP upon a termination of employment, other than for "cause", after the participant has completed 10 full calendar years of service with the Bank. No benefit is payable under the Senior Executive SERP if the participant's employment is terminated for "cause" or if the participant voluntarily terminates before completing 10 full calendar years of service with the Bank. In addition, the payment of benefits under the Senior Executive SERP is conditioned upon certain agreements of the participant related to confidentiality, cooperation, non-competition, and non-solicitation. A participant will be entitled to a retirement benefit under the Senior Executive SERP if his or her employment with the Bank terminates other than for "cause". The "accrued benefit" is based on a percentage of the participant's final average earnings, which is determined based upon the participant's total annual compensation over the highest consecutive five calendar years of the participant's employment with the Bank, accrued over the participant's "required

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benefit service”. The percentages and years of service requirements are set forth in each participant’s Participation Agreement, and range from 25% to 35% and from 15 to 20 years.

The obligations related to the two SERP plans are indirectly funded by various life insurance contracts naming the Bank as beneficiary. The Bank has also indirectly funded the SERPs, as well as other benefits provided to other employees, through bank-owned life insurance. The Bank uses an actuarial method of amortizing unrecognized net gains or losses which result from actual experience and assumptions being different than those that are projected. The amortization method the Bank is using recognizes the net gains or losses over the average remaining service period of active employees, which exceeds the required amortization.

Selected financial information for the two SERP plans is as follows:

| | <u>2022</u> | <u>2021</u> |
|--|-------------------|-------------------|
| Change in benefit obligation: | (in thousands) | |
| Benefit obligation at the beginning of the year | \$ 5,754 | \$ 6,148 |
| Service cost | 131 | 148 |
| Interest cost | 124 | 100 |
| Actuarial gain | (553) | (357) |
| Benefits paid | (408) | (285) |
| Benefit obligation at the end of the year | <u>5,048</u> | <u>5,754</u> |
| Change in plan assets: | | |
| Fair value of plan assets at the beginning of year | - | - |
| Actual return on plan assets | - | - |
| Employer contributions | 408 | 285 |
| Benefits paid | (408) | (285) |
| Fair value of plan assets at the end of year | <u>-</u> | <u>-</u> |
| Funded status | \$ (5,048) | \$ (5,754) |
| Amount recognized in the Consolidated Balance Sheets consist of: | | |
| Accrued benefit liabilities | <u>\$ (5,048)</u> | <u>\$ (5,754)</u> |
| Amount recognized in the Accumulated Other Comprehensive Loss consists of: | | |
| Net actuarial loss | \$ 376 | \$ 1,106 |
| Prior service cost | - | 31 |
| Net amount recognized in equity - pre-tax | <u>\$ 376</u> | <u>\$ 1,137</u> |
| Accumulated benefit obligation at year end | <u>\$ 4,922</u> | <u>\$ 5,591</u> |

Assumptions used by the Bank in the determination of SERP information consisted of the following:

| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
|--|-------------|-------------|-------------|
| Discount rate for projected benefit obligation | 5.10 % | 2.23 % | 1.66 % |
| Discount rate for net periodic pension cost | 2.23 % | 1.66 % | 2.72 % |
| Salary scale | 3.00 % | 3.00 % | 3.00 % |

The discount rate utilized by the Company for determining future pension obligations is based on a review of long-term bonds that receive one of the two highest ratings given by a recognized rating agency. The discount rate determined on this basis increased from 2.23% at December 31, 2021 to 5.10% at December 31, 2022 (i.e. the measurement date) for the SERP.

The components of net periodic benefit cost consisted of the following:

| | <u>2022</u> | <u>2021</u> (in thousands) | <u>2020</u> |
|-------------------------------|---------------|-------------------------------|---------------|
| Service cost | \$ 131 | \$ 148 | \$ 155 |
| Interest cost | 124 | 100 | 151 |
| Net amortization and deferral | 209 | 314 | 381 |
| Net periodic benefit cost | <u>\$ 464</u> | <u>\$ 562</u> | <u>\$ 687</u> |

Expected benefit payments under the SERP over the next ten years at December 31, 2022 are as follows:

| | (in thousands) |
|------------------|----------------|
| 2023 | \$ 285 |
| 2024 | 3,009 |
| 2025 | 285 |
| 2026 | 285 |
| 2027 | 285 |
| Year 2028 - 2032 | 1,026 |

Other Compensation Plans

The Company has a non-qualified deferred compensation plan whereby directors and certain officers may defer a portion of their base pre-tax compensation. Additionally, the Company has a non-qualified executive incentive retirement plan, whereby the Company defers on behalf of certain officers a portion of their base compensation until retirement or termination of service, subject to certain vesting arrangements. Aggregate expense under these plans was approximately \$0.2 million in 2022 and 2021, and \$0.1 million in 2020. The benefit obligation, included in other liabilities in the Company's consolidated balance sheets, was \$1.9 million at December 31, 2022 and 2021 respectively.

These benefit plans are indirectly funded by bank-owned life insurance contracts with a total aggregate cash surrender value of approximately \$41.8 million and \$34.3 million at December 31, 2022 and 2021, respectively. Increases in cash surrender value are included in other non-interest income on the Company's Consolidated Statements of Income. Endorsement split-dollar life insurance benefits have also been provided to directors and certain officers of the Bank and its subsidiaries during employment.

The Company acquired a deferred compensation plan from FSB during 2020 which requires the Company to make scheduled payments to the participants. At December 31, 2022, this plan consisted of one participant that receives \$5 thousand monthly payments through June 2033. The benefit obligation, included in other liabilities in the Company's consolidated balance sheets, was \$0.7 million at December 31, 2022.

The Company also has a defined contribution retirement and thrift 401(k) Plan (the "401(k) Plan") for its employees who meet certain length of service and age requirements. The provisions of the 401(k) Plan allow eligible employees to contribute a portion of their annual salary, up to the IRS statutory limit. The 401(k) plan includes a Qualified Automatic Contribution Arrangement ("QACA"). This arrangement features automatic deferred contributions with annual escalation, a QACA matching contribution, and an additional matching contribution. Employees vest in employer contributions over six years. The Company's expense under the 401(k) Plan was approximately \$1.4 million in both 2022 and 2021, and \$1.2 million in 2020.

13. STOCK-BASED COMPENSATION

At December 31, 2022, the Company had two stock-based compensation plans, which are described below. The compensation cost charged against income for those plans was \$0.9 million in 2022, \$0.7 million in 2021, and \$0.6 million in 2020, and is included in “Salaries and Employee Benefits” in the Company’s Consolidated Statements of Income. All stock option and restricted stock expense is recorded on a straight-line basis over the requisite service period. In addition, expenses for director stock-based compensation were recognized to reflect \$0.2 million in 2022, \$0.2 million in 2021, and \$0.3 million in 2020, as part of “Other” expense in the Company’s Consolidated Statements of Income.

2019 Long-Term Equity Incentive Plan

Under the Company’s 2019 Long-Term Equity Incentive Plan (the “2019 Plan”) and, prior to the adoption of the 2019 Plan by shareholders in April 2019, under the Company’s 2009 Long-Term Incentive Plan (the “2009 Plan” and together with the 2019 Plan, the “Equity Plans”), the Company has granted options or restricted stock to officers, directors and key employees of the Company and its subsidiaries. Under the Equity Plans, the Company was authorized to issue up to 603,883 shares of common stock. Under the Equity Plans, the exercise price of each option is not to be less than 100% of the market price of the Company’s stock on the date of grant and an option’s maximum term is ten years. If available, the Company normally issues shares out of its treasury for any options exercised or restricted shares issued. The options have vesting schedules from 12 months through 5 years. At December 31, 2022, there were a total of 194,752 shares available for grant under the 2019 Plan. The Company may no longer make grants under the 2009 Plan.

