FIRST RELIANCE®
BANCSHARES

Annual Report 2022

TO OUR SHAREHOLDERS:

Three years ago, our leadership updated our strategic plan to serve as a roadmap for the bank and its associates. In addition to delivering a great customer and employee experience, we developed strategies to improve efficiency, growth, profitability, and risk management. This involved maintaining the right balance between growth and financial health, while establishing guardrails to manage risk. We are well on our way to reaching these goals, as 2022 saw strong growth across our markets, significant net interest margin expansion, and an earnings per share increase of over 12% year-over-year.

Despite some of the recent headlines surrounding banks, I'm excited to report that First Reliance Bank is in a strong financial position. We have thoughtfully developed robust risk management practices around our liquidity, credit, and capital management. As we have embarked on our organic growth strategy, we have prioritized safety & soundness, profitability, and growth, in that order. Our deposit base is relationship based and diverse, as over 75% is either insured or collateralized. Additionally, our deposit balances have continued to grow during the first quarter, as detailed in Note 25 of our attached financial statements. Our on and off-balance sheet liquidity together combine for approximately double the amount of uninsured and uncollateralized deposits within the bank.

I have been heartened to watch our team build deep relationships in our markets through the years. As we move ahead in 2023, we would first like to look back on 2022 at some of the numerous successes and challenges that defined the year and will shape the bank as we move forward.

Year in Review

In 2022, the bank continued its path of organic growth, highlighted by loan growth of approximately $75 million, or roughly 13%, and deposit growth of over $17 million, more than a 2% increase from year-end 2021. This solid loan growth served to normalize our loan to deposit ratio, which now stands at a very healthy 83%. The markets we serve are one of our greatest strengths. Our strong presence in the major markets of Charleston, Midlands, and Greenville has continued to bode well, as we saw significant loan growth in all three of these markets.

Asset quality has continued to improve, with a reduction in nonperforming assets as a percentage of total assets to 0.05% at December 31, 2022 from 0.10% at year-end 2021.

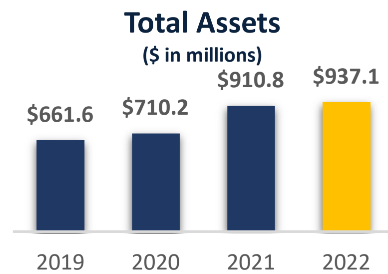
2022 brought about significant economic changes to the banking environment, highlighted by steadily rising interest rates, and continued inflationary pressures. The bank has stood strong in the face of these challenges and continued to prioritize safe & sound balance sheet growth, while increasing the profitability of our core banking business. Net interest margin expanded by 23 basis points year-over-year. Net income for the year was $5.9 million, or $0.73 per diluted share, compared to $5.3 million, or $0.65 per diluted share, for the year ended December 31, 2021. Additionally, ROE increased from 7.56% to 9.11% year-over-year, a reflection of the hard work and effort put in by our team during the year.

Our mortgage business faced constant headwinds from rising interest rates throughout 2022. While we were operating in an extremely tough environment for the mortgage industry, we were resilient and still profitable for the year. This has been a strong business line for us through the years, and we look forward to better days ahead once the mortgage landscape improves.

We have remained committed to improving our cost structure and efficiency. This is reflected in our efficiency ratio, which declined from 82.75% at year-end 2021, to 79.37% at December 31, 2022 despite the challenges in mortgage banking. We've also been significantly increasing our assets per employee. The legacy Indirect auto portfolio continues its gradual shrink on our balance sheet.

Asset Growth

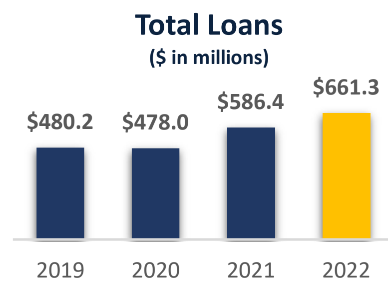
Total assets grew by $26.3 million during 2022, or 2.9%, from $910.8 million at December 31, 2021 to $937.1 million at December 31, 2022. This growth was mainly driven by an increase in loans and investment securities, offset by a decrease in cash.



Loan Growth and Asset Quality

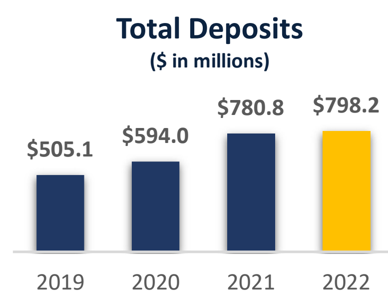
During 2022, we grew loans by $74.8 million, or 13%, from $586.4 million at December 31, 2021 to $661.3 million at December 31, 2022.

Our asset quality remained strong during the year, with the ratio of nonperforming assets to total assets decreasing to 0.05% at December 31, 2022 from 0.10% at December 31, 2021.



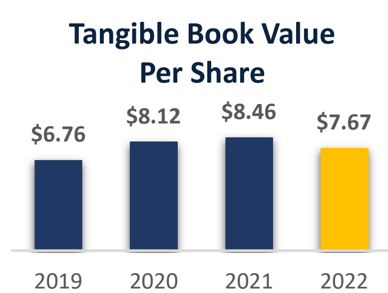
Deposit Growth

For the full year 2022, total deposits increased $17.4 million, or 2.2%; from $780.8 million at December 31, 2021 to $798.2 million at December 31, 2022. Transaction deposits to total deposits increased from 50.19% at December 31, 2021 to 51.05% at December 31, 2022.