The fair value of 2021 and 2020 option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions. There were no options granted during 2022:

| | 2022 | 2021 | 2020 |
|-----------------------------|------|---------|---------|
| Dividend Yield | - | 3.07 % | 4.55 % |
| Expected Life (years) | - | 7.18 | 7.09 |
| Expected Volatility | - | 27.54 % | 26.64 % |
| Risk-free Interest Rate | - | 1.51 % | 0.63 % |
| Weighted Average Fair Value | \$ - | \$ 7.80 | \$ 3.41 |

The Company used historical volatility calculated using daily closing prices for its common stock over periods that match the expected term of the option granted to estimate the expected volatility. The risk-free interest rate assumption was based upon U.S. Treasury yields appropriate for the expected term of the Company’s stock options based upon the date of grant. The expected dividend yield was based upon the Company’s recent history of paying dividends. The expected life was based upon the options’ expected vesting schedule and historical exercise patterns.

Stock options activity for 2022 was as follows:

| | Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|--------------------------------|----------|---------------------------------|---|--|
| Balance, December 31, 2021 | 232,643 | \$ 29.77 | | |
| Granted | - | - | | |
| Exercised | (34,764) | 20.64 | | |
| Expired | (3,279) | 39.71 | | |
| Forfeited | (956) | 36.12 | | |
| Balance, December 31, 2022 | 193,644 | \$ 31.21 | 4.97 | \$ 1,421 |
| Exercisable, December 31, 2022 | 151,220 | \$ 31.13 | 4.15 | \$ 1,150 |

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Future compensation cost expected to be expensed over the weighted average remaining contractual term for remaining outstanding options is \$0.1 million. The unrecognized compensation cost is scheduled to be recognized as follows:

| | (in thousands) |
|------|----------------|
| 2023 | \$ 48 |
| 2024 | 40 |
| 2025 | 35 |

Restricted stock award, unit, and performance unit activity for 2022 was as follows:

| | Shares | Weighted Average Grant Date Fair Value |
|----------------------------|----------|--|
| Balance, December 31, 2021 | 40,974 | \$ 32.79 |
| Granted | 33,017 | 39.21 |
| Vested | (20,978) | 33.00 |
| Forfeited | (2,469) | 38.49 |
| Balance, December 31, 2022 | 50,544 | \$ 36.62 |

As of December 31, 2022, there was \$1.3 million in unrecognized compensation cost related to restricted share-based compensation arrangements granted under the Equity Plans. The unrecognized compensation cost is scheduled to be recognized as follows:

| | (in thousands) |
|------|----------------|
| 2023 | \$ 655 |
| 2024 | 391 |
| 2025 | 235 |

During fiscal years 2022, 2021, and 2020, the following activity occurred under the Company's plans:

| | 2022 | 2021 | 2020 |
|--|--------|----------------|--------|
| | | (in thousands) | |
| Total intrinsic value of stock options exercised | \$ 621 | \$ 488 | \$ 206 |
| Total fair value of restricted stock awards vested | \$ 828 | \$ 701 | \$ 577 |

Employee Stock Purchase Plan

The Company also maintains the Evans Bancorp, Inc. Employee Stock Purchase Plan (the "Purchase Plan"). As of December 31, 2022, there were 48,081 shares of common stock available to issue to full-time employees of the Company and its subsidiaries, nearly all of whom are eligible to participate. Under the terms of the Purchase Plan, employees can choose each year to have up to 15% of their annual base earnings withheld to purchase the Company's common stock. Employees can purchase stock only on June 30 and December 31 each year during the term of the Purchase Plan for 85% of the price on the purchase date. Under the Purchase Plan, the Company issued 12,730, 12,166, and 19,434 shares to employees in 2022, 2021, and 2020, respectively. Compensation cost is calculated by the value of the 15% discount only. The compensation cost that was charged against income for the Purchase Plan was less than \$0.1 million in 2022, 2021, and 2020.

14. INCOME TAXES

The components of the provision for income taxes were as follows:

| | 2022 | 2021 | 2020 |
|--|-----------------|-----------------|-----------------|
| | (in thousands) | | |
| Current federal tax expense | \$ 5,472 | \$ 4,951 | \$ 2,283 |
| Current state tax expense | 1,440 | 1,412 | 1,131 |
| Total current tax expense | 6,912 | 6,363 | 3,414 |
| Deferred federal tax expense (benefit) | \$ 153 | \$ 1,165 | \$ (1,356) |
| Deferred state tax expense (benefit) | 98 | 355 | (496) |
| Total deferred tax expense (benefit) | 251 | 1,520 | (1,852) |
| Total income tax provision | <u>\$ 7,163</u> | <u>\$ 7,883</u> | <u>\$ 1,562</u> |

The Company's provision for income taxes differs from the amounts computed by applying the federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

| | 2022 | | 2021 | | 2020 | |
|-------------------------------------|-----------------|-------------|-----------------|-------------|-----------------|-------------|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| | (in thousands) | | | | | |
| Tax provision at statutory rate | \$ 6,206 | 21 % | \$ 6,704 | 21 % | \$ 2,690 | 21 % |
| Change in taxes resulting from: | | | | | | |
| Tax-exempt income | (224) | (1) | (230) | - | (203) | (2) |
| Historic tax credit | - | - | (24) | - | (1,643) | (13) |
| State taxes, net of federal benefit | 1,215 | 4 | 1,396 | 4 | 502 | 4 |
| Other items, net | (34) | - | 37 | - | 216 | 2 |
| Income tax provision | <u>\$ 7,163</u> | <u>24 %</u> | <u>\$ 7,883</u> | <u>25 %</u> | <u>\$ 1,562</u> | <u>12 %</u> |

In 2020, the Company recognized significant impact from its investments in partnerships that incurred expenses related to the rehabilitation of certified historic structures located in New York State after the historic structures were placed in service. At the time a historic structure is placed in service, the Bank is eligible for a federal and New York State tax credit. For New York State, any new credit earned from rehabilitated historic properties placed in service on or after January 1, 2015 not used in the current tax year will be treated as a refund or overpayment of tax to be credited to the next year's tax. Since the realization of the tax credit does not depend on the Bank's generation of future taxable income or the Bank's ongoing tax status or tax position, the refund is not considered an element of income tax accounting. In such cases, the Bank would not record the credit as a reduction of income tax expense; rather, the Bank includes the refundable New York State tax credit in non-interest income with a corresponding receivable recorded in other assets. There were no significant historic tax credit transactions during 2022 and 2021.

The following table presents the impact on the results of operations from the Bank's historic tax credit activity for the years ended December 31, 2022, 2021 and 2020.

| | 2022 | 2021 | 2020 |
|--------------------------------------|-------------|--------------|-----------------|
| Loss on tax credit investment | \$ - | \$ (30) | \$ (2,475) |
| Refundable state historic tax credit | - | 21 | 1,857 |
| Income tax benefit | - | 24 | 1,643 |
| Total HTC income | <u>\$ -</u> | <u>\$ 15</u> | <u>\$ 1,025</u> |

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At December 31, 2022 and 2021 the components of the net deferred tax asset were as follows:

| | 2022 | 2021 |
|---|------------------|------------------|
| | (in thousands) | |
| Deferred tax assets: | | |
| Pension and SERP plans | \$ 1,456 | \$ 1,687 |
| Allowance for loan and lease losses | 4,987 | 4,744 |
| Deferred compensation | 526 | 576 |
| Loss on investment in tax credit | 59 | 135 |
| Stock options granted | 277 | 193 |
| State tax credit carryforward | 185 | 185 |
| Lease liabilities | 1,223 | 1,353 |
| State net operating loss | 368 | 387 |
| Net unrealized losses on securities | 16,543 | 1,109 |
| Fair value adjustments of business combinations | 470 | 623 |
| Other | 33 | 29 |
| Gross deferred tax assets | <u>\$ 26,127</u> | <u>\$ 11,021</u> |
| Deferred tax liabilities: | | |
| Depreciation and amortization | \$ 1,154 | \$ 1,187 |
| Right of use assets | 1,137 | 1,254 |
| Prepaid expenses | 382 | 308 |
| Deferred loan fees and costs | 279 | 161 |
| Mortgage servicing asset | 295 | 238 |
| Other | 30 | - |
| Gross deferred tax liabilities | <u>\$ 3,277</u> | <u>\$ 3,148</u> |
| Net deferred tax asset | <u>\$ 22,850</u> | <u>\$ 7,873</u> |

The net deferred tax asset at December 31, 2022 and 2021 is included in “other assets” in the Company’s consolidated balance sheets.

In assessing the ability of the Company to realize the benefit of the deferred tax assets, management considers whether it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized, including assessing all positive and negative evidence and the weight of such evidence. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, availability of operating loss carrybacks, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income, the opportunity for net operating loss carrybacks, and projections for future taxable income over the periods which deferred tax assets are deductible, management believes it is more likely than not that the Company will generate sufficient taxable income to realize the benefits of these deductible differences at December 31, 2022.

The state tax credit carryforward has an indefinite life with no expiration date in which to utilize the credit.

The Company did not have any unrecognized tax benefits for the years ended December 31, 2022, 2021, and 2020.

Accrued penalties and interest were immaterial at December 31, 2022 and 2021.

The Company is subject to routine audits of its tax returns by the Internal Revenue Service (“IRS”) and various state taxing authorities. The tax years 2019-2021 remain subject to examination by the IRS.

15. REVENUE RECOGNITION OF NON-INTEREST INCOME

A description of the Company’s material revenue streams in non-interest income accounted for under ASC 606 follows:

Insurance Service and Fees: Insurance services revenue relates to various revenue streams from services provided by TEA and the Bank:

- TEA earns commission revenue from selling commercial and personal property and casualty (“P&C”) insurance as well as employee benefits (“EB”) solutions to commercial customers.

TEA has agreements with various insurance companies to sell policies to customers on behalf of the carriers. The performance obligation for TEA is to sell annual P&C policies to commercial customers and consumers. This performance obligation is met when a new policy is sold or when an existing policy renews. The policies are generally one year terms. In the agreements with the respective insurance companies, a commission rate is agreed upon. The commission is recognized at the time of the sale of the policy or when a policy renews.

TEA has signed contracts with insurance carriers that enable TEA to sell benefit plans to commercial customers on behalf of the insurance carriers. The performance obligation for TEA is to sell the plans to commercial customers. After the initial sale when the customer signs an agreement to purchase the offered benefit plan, the performance obligation is met each month when a customer continues utilizing benefit plans from the carrier. The customer does not commit to a specific length of time with the carrier. In the agreements with the respective insurance companies, a commission rate is agreed upon. Revenue is recognized each month when the customer continues with the benefit plan sold by TEA.

- TEA also earns contingent profit sharing revenue. The insurance companies measure the loss ratio for TEA’s customers and pay TEA according to how profitable TEA customers are.

TEA has signed written agreements with insurance carriers that document payouts to TEA based on the loss ratios of its customers. The performance obligation for TEA is to maintain a customer base with loss ratios below the agreed upon thresholds. In the contracts with the insurance companies, payout rates based on loss ratios are documented. The consideration is variable as loss ratios vary based on customer experience. TEA’s performance obligation is over the course of the year as its customers’ performance with insurance carriers is measured throughout the year as losses occur. Due to the variable nature of contingent profit sharing revenue, TEA will accrue contingent profit sharing revenue throughout the year based on recent historical results. As loss events occur and overall performance becomes known to TEA, accrual adjustments will be made until the cash is ultimately received.

- Financial services commission revenue from the Bank related to wealth management such as life insurance, annuities, and mutual funds sales is also included in the “insurance service and fees” line of the income statement.

The Company earns wealth management fees from its contracts with customers for certain financial services. Fees that are transaction-based are recognized at the point in time that the transaction is executed. Other related services provided include financial planning services and the fees the Bank earns are recognized when the services are rendered.

- Insurance claims services revenue is recorded at Frontier Claims Services, Inc. (“FCS”).

FCS has signed agreements with insurance companies to perform claims services including investigative and adjustment services related to residential and commercial lines. The performance obligation is for FCS to investigate the insurance claims and inspecting the damage to determine the extent of the insurance company’s liability. FCS is paid based on time and materials expended to investigate the claim. The rates paid are determined in the agreement between FCS and the respective insurance companies. Upon completion of its claims inspection work, FCS bills the insurance company for services rendered and recognizes the revenue earned. FCS discontinued operations on December 31, 2021.

A disaggregation of the total insurance service and other fees at December 31, 2022, 2021, and 2020:

| | 2022 | 2021 | 2020 |
|--|------------------|------------------|------------------|
| | | (in thousands) | |
| Commercial property and casualty insurance commissions | \$ 4,308 | \$ 3,993 | \$ 4,023 |
| Personal property and casualty insurance commissions | 3,363 | 3,288 | 3,388 |
| Employee benefits sales commissions | 851 | 902 | 1,173 |
| Profit sharing and contingent revenue | 1,164 | 1,198 | 1,077 |
| Wealth management and other financial services | 632 | 638 | 516 |
| Insurance claims services revenue | - | 285 | 292 |
| Other insurance-related revenue | 135 | 153 | 141 |
| Total insurance service and other fees | <u>\$ 10,453</u> | <u>\$ 10,457</u> | <u>\$ 10,610</u> |

Service charges on deposit accounts

The Company earns fees from its deposit customers for transaction-based, account maintenance and overdraft. 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 customer'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. Similarly, overdraft fees are recognized at the point in time that the overdraft occurs as this corresponds with the Company's performance obligation. Service charges on deposit accounts are withdrawn from the customer's account balance.

Interchange fee income

The Company earns interchange fees from cardholder transactions conducted through the Mastercard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized concurrent with the transaction processing services provided to the cardholder. Interchange income is presented on the Consolidated Statements of Income net of expenses.

16. RELATED PARTY TRANSACTIONS

The Bank has entered into loan transactions with certain directors, executive officers, significant shareholders and their affiliates (related parties) in the ordinary course of its business. The aggregate outstanding principal balance of loans to such related parties on December 31, 2022 and 2021 was \$0.9 million and \$1.7 million, respectively. During 2022, there were \$7.3 million of advances and new loans to such related parties, and repayments amounted to \$8.1 million. Deposits from related parties were \$4.3 million and \$2.6 million as of December 31, 2022 and 2021, respectively.