Tangible Book Value

During the year, tangible book value per share declined to $7.67 at December 31, 2022, from $8.46 at December 31, 2021. This was largely in part due to unrealized losses in AOCI, which totaled $14.1 million at December 31, 2022. Excluding AOCI, adjusted TBV per share was $9.40 at the end of 2022.



Technology

We continue to make our commitment to technology an important part of our future. This includes investments in technology and security to improve operational efficiencies and automate processes, as well as enhance our products and services and increase customer satisfaction. We've improved our account opening process, which has decreased opening times by over 50%. Additionally, we've adopted a hybrid mortgage closing process that allows many documents to be executed digitally. As our ability to serve our customers continues to grow, our belief is that we will be a preferred choice for customers looking for a local financial institution with 21st century banking capabilities.

Competition

We recognize that we operate in a very demanding environment. The banking business is highly competitive. We experience competition in our market areas from a variety of different challengers; from traditional banks to fintech. This includes competition for customers as well as personnel. As these competitive pressures intensify, we must remain proactive in leveraging our strong foundation and customer-focused culture while continuing to execute our growth strategy.

Our People

Perhaps our most important asset, our people are fundamental to our growth. When our associates succeed, we succeed. Everything we do begins with our employees and is driven by their commitment to our culture.   We understand that having long-standing relationships with our customers, and deep ties to the community are important, as our people live and work in the same communities as our customers. As regional banks continue to grow, our commitment to make the lives of our customers better sets us apart from the competition.

In Closing

As the past year has shown us, banking continues to be an ever-changing and challenging industry. However, we have remained consistent about prioritizing safety & soundness, growth, and profitability; all while remaining focused on developing relationships and meeting the financial needs of our customers. Going forward, we will continue to rely on our people and will embrace new technologies to strengthen our existing relationships and open doors to a new generation of customers. We look forward to executing our strategic plans as we strive to be a **Great Place to Work, a Great Place to Bank, and a Great Place to Invest**.

I am extremely appreciative of all our employee's hard work and look forward to an exciting 2023.

Our best days are ahead of us.

Sincerely,

F.R. "Rick" Saunders Jr.
Chief Executive Officer

First Reliance Bancshares, Inc. and Subsidiary

Report on Consolidated Financial Statements

As of and for the years ended December 31, 2022 and 2021

Contents

Independent Auditor's Report

The Board of Directors
First Reliance Bancshares, Inc. and Subsidiary
Florence, South Carolina

Opinion

We have audited the consolidated financial statements of First Reliance Bancshares, Inc. and its Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

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

Elliott Davis, LLC

Columbia, South Carolina
March 29, 2023

First Reliance Bancshares, Inc. and Subsidiary

Consolidated Balance Sheets

As of December 31, 2022 and 2021

	2022	2021
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 3,916,889	$ 5,299,431
Interest-bearing deposits with other banks	29,880,421	144,824,529
Total cash and cash equivalents	33,797,310	150,123,960
Time deposits in other banks	258,718	257,173
Marketable equity securities	133,715	137,859
Securities available-for-sale	162,096,848	81,779,260
Nonmarketable equity securities	1,787,200	837,000
Total investment securities	164,017,763	82,754,119
Mortgage loans held for sale	7,940,056	23,844,303
Loans receivable	661,250,516	586,445,473
Less allowance for loan losses	(7,659,794)	(7,039,576)
Loans, net	653,590,722	579,405,897
Premises, furniture and equipment, net	22,811,450	22,805,006
Accrued interest receivable	2,765,106	1,703,143
Other real estate owned	-	135,000
Cash surrender value life insurance	18,835,768	18,475,896
Net deferred tax assets	8,628,905	4,128,214
Mortgage servicing rights	10,441,422	14,057,097
Core deposit intangibles	147,094	244,474
Goodwill	690,917	690,917
Right of use asset	5,977,748	6,634,220
Other assets	7,210,167	5,537,376
Total assets	$ 937,113,146	$ 910,796,795
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 255,426,725	$ 238,018,563
Interest-bearing transaction accounts	152,012,419	153,888,994
Savings	287,043,628	262,998,387
Time deposits $250,000 and over	23,152,023	26,868,239
Other time deposits	80,549,048	99,059,140
Total deposits	798,183,843	780,833,323
Securities sold under agreement to repurchase	7,367,861	11,372,325
Advances from Federal Home Loan Bank	30,000,000	10,000,000
Subordinated debentures	15,380,951	15,349,205
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	331,678	142,732
Lease liability	6,197,620	6,781,650
Other liabilities	6,045,329	5,205,909
Total liabilities	873,817,282	839,995,144
Shareholders' Equity		
Series D non-cumulative preferred stock, $0.01 par value; 70,000 shares authorized; 53,732 and 54,732 shares issued and outstanding at December 31, 2022 and 2021, respectively	537	547
Common stock, $0.01 par value; 20,000,000 shares authorized; 8,730,262 and 8,793,108 shares issued; and 8,140,311 and 8,258,410 shares outstanding at December 31, 2022 and 2021, respectively	87,303	87,931
Capital surplus	53,967,630	53,855,594
Treasury stock, at cost, 589,951 and 534,698 shares at December 31, 2022 and 2021, respectively	(4,502,374)	(4,322,496)
Nonvested restricted stock	(2,121,128)	(2,668,238)
Retained earnings	29,916,355	23,985,343
Accumulated other comprehensive loss	(14,052,459)	(137,030)
Total shareholders' equity	63,295,864	70,801,651
Total liabilities and shareholders' equity	$ 937,113,146	$ 910,796,795