17. CONTINGENT LIABILITIES AND COMMITMENTS

The Company's consolidated financial statements do not reflect various commitments and contingent liabilities which arise in the normal course of business and which involve elements of credit risk, interest rate risk, and liquidity risk. These commitments and contingent liabilities are commitments to extend credit and standby letters of credit. A summary of the Bank's commitments and contingent liabilities at December 31, 2022 and 2021 is as follows:

| | <u>December 31,</u> <u>2022</u> | | <u>December 31,</u> <u>2021</u> |
|------------------------------|------------------------------------|-----------|------------------------------------|
| | (in thousands) | | |
| Commitments to extend credit | \$ 376,167 | \$ | 394,953 |
| Standby letters of credit | 3,673 | | 4,636 |
| Total | <u>\$ 379,840</u> | <u>\$</u> | <u>399,589</u> |

Commitments to extend credit and standby letters of credit all include exposure to some credit loss in the event of non-performance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extensions of credit that are recorded on the Consolidated Balance Sheets. Because these instruments have fixed maturity dates, and because they may expire without being drawn upon, they do not necessarily represent cash requirements to the Bank. The Bank has not incurred any losses on its commitments during the past three years and has not recorded a reserve for its commitments.

The Company has entered into contracts with third parties, some of which include indemnification clauses. Examples of such contracts include contracts with third-party service providers, brokers and dealers, correspondent banks, and purchasers of residential mortgages. Additionally, the Company has bylaws, policies, and agreements under which it agrees to indemnify its officers and directors from liability for certain events or occurrences while the directors or officers are, or were, serving at the Company's request in such capacities. The Company indemnifies its officers and directors to the fullest extent allowed by law. The maximum potential amount of future payments that the Company could be required to make under these indemnification provisions is unlimited, but would be affected by all relevant defenses to such claims, as well as directors' and officers' liability insurance maintained by the Company. Due to the nature of these indemnification provisions, it is not possible to quantify the aggregate exposure to the Company resulting from them.

Certain lending commitments for construction residential mortgage loans are considered derivative instruments under the guidelines of GAAP. The changes in the fair value of these commitments, due to interest rate risk, are not recorded on the consolidated balance sheets as the fair value of these derivatives is not considered to be material.

The Company leases certain offices, land and equipment under long-term operating leases. The aggregate minimum annual rental commitments under these leases total approximately \$1.1 million in 2023, \$0.9 million 2024, \$0.7 million 2025, \$0.7 million in 2026, \$0.4 million in 2027 and \$1.4 million thereafter. The rental expense under operating leases contained in the Company's Consolidated Statements of Income was \$1.1 million in 2022, \$1.1 million in 2021, and \$1.0 million in 2020.

18. CONCENTRATIONS OF CREDIT

All of the Bank's loans, commitments, and standby letters of credit have been granted to customers in the Bank's primary market areas of the Western New York and the Finger Lakes Region of New York State. Investments in state and municipal securities also involve governmental entities within the Bank's primary market area. The concentrations of credit by type of loan are set forth in Note 4 to these Consolidated Financial Statements, "Loans and the Allowance for Loan Losses." The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit were granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit to any single borrower or group in excess of 15% of capital.

19. SEGMENT INFORMATION

The Company is comprised of two primary business segments: banking activities and insurance agency activities. The operating segments are separately managed and their performance is evaluated based on net income. The banking business segment includes both commercial and consumer banking services, including a wide array of lending and depository services as well as offering non-deposit investment products, such as annuities and mutual funds. The insurance agency segment includes the activities of selling various premium-based insurance policies on a commission basis, including business and personal insurance, employee benefits, surety bonds, risk management, life, disability and long-term care coverage, as well as providing claims adjusting services to various insurance companies. All sources of segment specific revenues and expenses contributed to management's definition of net income. Revenues from transactions between the two segments are not significant.

The following tables set forth information regarding these segments for the years ended December 31, 2022, 2021, and 2020.

| | 2022 | | |
|---|--------------------|---|-----------|
| | Banking Activities | Insurance Agency Activities (in thousands) | Total |
| Net interest income | \$ 72,955 | \$ - | \$ 72,955 |
| Provision for loan losses | 2,739 | - | 2,739 |
| Net interest income after provision for loan losses | 70,216 | - | 70,216 |
| Insurance service and fees | 616 | 9,837 | 10,453 |
| Other non-interest income | 8,818 | - | 8,818 |
| Amortization expense | 19 | 381 | 400 |
| Other non-interest expense | 52,119 | 7,416 | 59,535 |
| Income before income taxes | 27,512 | 2,040 | 29,552 |
| Income tax provision | 6,636 | 527 | 7,163 |
| Net income | \$ 20,876 | \$ 1,513 | \$ 22,389 |

| | 2021 | | |
|--|--------------------|---|-----------|
| | Banking Activities | Insurance Agency Activities (in thousands) | Total |
| Net interest income | \$ 72,785 | \$ - | \$ 72,785 |
| Credit for loan losses | (1,513) | - | (1,513) |
| Net interest income after credit for loan losses | 74,298 | - | 74,298 |
| Insurance service and fees | 580 | 9,877 | 10,457 |
| Other non-interest income | 8,136 | 254 | 8,390 |
| Amortization expense | 21 | 516 | 537 |
| Other non-interest expense | 52,843 | 7,839 | 60,682 |
| Income before income taxes | 30,150 | 1,776 | 31,926 |
| Income tax provision | 7,421 | 462 | 7,883 |
| Net income | \$ 22,729 | \$ 1,314 | \$ 24,043 |

| | 2020 | | |
|--|-----------------------|--|------------------|
| | Banking Activities | Insurance Agency Activities (in thousands) | Total |
| Net interest income (expense) | \$ 59,793 | \$ (11) | \$ 59,782 |
| Provision for loan losses | 5,351 | - | 5,351 |
| Net interest income (expense) after provision for loan losses | 54,442 | (11) | 54,431 |
| Insurance service and fees | 488 | 10,122 | 10,610 |
| Other non-interest income | 7,623 | 4 | 7,627 |
| Amortization expense | 15 | 518 | 533 |
| Other non-interest expense | 51,322 | 8,005 | 59,327 |
| Income before income taxes | 11,216 | 1,592 | 12,808 |
| Income tax provision | 1,143 | 419 | 1,562 |
| Net income | <u>\$ 10,073</u> | <u>\$ 1,173</u> | <u>\$ 11,246</u> |

| | December 31, 2022 | December 31, 2021 |
|---------------------------------|----------------------|----------------------|
| | (in thousands) | |
| Identifiable Assets, Net | | |
| Banking activities | \$ 2,160,545 | \$ 2,192,348 |
| Insurance agency activities | 17,965 | 18,292 |
| Consolidated Total Assets | <u>\$ 2,178,510</u> | <u>\$ 2,210,640</u> |

20. FAIR VALUE OF ASSETS AND LIABILITIES

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

There are three levels of inputs to fair value measurements:

- Level 1 inputs are quoted prices for identical instruments in active markets;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs.

Observable market data should be used when available.