See Notes to Consolidated Financial Statements

First Reliance Bancshares, Inc. and Subsidiary
Consolidated Statements of Operations
For the years ended December 31, 2022 and 2021

	2022	2021
Interest income:		
Loans, including fees	$ 28,564,688	$ 25,285,559
Investment securities:		
Taxable	3,639,528	1,052,207
Tax exempt	115,481	150,927
Other interest income	885,851	234,522
Total	33,205,548	26,723,215
Interest expense:		
Deposits	1,964,637	1,034,912
Federal Home Loan Bank advances	109,983	164,250
Subordinated debentures	1,072,846	808,249
Other interest expense	17,213	10,673
Total	3,164,679	2,018,084
Net interest income	30,040,869	24,705,131
Provision for loan losses	480,000	302,700
Net interest income after provision for loan losses	29,560,869	24,402,431
Noninterest income:		
Mortgage banking income	3,733,991	9,531,044
Service charges on deposit accounts	1,392,412	1,221,059
Other service charges, commissions, and fees	2,092,696	2,038,201
Income from bank owned life insurance	359,872	374,075
Gain on sale of investment securities	-	81,176
Gain on sale of loans	-	326,275
Gain on disposal of fixed assets	23,259	68,912
Gain on sale of mortgage servicing rights	681,827	-
Other	696,157	562,035
Total	8,980,214	14,202,777
Noninterest expenses:		
Salaries and benefits	19,006,038	20,742,059
Occupancy and equipment	3,589,102	3,221,157
Data processing, technology, and communications	3,268,335	3,546,703
Professional fees	751,377	916,302
Marketing	743,379	419,137
Other	3,611,560	3,352,204
Total	30,969,791	32,197,562
Income before income taxes	7,571,292	6,407,646
Income tax expense	1,640,280	1,130,908
Net income	$ 5,931,012	$ 5,276,738
Average common shares outstanding, basic	7,779,396	7,749,029
Average common shares outstanding, diluted	8,127,148	8,142,101
Income per common share:		
Basic income per common share	$ 0.76	$ 0.68
Diluted income per common share	0.73	0.65

See Notes to Consolidated Financial Statements

First Reliance Bancshares, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2022 and 2021

	2022	2021
Net income	$ 5,931,012	$ 5,276,738
Other comprehensive loss, net of tax:		
Unrealized holding losses on securities available-for-sale	(18,429,822)	(1,603,996)
Reclassification adjustment for realized gains included in earnings	-	(81,176)
Income tax benefit	4,514,391	420,281
Other comprehensive loss, net of tax	(13,915,431)	(1,264,891)
Comprehensive (loss) income	$ (7,984,419)	$ 4,011,847

See Notes to Consolidated Financial Statements

First Reliance Bancshares, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2022 and 2021

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Capital Surplus	Treasury Stock	Nonvested Restricted Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2020	55,932	559	8,564,056	85,641	51,971,579	(1,679,952)	(1,486,440)	18,708,605	1,127,861	68,727,853
Net income	-	-	-	-	-	-	-	5,276,738	-	5,276,738
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	(1,264,891)	(1,264,891)
Conversion of Preferred Stock - Series D to Common Stock	(1,200)	(12)	1,200	12	-	-	-	-	-	-
Net issuance of Common Stock	-	-	294,878	2,948	2,188,964	-	-	-	-	2,192,022
Restricted Stock Forfeitures	-	-	(67,026)	(670)	(388,020)	-	-	-	-	(388,800)
Net change in restricted stock	-	-	-	-	-	-	(1,181,798)	-	-	(1,181,798)
Stock based compensation	-	-	-	-	83,071	-	-	-	-	83,071
Purchase of treasury stock	-	-	-	-	(2,642,544)	-	-	-	-	(2,642,544)
Balance, December 31, 2021	54,732	547	8,793,108	87,931	53,855,594	(4,322,496)	(2,668,238)	23,985,343	(137,030)	70,801,651
Net income	-	-	-	-	-	-	-	5,931,012	-	5,931,012
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	(13,915,429)	(13,915,429)
Conversion of Preferred Stock - Series D to Common Stock	(1,000)	(10)	1,000	10	-	-	-	-	-	-
Issuance of Common Stock	-	-	36,925	369	553,740	-	-	-	-	554,415
Restricted Stock Forfeitures	-	-	(100,771)	(1,007)	(814,127)	-	-	-	-	(815,440)
Net change in restricted stock	-	-	-	-	-	-	547,110	-	-	547,110
Stock based compensation	-	-	-	-	372,423	-	-	-	-	372,423
Purchase of treasury stock	-	-	-	-	-	-	(179,878)	-	-	(179,878)
Balance, December 31, 2022	53,732	$ 537	8,730,262	$87,303	$ 53,967,630	$ (4,502,374)	$ (2,121,128)	$ 29,916,355	$ (14,052,459)	$ 63,295,864

See Notes to Consolidated Financial Statements

First Reliance Bancshares, Inc. and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2022 and 2021

	2022	2021
Cash flows from operating activities:		
Net income	$ 5,931,012	$ 5,276,738
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	480,000	302,700
Depreciation expense	1,112,170	935,042
Loss (gain) on change in fair value of marketable equity securities	4,144	(8,435)
Discount accretion and premium amortization on investment securities	407,576	177,263
Discount accretion on purchased loans	(303,103)	(201,896)
Gain on disposal of fixed assets	(23,259)	(68,912)
Loss on sale of other real estate owned	15,838	-
Gain on sale of investment securities	-	(81,176)
Write down of other real estate owned	-	29,295
Originations of mortgages held for sale	(221,328,200)	(503,886,940)
Proceeds from sales of mortgages held for sale	240,966,438	525,215,558
Mortgage banking income	(3,733,991)	(9,531,044)
Proceeds from sale of Paycheck Protection Program loans	-	20,352,492
Loss on sale of Paycheck Protection Program loans	-	(326,275)
Proceeds from sale of mortgage servicing rights	5,621,661	-
Gain on sale of mortgage servicing rights	(681,827)	-
Core deposit intangible amortization	97,380	121,980
Gain on extinguishment of debt	(5,314)	-
Amortization of debt issuance costs	31,746	20,939
Deferred income taxes, net of allowance	13,700	(255,927)
Increase in cash surrender value of life insurance	(359,872)	(374,075)
Stock based compensation expense	54,623	83,071
Increase in mortgage servicing rights, net	(1,324,159)	(2,036,485)
Increase in accrued interest receivable	(1,061,963)	(157,282)
(Increase) decrease in other assets	(1,016,318)	4,598,034
Increase (decrease) in accrued interest payable	188,946	(112,990)
Increase (decrease) in other liabilities	260,704	(527,703)
Net cash provided by operating activities	25,347,932	39,543,972
Cash flows from investing activities:		
Purchases of securities available-for-sale	(113,005,110)	(67,859,431)
Purchases of marketable equity securities	-	(100,000)
Maturities of securities available-for-sale	12,850,125	9,977,087
Proceeds on sales of securities available-for-sale	1,000,000	7,051,719
Net (increase) decrease in nonmarketable equity securities	(950,200)	239,400
Net increase in time deposits in other banks	(1,545)	(1,535)
Net increase in loans receivable	(74,361,722)	(127,738,261)
Purchases of premises, furniture and equipment	(1,146,305)	(5,180,588)
Proceeds from disposal of premises, furniture and equipment	50,950	-
Proceeds from sale of other real estate owned	119,162	-
Net cash used in investing activities	(175,444,645)	(183,611,609)

See Notes to Consolidated Financial Statements

First Reliance Bancshares, Inc. and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2022 and 2021

	2022	2021
Cash flows from financing activities:		
Net increase in demand deposits, interest-bearing transaction accounts and savings accounts	39,576,828	200,337,505
Net decrease in certificates of deposit and other time deposits	(22,226,308)	(13,504,424)
Net increase in advances from Federal Home Loan Bank	20,000,000	-
Net (decrease) increase in securities sold under agreements to repurchase	(4,004,464)	5,849,453
Issuance of subordinated debentures, net of issuance costs	-	9,841,268
Redemption of subordinated debentures	-	(5,000,000)
Issuance of common stock	56,775	1,803,222
Decrease (increase) in nonvested restricted stock	547,110	(1,181,798)
Purchase of treasury stock	(179,878)	(2,642,544)
Net cash provided by financing activities	33,770,063	195,502,682
Net (decrease) increase cash and cash equivalents	(116,326,650)	51,435,045
Cash and cash equivalents, beginning of year	150,123,960	98,688,915
Cash and cash equivalents, end of year	$ 33,797,310	$ 150,123,960
Cash paid during the year for:		
Income taxes	$ 2,246,350	$ 1,705,251
Interest	2,975,733	2,131,074
Supplemental noncash investing and financing activities:		
Net change in unrealized gains on investment securities	$ (13,915,429)	$ (1,264,891)
Initial recognition of right-of-use asset	-	1,651,405
Initial recognition of lease liability	-	1,651,405

See Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Organization:

First Reliance Bancshares, Inc. (the "Company") was incorporated under the laws of the State of South Carolina on April 12, 2001 to serve as a bank holding company for its subsidiary, First Reliance Bank (the "Bank"), and acquired all of the shares of the Bank on April 1, 2002 in a statutory share exchange. First Reliance Bank was incorporated on August 9, 1999 and commenced business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets throughout South Carolina and North Carolina. The Bank is a South Carolina chartered commercial bank, and its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions. In 2005, the Company formed First Reliance Capital Trust I (the "Trust") for the purpose of issuing trust preferred securities. In accordance with current accounting guidance, the Trust is not consolidated in these financial statements.

Management's estimates:

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, including valuation allowances for impaired loans, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, and the valuation of investment securities. In connection with the determination of the allowances for losses on loans and valuation of foreclosed real estate, management obtains independent appraisals in accordance with regulatory policy. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

Concentrations of credit risk:

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily throughout South Carolina and North Carolina. At December 31, 2022 and 2021, the majority of the total loan portfolio was to borrowers from within these areas.

Note 1. Summary of Significant Accounting Policies, Continued

Concentrations of credit risk, continued:

The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to groups of borrowers or industries that would also be affected by sector-specific economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g., principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Management has determined that there is minimal concentration of credit risk associated with its lending policies or practices.