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those assets and liabilities which are measured at fair value on a recurring basis at December 31, 2022 and 2021:

| (in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|---------------------------------------|---------|------------|---------|------------|
| December 31, 2022 | | | | |
| Securities available-for-sale: | | | | |
| US treasuries and government agencies | \$ - | \$ 140,682 | \$ - | \$ 140,682 |
| States and political subdivisions | - | 21,822 | - | 21,822 |
| Mortgage-backed securities | - | 201,822 | - | 201,822 |
| December 31, 2021 | | | | |
| Securities available-for-sale: | | | | |
| US treasuries and government agencies | \$ - | \$ 96,818 | \$ - | \$ 96,818 |
| States and political subdivisions | - | 6,246 | - | 6,246 |
| Mortgage-backed securities | - | 202,895 | - | 202,895 |

Securities available for sale

Fair values for available for sale securities are determined using independent pricing services and market-participating brokers. The Company utilizes a third-party for these pricing services. The third-party utilizes evaluated pricing models that vary by asset class and incorporate available trade, bid and other market information for structured securities, cash flow and, when available, loan performance data. Because many fixed income securities do not trade on a daily basis, the third-party service provider's evaluated pricing applications apply information as applicable through processes, such as benchmarking of like securities, sector groupings, and matrix pricing, to prepare evaluations. In addition, our third-party pricing service provider uses model processes, such as the Option Adjusted Spread model, to assess interest rate impact and develop prepayment scenarios. The models and the process take into account market convention. For each asset class, a team of evaluators gathers information from market sources and integrates relevant credit information, perceived market movements and sector news into the evaluated pricing applications and models. The third-party, at times, may determine that it does not have sufficient verifiable information to value a particular security. In these cases the Company will utilize valuations from another pricing service.

On a quarterly basis the Company reviews changes, as submitted by our third-party pricing service provider, in the market value of its securities portfolio. Individual changes in valuations are reviewed for consistency with general interest rate movements and any known credit concerns for specific securities. Additionally, on a quarterly basis the Company has its entire securities portfolio priced by a second pricing service to determine consistency with another market evaluator. If, on the Company's review or in comparing with another servicer, a material difference between pricing evaluations were to exist, the Company may submit an inquiry to our third-party pricing service provider regarding the data used to value a particular security. If the Company determines it has market information that would support a different valuation than our third-party service provider's evaluation it can submit a challenge for a change to that security's valuation. There were no material differences in valuations noted in 2022 or 2021.

Securities available for sale are classified as Level 2 in the fair value hierarchy as the valuation provided by the third-party provider uses observable market data.

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements. The following table presents for each of the fair-value hierarchy levels as defined in this footnote, those assets and liabilities which are measured at fair value on a nonrecurring basis at December 31, 2022 and 2021:

| (in thousands) | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Fair Value</u> |
|-------------------------------------|----------------|----------------|----------------|-------------------|
| December 31, 2022 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 1,170 | \$ 1,170 |
| December 31, 2021 | | | | |
| Collateral dependent impaired loans | \$ - | \$ - | \$ 4,608 | \$ 4,608 |

Impaired loans

Collateral dependent loans carried at fair value have been partially charged-off or receive specific allocations of the allowance for credit losses. The Company evaluates and values collateral dependent impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral value has a unique appraisal and management's discount of the value is based on factors unique to each impaired loan. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan, which ranges from 10%-50%. Fair value is estimated based on the value of the collateral securing these loans. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

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The Company has an appraisal policy in which appraisals are obtained upon a commercial loan being downgraded on the Company's internal loan rating scale to a special mention or a substandard depending on the amount of the loan, the type of loan and the type of collateral. All impaired commercial loans are graded substandard or worse on the internal loan rating scale. For consumer loans, the Company obtains appraisals when a loan becomes 90 days past due or is determined to be impaired, whichever occurs first. Subsequent to the downgrade or reaching 90 days past due, if the loan remains outstanding and impaired for at least one year more, management may require another follow-up appraisal. Between receipts of updated appraisals, if necessary, management may perform an internal valuation based on any known changing conditions in the marketplace such as sales of similar properties, a change in the condition of the collateral, or feedback from local appraisers. Collateral dependent impaired loans had a gross value of \$1.5 million, with an allowance for loan loss of \$0.4 million, at December 31, 2022 compared with \$5.0 million and \$0.4 million, respectively, at December 31, 2021.

At December 31, 2022 and 2021, the estimated fair values of the Company's financial instruments, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis, were as follows:

| | December 31, 2022 | | December 31, 2021 | |
|---|-------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (in thousands) | | (in thousands) | |
| Financial assets: | | | | |
| Level 1: | | | | |
| Cash and cash equivalents | \$ 23,054 | \$ 23,054 | \$ 244,785 | \$ 244,785 |
| Level 2: | | | | |
| Available for sale securities | 364,326 | 364,326 | 305,959 | 305,959 |
| FHLB and FRB stock | 13,511 | N/A | 6,084 | N/A |
| Level 3: | | | | |
| Held to maturity securities | 6,949 | 6,809 | 3,165 | 3,179 |
| Loans, net | 1,652,931 | 1,564,641 | 1,553,467 | 1,573,420 |
| Financial liabilities: | | | | |
| Level 1: | | | | |
| Demand deposits | \$ 493,710 | \$ 493,710 | \$ 492,864 | \$ 492,864 |
| NOW deposits | 273,359 | 273,359 | 259,908 | 259,908 |
| Savings deposits | 801,943 | 801,943 | 1,019,925 | 1,019,925 |
| Level 2: | | | | |
| Securities sold under agreement to repurchase | 7,147 | 7,147 | 4,112 | 4,112 |
| Other borrowed funds | 193,001 | 192,443 | 32,879 | 32,990 |
| Subordinated debt | 31,075 | 30,263 | 30,974 | 32,111 |
| Level 3: | | | | |
| Time deposits | 202,667 | 199,910 | 164,340 | 164,574 |

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

FHLB and FRB stock

The carrying value of FHLB and FRB stock, which are non-marketable equity investments, approximates fair value.

Deposits

The fair value of demand deposits, NOW accounts, muni-vest accounts and regular savings accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated using the rates currently offered for deposits of similar remaining maturities.

Borrowed Funds and Securities Sold Under Agreement to Repurchase

The fair value of securities sold under agreement to repurchase approximates its carrying value. The fair value of other borrowed funds was estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Subordinated Debt

Subordinated debt consists of subordinated notes and trust preferred capital securities. There is no active market for the Company’s trust preferred capital securities and there have been no issuances of similar instruments in recent years. The Company looked at a market bond index to estimate a discount margin to value the debentures. The discount margin was very similar to the spread to LIBOR established at the issuance of the debentures. As a result, the Company determined that the fair value of the adjustable-rate debentures approximates their face amount. The Company utilizes active markets with similar assets to determine the fair value of the subordinated notes.

Pension Plan Assets

Refer to Note 12 to these Consolidated Financial Statements, “Employee Benefits and Deferred Compensation Plans” for the fair value analysis of the Pension Plan assets.

21. REGULATORY MATTERS

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table that follows) of Common Equity Tier I, Total Capital, and Tier I Capital (as defined in FRB regulations) to risk-weighted assets (as defined in FRB regulations), and of Tier I capital (as defined in FRB regulations) to average assets (as defined in FRB regulations). Management believes that as of December 31, 2022 and 2021 the Bank met all capital adequacy requirements to which they are subject.

The most recent notification from their regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Common Equity Tier I, total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank’s category rating.