There are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e., balloon payment loans). These loans are underwritten and monitored to manage the associated risks and management believes that these particular practices do not subject the Company to unusual credit risk. The Company's investment portfolio consists principally of obligations of the United States and its agencies or its corporations and obligations of state and local governments. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Debt securities available-for-sale:

Debt securities available-for-sale are carried at amortized cost and adjusted to fair value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded as part of accumulated other comprehensive income in shareholders' equity, net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of investments available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale. The amortization of premiums and accretion of discounts are recognized in interest income using a methodology that approximates a level yield of interest over the estimated remaining period to maturity.

Note 1. Summary of Significant Accounting Policies, Continued

Marketable equity securities:

Marketable equity securities are carried at fair value, with changes in fair value recorded within other noninterest income in the consolidated statements of operations. Dividends received on marketable equity securities are included as a separate component of interest income.

Nonmarketable equity securities:

At December 31, 2022 and 2021, nonmarketable equity securities consist of the following:

	2022	2021
Federal Home Loan Bank stock	$ 1,729,100	$ 778,900
Community Bankers Bank stock	58,100	58,100
Total	$ 1,787,200	$ 837,000

Nonmarketable equity securities are carried at cost since there is no quoted market value and no ready market exists. Investment in the Federal Home Loan Bank of Atlanta (“FHLB”) is a condition to borrowing from that bank, and the stock is pledged to collateralize such borrowings. Dividends received on nonmarketable equity securities are included as a separate component of interest income.

Loans receivable:

Loans receivable are stated at their amortized cost basis, net of any charge-offs. Interest income is recognized in the period earned and is computed based upon the unpaid principal balance.

When serious doubt exists as to the collectability of a loan or when a loan becomes contractually 90 days past due as to principal or interest, interest income is discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed. Loans are removed from nonaccrual status when they become current as to both principal and interest, when concern no longer exists as to the collectability of the principal and interest, and after a sufficient history of satisfactory payment performance has been established.

Loan origination and commitment fees and certain direct loan origination costs are deferred and amortized as an adjustment of the related loan yields. Generally, these amounts are amortized over the contractual life of the related loans or commitments.

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company’s problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected.

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for loan losses:

The allowance for loan losses is management's estimate of losses inherent in the loan portfolio. It is established through a provision for loan losses charged to earnings. Charged-off loans are charged against the allowance when the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For these loans, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors.

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

In situations where, for economic or legal reasons related to a borrower's financial difficulties, a concession to the borrower is granted that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring. The restructuring of a loan may include the transfer from the borrower to the Company of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan, modification of the loan terms, or a combination of the above.

Premises, furniture and equipment:

Premises, furniture and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 40 years and for furniture and equipment of 5 to 10 years. Leasehold improvements are amortized over the term of the lease. The cost of assets sold or otherwise disposed of and the related allowance for depreciation is eliminated from the accounts and the resulting gains or losses are reflected in the consolidated statements of operations when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized based upon the Company's policy.

Note 1. Summary of Significant Accounting Policies, Continued

Other real estate owned:

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is carried at the lower of cost or the fair market value minus estimated costs to sell. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses to maintain such assets and subsequent changes in the valuation allowance are included in other noninterest expense along with gains and losses on disposal.

Cash surrender value of life insurance:

Cash surrender value of life insurance represents the cash value of policies on certain current and former officers and directors of the Company.

Residential mortgage loans held for sale:

Loans held for sale represent loans originated or acquired by the Company with the intent to sell. The Company has elected the lower of cost or market in accounting for residential mortgage loans held for sale. These loans are initially recorded and carried at lower of cost or market value, with any subsequent decreases in fair value recognized in mortgage banking income. Loan origination fees are recorded when earned.

The Company issues rate lock commitments to borrowers on prices quoted by secondary market investors. Derivatives related to these commitments are recorded as either assets or liabilities in the balance sheet and are measured at fair value. Changes in the fair value of the derivatives are recorded in mortgage banking income in the consolidated statements of operations.

Mortgage servicing rights:

Mortgage servicing rights (“MSRs”) represent the present value of the future net servicing fees from servicing mortgage loans. Servicing assets and servicing liabilities must be initially measured at fair value, if practicable. The Company’s servicing assets are initially measured at fair value and are subsequently measured using either the fair value method or the amortization method, depending on the asset class, which has been determined to be vintage (or loan origination) year.

The methodology used to determine the fair value of MSRs is subjective and requires the development of a number of assumptions, including anticipated prepayments of loan principal. Fair value is determined by estimating the present value of the asset’s future cash flows utilizing market-based prepayment rates, discount rates and other assumptions validated through comparison to trade information, industry surveys and with the use of independent third party appraisals. Risks inherent in the MSRs’ valuation include higher than expected prepayment rates and/or delayed receipt of cash flows. The value of MSRs is significantly affected by mortgage interest rates available in the marketplace, which influence mortgage loan prepayment speeds. In general, during periods of declining interest rates, the value of mortgage servicing rights declines due to increasing prepayments attributable to increased mortgage refinance activity. Conversely, during periods of rising interest rates, the value of servicing rights generally increases due to reduced refinance activity.

Note 1. Summary of Significant Accounting Policies, Continued

Mortgage servicing rights, continued:

MSRs accounted for using the fair value method are carried at fair value with changes in fair value, changes due to paydowns and payoffs of underlying loans, and servicing fees (cost) recorded in mortgage banking income in the consolidated statements of operations.

For MSRs accounted for using the amortization method, the amortization is determined in proportion to, and over the period of, the estimated net servicing income and recorded in mortgage banking income in the consolidated statements of operations. These MSRs are evaluated quarterly for possible impairment. If the impairment evaluation indicates that the carrying amount of the servicing assets exceeds their fair value, the carrying amount is reduced by recording a charge to income in the amount of such excess and establishing a valuation reserve allowance. If impairment is determined to be other-than-temporary, a direct write-off of the carrying amount would be recorded.

Core deposit intangible:

As a result of a business combination, the Company may recognize an intangible asset representing the estimated value of core deposits assumed. The Company amortizes the intangible assets over their estimated useful lives. Core deposit intangibles are periodically reviewed for reasonableness and are evaluated for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable.

Goodwill:

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is not amortized but tested for impairment on an annual basis, or more often, if events or circumstances indicate there may be impairment. Goodwill impairment exists when a reporting unit's carrying value of goodwill exceeds its implied fair value. Authoritative guidance governing the testing of indefinite lived intangible assets for impairment allows the option to first assess Goodwill by utilizing qualitative factors in determining if it is more likely than not that carrying value exceeds fair value. If, through this analysis, it is determined that it is more likely than not that carrying value exceeds fair value, then the next step requires estimation of the fair value of the reporting unit by quantitative assessment. If the fair value of the reporting unit exceeds its carrying value, no further testing is required. An impairment charge is recognized if the carrying value of the reporting unit's goodwill exceeds its implied fair value. The Company has performed the annual impairment analysis as of December 31, 2022 and concluded no impairment exists.

Liabilities for representations and warranties:

The Company is exposed to certain liabilities under representations and warranties made to purchasers of mortgage loans and servicing rights that require indemnification or repurchase of loans. At the time it issues a guarantee, the Company assesses the need to recognize an initial liability for the fair value of obligations assumed under the guarantee.

Note 1. Summary of Significant Accounting Policies, Continued

Liabilities for representations and warranties, continued:

If determined to be necessary based on the nature of the guarantee, the Company will establish a contingency reserve for its liabilities under representations and warranties provided to purchasers of its mortgage loans and servicing rights. This reserve is maintained at a level considered appropriate by management to provide for known and inherent losses. The reserve is based upon a continuing review of past loss experience, estimates and assumptions of risk elements and future economic conditions. Additions to the reserve are recorded in other expenses.

Management's judgment about the adequacy of any reserve is based upon a number of assumptions about future events which it believes to be reasonable but which may or may not be accurate. There is no assurance that increases in the reserve will not be required in future periods. The Company may from time-to-time be required to repurchase mortgage loans previously sold to investors due to loan nonperformance. Based on management's analysis of current representations and guarantees, the Company had a reserve of $25,000 at December, 31, 2022. The Company did not have a reserve at December 31, 2021.

Revenue recognition:

In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation.

The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services that are promised within each contract, identifies those that contain performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Service Charges on Deposit Accounts: The Bank earns fees from its deposit customers for account maintenance, transaction-based and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Note 1. Summary of Significant Accounting Policies, Continued

Revenue recognition, continued:

Check Card Fee Income: Included within other service charges, commissions and fees, check card fee income represents fees earned when a debit card issued by the Bank is used. The Bank earns interchange fees from debit cardholder transactions through the Mastercard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the card. Certain expenses directly associated with the debit card are recorded on a net basis with the fee income.

Gains/Losses on OREO Sales: Gains/losses on the sale of OREO are included in noninterest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at the time of each real estate closing.

Income taxes:

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and 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 the provision for income taxes. In addition, deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Interest and penalties related to income tax matters are recognized in income tax expense.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement.

Advertising expense:

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs were $662,468 and $291,769 for 2022 and 2021, respectively, and are recorded within marketing expense.

Retirement benefits:

A retirement savings plan is sponsored by the Company and provides retirement benefits to substantially all officers and employees who meet certain age and service requirements. The plan includes a “salary reduction” feature pursuant to Section 401(k) of the Internal Revenue Code. In 2004, the Company converted the 401(k) plan to a 404(c) plan.

Note 1. Summary of Significant Accounting Policies, Continued

Retirement benefits, continued:

The 404(c) plan changes investment alternatives to include the Company's stock. Under the plan and present policies, participants are permitted to make contributions up to 15% of their annual compensation. At its discretion, the Company can make matching contributions up to 6% of the participants' compensation.

The Company charged $460,803 and $393,702 to salaries and benefits expense for the retirement savings plan in 2022 and 2021, respectively. In addition, the Company made elective contributions to the employee stock ownership plan during 2022 and 2021 totaling $150,021 and $103,507, respectively, which is recorded within salaries and benefits expense.

During 2006, the Board of Directors approved a supplemental retirement plan for the directors and certain officers. These benefits are not qualified under the Internal Revenue Code and they are not funded. For 2022 and 2021, the supplemental retirement expense was $202,087 and $193,241. The current accrued but unfunded amount is $2,588,144 and $2,401,001 at December 31, 2022 and 2021, respectively. However, certain funding is provided informally and indirectly by bank owned life insurance policies. The cash surrender value of the life insurance policies is recorded as a separate line item in the accompanying consolidated balance sheets at $18,835,768 and $18,475,896 at December 31, 2022 and 2021, respectively.