The Bank’s actual capital amounts and ratios were as follows:

| | December 31, 2022 | | | | | |
|---|--------------------------|---------|--|-------|---|--------|
| | (in thousands) | | | | | |
| | Bank | | Minimum for Capital Adequacy Purposes | | Minimum to be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Common Equity Tier I (to Risk Weighted Assets) | \$ 215,262 | 13.16 % | \$ 73,627 | 4.5 % | \$ 106,350 | 6.5 % |
| Total Capital (to Risk Weighted Assets) | \$ 234,700 | 14.34 % | \$ 130,893 | 8.0 % | \$ 163,616 | 10.0 % |
| Tier I Capital (to Risk Weighted Assets) | \$ 215,262 | 13.16 % | \$ 98,170 | 6.0 % | \$ 130,893 | 8.0 % |
| Tier I Capital (to Average Assets) | \$ 215,262 | 9.77 % | \$ 88,174 | 4.0 % | \$ 110,217 | 5.0 % |

| | December 31, 2021 | | | | | |
|--|--------------------------|--------|--|-------|---|-------|
| | (in thousands) | | | | | |
| | Bank | | Minimum for Capital Adequacy Purposes | | Minimum to be Well Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Common Equity Tier I (to Risk Weighted Assets) | \$ 200,420 | 13.68% | \$ 65,940 | 4.5 % | \$ 95,247 | 6.5% |
| Total Capital (to Risk Weighted Assets) | \$ 218,740 | 14.93% | \$ 117,227 | 8.0 % | \$ 146,534 | 10.0% |
| Tier I Capital (to Risk Weighted Assets) | \$ 200,420 | 13.68% | \$ 87,921 | 6.0 % | \$ 117,227 | 8.0% |
| Tier I Capital (to Average Assets) | \$ 200,420 | 9.19% | \$ 87,278 | 4.0 % | \$ 109,098 | 5.0 % |

Dividends are paid as declared by the Board of Directors. Under New York law, the Company may pay dividends only if it is solvent and would not be rendered insolvent by the dividend payment and only from unrestricted and unreserved earned surplus, or if there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

The Company and the Bank are subject to dividend restrictions imposed by the FRB and the OCC, respectively. In general, it is the policy of the FRB that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company is consistent with the organization's capital needs, asset quality and overall financial condition. Dividends may be paid by the Bank only if it would not impair the Bank's capital structure, if the Bank's surplus is at least equal to its common capital and if the dividends declared in any year do not exceed the total of retained net profits in that year combined with retained profits of the preceding two years.

22. PARENT COMPANY ONLY FINANCIAL INFORMATION

Parent company (Evans Bancorp, Inc.) only condensed financial information is as follows:

CONDENSED BALANCE SHEETS

| | December 31, | |
|---|---------------------|-------------------|
| | 2022 | 2021 |
| | (in thousands) | |
| ASSETS | | |
| Cash | \$ 1,129 | \$ 1,864 |
| Other assets | 534 | 478 |
| Investment in subsidiaries | 184,451 | 213,717 |
| Total assets | <u>\$ 186,114</u> | <u>\$ 216,059</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES: | | |
| Subordinated debt | \$ 31,075 | \$ 30,974 |
| Other liabilities | 1,046 | 1,193 |
| Total liabilities | <u>32,121</u> | <u>32,167</u> |
| STOCKHOLDERS' EQUITY | | |
| Total Stockholders' Equity | <u>\$ 153,993</u> | <u>\$ 183,892</u> |
| Total liabilities and stockholders' equity | <u>\$ 186,114</u> | <u>\$ 216,059</u> |

CONDENSED STATEMENTS OF INCOME

| | December 31, | | |
|--|---------------------|------------------|------------------|
| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
| | (in thousands) | | |
| Dividends from subsidiaries | \$ 11,500 | \$ 8,100 | \$ 4,500 |
| Income | - | - | - |
| Expenses | (2,497) | (2,565) | (3,290) |
| Income before equity in undistributed earnings of subsidiaries | 9,003 | 5,535 | 1,210 |
| Equity in undistributed earnings of subsidiaries | 13,386 | 18,508 | 10,036 |
| Net income | <u>\$ 22,389</u> | <u>\$ 24,043</u> | <u>\$ 11,246</u> |

CONDENSED STATEMENTS OF CASH FLOWS

| | Year Ended | | |
|---|-------------------|-----------------|-----------------|
| | <u>2022</u> | <u>2021</u> | <u>2020</u> |
| | (in thousands) | | |
| Operating Activities: | | | |
| Net income | \$ 22,389 | \$ 24,043 | \$ 11,246 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Undistributed earnings of subsidiaries | (13,386) | (18,508) | (10,036) |
| Changes in assets and liabilities affecting cash flow: | | | |
| Other assets | (56) | 7 | (78) |
| Other liabilities | (147) | (30) | (48) |
| Other | 352 | 361 | 314 |
| Net cash provided by operating activities | 9,152 | 5,873 | 1,398 |
| Investing Activities: | | | |
| Investment in subsidiaries | - | - | (15,000) |
| Net cash used in investing activities | - | - | (15,000) |
| Financing Activities: | | | |
| Proceeds from issuance of common stock | 1,051 | 890 | 717 |
| Cash dividends paid | (6,942) | (6,541) | (5,991) |
| Repurchase of treasury stock | (4,140) | - | - |
| Reissuance of treasury stock | 144 | - | - |
| Proceeds from long-term borrowings | - | - | 20,000 |
| Debt issuance cost of long term borrowings | - | - | (509) |
| Net cash (used in) provided by financing activities | (9,887) | (5,651) | 14,217 |
| Net increase (decrease) in cash | (735) | 222 | 615 |
| Cash beginning of year | 1,864 | 1,642 | 1,027 |
| Cash ending of year | <u>\$ 1,129</u> | <u>\$ 1,864</u> | <u>\$ 1,642</u> |

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

Not applicable.

Item 9A. CONTROLS AND PROCEDURES

- (a) **Disclosure Controls and Procedures.** An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of December 31, 2022. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures as of December 31, 2022 were effective.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, believes that the audited consolidated financial statements contained in this Annual Report on Form 10-K fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the fiscal years presented in conformity with GAAP.

- (b) **Management's Annual Report on Internal Control Over Financial Reporting.** Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) 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 authorization of management and directors of the Company; and (iii) 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.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements prepared for external purposes in accordance with generally accepted accounting principles. Because of 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 the changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Our management under the direction of the audit committee conducted an assessment of the effectiveness of the system of internal control over financial reporting as of December 31, 2022 using the criteria set forth in the report of the Treadway Commission's Committee on Sponsoring Organizations ("COSO") - Internal Control - Integrated Framework (2013). Based on that assessment, our management believes that, as of December 31, 2022, the Company's internal control over financial reporting was effective based on the COSO criteria.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management's report in this annual report.

- (c) **Changes in Internal Control Over Financial Reporting.** No changes in the Company's internal control over financial reporting were identified in the fiscal quarter ended December 31, 2022 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. OTHER INFORMATION

None

Item 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

None

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information called for by this item is incorporated herein by reference to the material under the captions "Information Regarding Directors, Director Nominees and Executive Officers," "Delinquent Section 16(a) Reports," "Corporate Governance – Code of Ethics for Chief Executive Officer and Principal Financial Officers," and "Board of Director Committees – Audit Committee" in the Company's definitive proxy statement relating to its 2023 annual meeting of shareholders to be held on May 2, 2023 (the "Proxy Statement").

Item 11. EXECUTIVE COMPENSATION

The information called for by this item is incorporated herein by reference to the material under the captions "Director Compensation," "Executive Compensation," "Corporate Governance – Compensation Risk," "Board of Director Committees – Human Resource and Compensation Committee," "Human Resource and Compensation Committee Interlocks and Insider Participation" and "Human Resource and Compensation Committee Report" in the Proxy Statement.

The material incorporated herein by reference to the material under the caption, "Human Resource and Compensation Committee Report" in the Proxy Statement is deemed "furnished" in this Annual Report on Form 10-K and shall not be deemed to be "soliciting material" or to be "filed" with the SEC or subject to the liabilities of Section 18 of the Exchange Act, except to the extent that the Company specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

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

The information called for by this item is incorporated herein by reference to the material under the captions "General Information - Security Ownership of Management and Certain Beneficial Owners" and "General Information – Equity Compensation Plans" in the Proxy Statement.

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

The information called for by this item is incorporated herein by reference to the material under the captions "Corporate Governance – Independence of Directors" and "Transactions with Related Persons" in the Proxy Statement.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information called for by this item is incorporated herein by reference to the material under the caption "Independent Registered Public Accounting Firm" in the Proxy Statement.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as a part of this Report on Form 10-K:

1. Financial statements: The following audited consolidated financial statements and notes thereto and the material under the caption "Report of Independent Registered Public Accounting Firm" in Part II, Item 8 of this Annual Report on Form 10-K are incorporated herein by reference:

Report of Independent Registered Public Accounting Firm (Crowe LLP)
Consolidated Balance Sheets - December 31, 2022 and 2021
Consolidated Statements of Income - Years Ended December 31, 2022, 2021 and 2020
Consolidated Statements of Comprehensive Income (Loss) - Years Ended December 31, 2022, 2021 and 2020
Consolidated Statements of Changes in Stockholders' Equity - Years Ended December 31, 2022, 2021 and 2020
Consolidated Statements of Cash Flows - Years Ended December 31, 2022, 2021 and 2020
Notes to Consolidated Financial Statements
2. All other financial statement schedules are omitted because they are not applicable or the required information is included in the Company's Consolidated Financial Statements or Notes thereto included in Part II, Item 8 of this Annual Report on Form 10-K.
3. Exhibits

The following exhibits are filed as a part of this report:

EXHIBIT INDEX

- 3.1 Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3a to the Company's Registration Statement on Form S-4 (Registration No. 33-25321), as filed on November 7, 1988). (Filed on paper – hyperlink is not required pursuant to Rule 105 of Regulation S-T)
- 3.1.1 Certificate of Amendment to the Company's Certificate of Incorporation (incorporated by reference to Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 1997, as filed on May 14, 1997). (Filed on paper – hyperlink is not required pursuant to Rule 105 of Regulation S-T)
- 3.2 [Amended and Restated Bylaws of the Company, effective as of January 24, 2023 \(incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on January 30, 2023\).](#)
- 4.1 [Indenture between the Company, as Issuer, and Wilmington Trust Company, as Trustee, dated as of October 1, 2004 \(incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2004, as filed on November 4, 2004\).](#)
- 4.2 [Form of Floating Rate Junior Subordinated Debt Security due 2034 \(incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2004, as filed on November 4, 2004\).](#)
- 4.3 [Amended and Restated Declaration of Trust of Evans Capital Trust 1, dated as of October 1, 2004 \(incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2004, as filed on November 4, 2004\).](#)
- 4.4 [Guarantee Agreement of the Company, dated as of October 1, 2004 \(incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2004, as filed on November 4, 2004\).](#)
- 4.5 [Description of Evans Bancorp, Inc. Securities \(incorporated by reference to Exhibit 4.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019, as filed on March 12, 2020\).](#)
- 4.6 [Indenture, dated as of July 9, 2020, by and between Evans Bancorp, Inc. and UMB Bank, National Association, as trustee, including form of 6.00% Fixed-to-Floating Rate Subordinated Note due 2030 of Evans Bancorp, Inc. \(incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, as filed on July 9, 2020\).](#)
- 10.1 [Evans Bancorp, Inc. Dividend Reinvestment Plan \(incorporated by reference to the Company's Registration Statement on Form S-3D \(Registration No. 333-249269\), as filed on October 2, 2020\).](#)
- 10.2* [Evans Bancorp, Inc. 2013 Employee Stock Purchase Plan \(incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A, as filed on March 21, 2013\).](#)
- 10.3* [Evans Bancorp, Inc. 2009 Long-Term Equity Incentive Plan \(incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A, as filed on April 1, 2009\).](#)
- 10.4* [Evans National Bank Deferred Compensation Plan for Officers and Directors \(incorporated by reference to Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed on March 18, 2004\).](#)
- 10.5* [Form of Deferred Compensation Participatory Agreement \(incorporated by reference to Exhibit 10.16 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005\).](#)
- 10.6* [Evans National Bank Executive Life Insurance Plan \(incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 as filed on March 18, 2004\).](#)
- 10.7* [Form of Executive Life Insurance Split-Dollar Endorsement Participatory Agreement \(incorporated by reference to Exhibit 10.17 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005\).](#)
- 10.8* [First Amendment to the Evans National Bank Executive Life Insurance Plan \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on May 2, 2007\).](#)
- 10.9* [Evans National Bank Supplemental Executive Retirement Plan \(incorporated by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed on March 18, 2004\).](#)
- 10.10* [Form of Supplemental Executive Retirement Participatory Agreement \(incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, as filed on March 28, 2005\).](#)
- 10.11* [Summary of Evans Excels Plan \(incorporated by reference to Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed on March 1, 2018\).](#)
- 10.12* [Evans Bank, N.A. Supplemental Executive Retirement Plan for Senior Executives \(incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as filed on March 3, 2014\).](#)
- 10.13* [Restricted Stock Award Agreement granted by Evans Bancorp, Inc. to Directors under the Evans Bancorp, Inc. 2009 Long-Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010, as filed on August 4, 2010\).](#)
- 10.14* [Stock Option Agreement granted by Evans Bancorp, Inc. to Directors under the Evans Bancorp, Inc. 2009 Long-Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010, as filed on August 4, 2010\).](#)