The Company has split-dollar life insurance arrangements with certain of its officers. At December 31, 2022 and 2021, the split-dollar liability relating to these arrangements totaled $438,042 and $412,277 respectively. For 2022 and 2021, the Company recognized net expenses of $25,765 and $24,251, respectively, related to these arrangements, which are recorded within salaries and benefits expense.

Stock-based compensation:

The Company can issue stock options, restricted stock, restricted stock units, and other stock-based awards to directors, officers and other key employees. The Company accounts for stock compensation in accordance with Accounting Standards Codification ("ASC") Topics 718 and 505. Under those provisions, the Company has adopted a fair value-based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized on a straight-line basis over the service period, which is usually the vesting period, taking into account retirement eligibility. As a result, compensation expense relating to stock-based awards is reflected in net income as part of salaries and benefit expense in the consolidated statements of operations.

Common stock owned by the employee stock ownership plan ("ESOP"):

All shares held by the ESOP are treated as outstanding for purposes of computing earnings per share. Purchases and redemptions of the Company's common stock by the ESOP are at estimated fair value as determined by market price of the shares. Dividends on shares held by the ESOP are charged to retained earnings. At December 31, 2022 and 2021, the ESOP owned 472,962 and 474,708 shares of the Company's common stock with an estimated value of $4,124,228 and $4,842,026, respectively. All of these shares were allocated to participants.

Note 1. Summary of Significant Accounting Policies, Continued

Income per common share:

Basic income per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and similar share-based compensation instruments and are determined using the treasury stock method (see Note 20).

Statements of cash flows:

For purposes of reporting cash flows in the consolidated financial statements, the Company considers certain highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks and federal funds sold. Generally, federal funds are sold for one-day periods. Changes in the valuation account of securities available-for-sale, including the deferred tax effects, are considered noncash transactions for purposes of the statement of cash flows and are presented in detail in the notes to the consolidated financial statements.

Off-balance sheet financial instruments:

In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the consolidated financial statements when they become payable by the customer.

Comprehensive income:

The Company reports comprehensive income in accordance with ASC 220, "*Comprehensive Income*." The standard requires that all items that are required to be reported under accounting standards as comprehensive income be reported in a financial statement that is displayed with the same prominence as other consolidated financial statements. The disclosure requirements have been included in the Company's consolidated statements of comprehensive income.

Business combinations and method of accounting for loans acquired:

The Company accounts for its acquisitions under Financial Accounting Standards Board ("FASB") ASC Topic 805, "*Business Combinations*," which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC Topic 820, "*Fair Value Measurements and Disclosures.*"

Note 1. Summary of Significant Accounting Policies, Continued

Business combinations and method of accounting for loans acquired, continued:

Purchased credit-impaired ("PCI") loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB Accounting Standards Codification Topic 310-30, "*Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality,"* formerly American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 03-3, "*Accounting for Certain Loans or Debt Securities Acquired in a Transfer*," and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be PCI loans. Evidence of credit quality deterioration as of purchase dates may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. The Company considers expected prepayments and estimates the amount and timing of expected principal, interest and other cash flows for each loan or pool of loans meeting the criteria above, and determines the excess of the loan's scheduled contractual principal and contractual interest payments over all cash flows expected to be collected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the loan's or pool's cash flows expected to be collected over the fair value for the loan or pool of loans, is accreted into interest income over the remaining life of the loan or pool (accretable difference). Subsequent to the acquisition date, increases in cash flows expected to be received in excess of the Company's initial estimates are reclassified from nonaccretable difference to accretable difference and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses. Acquired non-PCI loans are recorded at their initial fair value and adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and additional provisioning that may be required.

Recently issued accounting pronouncements:

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The standard ("ASU 2016-13") will replace the current incurred loss approach with an expected loss model, referred to as the current expected credit loss ("CECL") model. The new standard will apply to financial assets subject to credit losses and measured at amortized cost and certain off-balance-sheet credit exposures, which include, but are not limited to, loans, leases, held-to-maturity securities, loan commitments and financial guarantees. ASU 2016-13 simplifies the accounting for purchased credit-impaired debt securities and loans and expands the disclosure requirements regarding an entity's assumptions, models and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. The amendments will be effective for the Company for interim and annual reporting periods beginning after December 15, 2022. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Upon adoption, ASU 2016-13 provides for a modified retrospective transition by means of a cumulative effect adjustment to equity as of the beginning of the period in which the guidance is effective.

Note 1. Summary of Significant Accounting Policies, Continued

Recently issued accounting pronouncements, continued:

The Company is finalizing its evaluation of the adoption of this ASU. The Company to date has selected the software vendor of choice for implementation, sourced and tested required data from the Company's loan systems, tested data feeds to the model, finalized its assessment of current and forecasted macroeconomic factors and assumptions, determined appropriate segmentations of its portfolio, selected a preliminary forecast period for reasonable and supportable forecasts and reversion methodology, and has performed parallel runs of the model. The Company is currently finalizing its contract for independent third parties of model validation and internal audit of the CECL model, and process, testing and finalization of internal controls. The Company currently estimates the allowance for loan losses will increase to approximately $8 million and is inclusive of the gross up of the allowance for expected credit losses on purchased credit deteriorated assets. In addition, the Company expects to recognize a liability for unfunded commitments of approximately $1 million upon adoption. The Company will finalize the adoption during the first quarter of 2023.

In March 2022, the FASB issued amendments which are intended to improve the decision usefulness of information provided to investors about certain loan re-financings, restructurings, and write-offs. The amendments are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoptions is permitted. The Company does not expect these amendments to have a material effect on its financials statements.