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- 10.15* [Restricted Stock Award Agreement granted by Evans Bancorp, Inc. to Employees under the Evans Bancorp, Inc. 2009 Long-Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010, as filed on August 4, 2010\).](#)
- 10.16* [Employment Agreement by and among Evans Bank, N.A., the Company and David J. Nasca, executed and delivered by the Company and the Bank on September 14, 2009 and effective as of September 9, 2009 \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on September 17, 2009\).](#)
- 10.17* [Stock Option Agreement granted by Evans Bancorp, Inc. to Employees under the Evans Bancorp, Inc. 2009 Long-Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2010, as filed on August 4, 2010\).](#)
- 10.18* [Letter Agreement Regarding Insurance Coverage for James Tilley \(incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007, as filed on August 14, 2007\).](#)
- 10.19* [Evans Bancorp, Inc. Executive Severance Plan, as revised on July 26, 2016 \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on July 29, 2016\).](#)
- 10.20* [Evans Bancorp, Inc. Change in Control Agreement \(incorporated by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as filed on March 3, 2016\).](#)
- 10.21* [Evans Bank, N.A. 2010 Amended and Restated Executive Incentive Retirement Plan on September 24, 2010 and effective October 1, 2010 \(incorporated by reference to Exhibit 10.31 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as filed on March 3, 2016\).](#)
- 10.22* [Evans Bancorp, Inc. Amended and Restated 2019 Long-Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on April 26, 2019\).](#)
- 10.23* [Employment Agreement, dated as of July 1, 2018, by and between The Evans Agency, LLC and Aaron Whitehouse \(incorporated by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019, as filed on March 12, 2020\).](#)
- 10.24* [Form of Employee Restricted Stock Award Agreement granted by Evans Bancorp, Inc. under the Evans Bancorp, Inc. Amended and Restated 2019 Long Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.2 to the Company's Form S-8 Registration Statement, filed on May 20, 2019\).](#)
- 10.25* [Form of Employee Stock Option Award Agreement granted by Evans Bancorp, Inc. under the Evans Bancorp, Inc. Amended and Restated 2019 Long Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.3 to the Company's Form S-8 Registration Statement, filed on May 20, 2019\).](#)
- 10.26* [Form of Director Restricted Stock Award Agreement granted by Evans Bancorp, Inc. under the Evans Bancorp, Inc. Amended and Restated 2019 Long Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.4 to the Company's Form S-8 Registration Statement, filed on May 20, 2019\).](#)
- 10.27* [Form of Director Stock Option Award Agreement granted by Evans Bancorp, Inc. under the Evans Bancorp, Inc. Amended and Restated 2019 Long Term Equity Incentive Plan \(incorporated by reference to Exhibit 10.5 to the Company's Form S-8 Registration Statement, filed on May 20, 2019\).](#)
- 10.28* [Non-Competition Agreement, dated as of March 3, 2020, by and between Evans Bancorp, Inc. and Kevin Maroney \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on May 1, 2020\).](#)
- 10.29* [Amendment Number One, dated as of September 21, 2020, to the Employment Agreement by and among Evans Bank, N.A., Evans Bancorp, Inc. and David J. Nasca, executed and delivered by the Company and the Bank on September 14, 2009 and effective as of September 9, 2009 \(incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed on September 25, 2020\).](#)
- 21.1 [Subsidiaries of the Company \(incorporated by reference to Exhibit 21.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019, as filed on March 12, 2020\).](#)
- 23.1 [Independent Registered Public Accounting Firm's Consent from Crowe LLP \(filed herewith\).](#)
- 24 [Power of Attorney \(included on the signature page of this Annual Report on Form 10-K\).](#)
- 31.1 [Certification of Principal Executive Officer pursuant to Rule 13a-14\(a\) and 15d-14\(a\), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 31.2 [Certification of Principal Financial Officer pursuant to Rule 13a-14\(a\) and 15d-14\(a\), as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 32.1 [Certification of Principal Executive Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 32.2 [Certification of Principal Financial Officer pursuant to 18 USC Section 1350 Chapter 63 of Title 18, United States Code, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 \(filed herewith\).](#)
- 101 The following materials from Evans Bancorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2022, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets – December 31, 2022 and 2021; (ii) Consolidated Statements of Income – years ended December 31, 2022, 2021, and 2020; (iii) Consolidated Statements of Comprehensive Income (Loss) – years ended December 31, 2022, 2021, and 2020; (iv) Consolidated Statements of Stockholder's Equity – years ended December 31, 2022, 2021, and 2020; (v) Consolidated Statements of Cash Flows – years ended December 31, 2022, 2021 and 2020; and (vi) Notes to Consolidated Financial Statements.

* Indicates a management contract or compensatory plan or arrangement.

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 Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized:

EVANS BANCORP, INC.

By: /s/ David J. Nasca
David J. Nasca
President and Chief Executive Officer
Date: March 3, 2023

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints, jointly and severally, David J. Nasca and John B. Connerton and each of them, as his true and lawful attorneys-in-fact and agents, each with full power of substitution, for him, and in his name, place and stead, in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with Exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their substitutes, may lawfully do or cause to be done by virtue hereof.

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

| Signature | Title | Date |
|---|--|---------------|
| <u>/s/ David J. Nasca</u> David J. Nasca | President and Chief Executive Officer/ Director (Principal Executive Officer) | March 3, 2023 |
| <u>/s/ John B. Connerton</u> John B. Connerton | Treasurer (Principal Financial Officer and Principal Accounting Officer) | March 3, 2023 |
| <u>/s/ Lee C. Wortham</u> Lee C. Wortham | Chairman of the Board / Director | March 3, 2023 |
| <u>/s/ Michael A. Battle</u> Michael A. Battle | Director | March 3, 2023 |
| <u>/s/ James E. Biddle Jr</u> James E. Biddle, Jr. | Director | March 3, 2023 |
| <u>/s/ Jody L. Lomeo</u> Jody L. Lomeo | Director | March 3, 2023 |
| <u>Kevin D. Maroney</u> | Director | March 3, 2023 |
| <u>/s/ Robert G. Miller Jr</u> Robert G. Miller, Jr. | Director | March 3, 2023 |
| <u>/s/ Kimberley A. Minkel</u> Kimberley A. Minkel | Director | March 3, 2023 |
| <u>/s/ Christina P. Orsi</u> Christina P. Orsi | Director | March 3, 2023 |
| <u>/s/ David R. Pfalzgraf Jr</u> David R. Pfalzgraf, Jr. | Director | March 3, 2023 |
| <u>/s/ Michael J. Rogers</u> Michael J. Rogers | Director | March 3, 2023 |
| <u>/s/ Nora B. Sullivan</u> Nora B. Sullivan | Director | March 3, 2023 |
| <u>/s/ Thomas H. Waring Jr</u> Thomas H. Waring, Jr. | Director | March 3, 2023 |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements (No 333-160262, No. 333-181018, No. 333-188164, and No. 333-231605) on Form S-8 and (No. 333-230819 and No. 333-249269) on Form S-3 of Evans Bancorp, Inc. of our report dated March 3, 2023 relating to the financial statements appearing in this Annual Report on Form 10-K.

/s/ Crowe LLP

Grand Rapids, Michigan
March 3, 2023

Certification

I, David J. Nasca, certify that:

1. I have reviewed this report on Form 10-K of Evans Bancorp, 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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - 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; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 3, 2023

/s/ David J. Nasca

David J. Nasca
President and Chief Executive Officer
(Principal Executive Officer)

Certification

I, John B. Connerton, certify that:

1. I have reviewed this report on Form 10-K of Evans Bancorp, 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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - 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; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 3, 2023

/s/ John B. Connerton

John B. Connerton

Treasurer

(Principal Financial Officer and Principal Accounting Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE AND FINANCIAL OFFICERS
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, David J. Nasca, the President and Chief Executive Officer of Evans Bancorp, Inc., certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge: (1) the Annual Report of Evans Bancorp, Inc. on Form 10-K for the fiscal year ended December 31, 2022 fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and (2) the information contained in such Annual Report on Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Evans Bancorp, Inc.

Date: March 3, 2023

By: /s/ David J. Nasca
Name: David J. Nasca
Title: President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE AND FINANCIAL OFFICERS
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, John B. Connerton, the Treasurer of Evans Bancorp, Inc., certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge: (1) the Annual Report of Evans Bancorp, Inc. on Form 10-K for the fiscal year ended December 31, 2022 fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and (2) the information contained in such Annual Report on Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Evans Bancorp, Inc.

Date: March 3, 2023

By: /s/ John B. Connerton
Name: John B. Connerton
Title: Treasurer
(Principal Financial Officer and Principal Accounting Officer)