In December 2022, the FASB issued amendments to extend the period of time preparers can use the reference rate reform relief guidance under Accounting Standards Codification (ASC) Topic 848 from December 31, 2022 to December 31, 2024, to address the fact that all London Interbank Offered Rate (LIBOR) tenors were not discontinued as of December 31, 2021, and some tenors will be published until June 2023. The amendments are effective immediately for all entities and applied prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Risks and uncertainties:

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies (regulatory risk). These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Note 2. Cash and Due From Banks

The Company is periodically required to maintain balances with the Federal Reserve computed as a percentage of deposits. At December 31, 2022 and 2021, the Company was not required to maintain a reserve balance.

Note 3. Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2022				
U.S. Treasury securities	$ 32,718,585	$ -	$ 1,910,616	$ 30,807,969
U.S. agency securities	5,805,577	-	430,391	5,375,186
Municipal securities	37,994,173	4,891	5,819,703	32,179,361
Mortgage-backed securities	76,923,586	-	9,710,832	67,212,754
Corporate bonds	7,905,067	-	480,369	7,424,698
Collateralized loan obligations	19,362,390	-	265,510	19,096,880
Total	$ 180,709,378	$ 4,891	$ 18,617,421	$ 162,096,848

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2021				
U.S. Treasury securities	$ 6,848,607	$ -	$ 13,152	$ 6,835,455
U.S. agency securities	7,630,674	391,861	-	8,022,535
Municipal securities	19,202,487	242,380	155,592	19,289,275
Mortgage-backed securities	45,780,200	221,794	922,289	45,079,705
Corporate bonds	2,500,000	54,960	2,670	2,552,290
Total	$ 81,961,968	$ 910,995	$ 1,093,703	$ 81,779,260

At December 31, 2022 and 2021, the Company had marketable equity securities totaling $133,715 and $137,859, respectively.

The Company did not have any securities classified as held-to-maturity at December 31, 2022 and 2021.

The following is a summary of maturities of securities available-for-sale as of December 31, 2022. The amortized cost and fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty. Mortgage-backed securities are presented as a separate line as paydowns are expected to occur before contractual maturity dates.

Note 3. Investment Securities, Continued

	Debt Securities Available-for-Sale	
	Amortized Cost	Fair Value
Due after one year but within five years	$ 32,836,053	$ 30,919,762
Due after five years through ten years	49,890,567	44,309,357
Due after ten years	21,059,172	19,654,975
	103,785,792	94,884,094
Mortgage-backed securities	76,923,586	67,212,754
Total	$180,709,378	$162,096,848

The following tables show gross unrealized losses and fair value of securities available-for-sale, aggregated by investment category, and length of time that individual securities have been in a continuous realized loss position at December 31, 2022 and 2021.

	December 31, 2022		December 31, 2021	
Securities Available-for-Sale	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Less Than 12 Months				
U.S. Treasury securities	$ 21,910,468	$ 1,020,843	$ 6,835,455	$ 13,152
U.S. agency securities	5,375,186	430,391	-	-
Municipal securities	18,086,471	2,756,674	12,347,761	155,592
Mortgage-backed securities	38,317,573	3,765,035	36,339,369	922,289
Corporate bonds	5,225,203	429,864	497,330	2,670
Collateralized loan obligations	14,700,000	265,510	-	-
Total	103,614,901	8,668,317	56,019,915	1,093,703

	December 31, 2022		December 31, 2021	
Securities Available-for-Sale	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Greater Than 12 Months				
U.S. Treasury securities	$ 8,897,501	$ 889,773	$ -	$ -
Municipal securities	12,184,339	3,063,029	-	-
Mortgage-backed securities	28,895,181	5,945,797	-	-
Corporate bonds	449,495	50,505	-	-
Total	50,426,516	9,949,104	-	-

At December 31, 2022 and 2021, the Company had eighty-three and twenty-three, respectively, individual investments available-for-sale that were in an unrealized loss position. The Company does not intend to sell these securities in the near future and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost. The Company believes that, based on industry analyst reports

Note 3. Investment Securities, Continued

and credit ratings, the deterioration in value is attributable to changes in market interest rates and, therefore, these losses are not considered other-than-temporary.

During 2022, the Company sold securities with proceeds of $1,000,000 and had no gains or losses on these sales. During 2021, the Company sold securities with proceeds of $7,051,719 and gross gains of $81,176. During 2022 and 2021, the Company recognized (losses) gains of $(4,144) and $8,435, respectively, within the consolidated statement of operations related to the decrease in fair value of marketable equity securities.

At December 31, 2022 and 2021, investment securities with a par value of $10,392,607 and $32,667,980 and a fair market value of $8,880,434 and $33,347,071, respectively, were pledged as collateral for securities under agreements to repurchase and to secure public deposits.

Note 4. Loans and Allowance for Loan Losses

Major classifications of loans receivable are summarized as follows at December 31:

	2022	2021
Real estate loans:		
Construction	$ 45,458,457	$ 51,224,463
Residential	181,006,315	146,762,207
Nonresidential	317,559,308	255,046,402
Total real estate loans	544,024,080	453,033,072
Commercial and industrial	65,479,589	60,290,755
Consumer and other	51,746,847	73,121,646
Total loans	$ 661,250,516	$ 586,445,473

Loans sold with limited recourse are 1-4 family residential mortgages originated by the Company and sold to various other financial institutions. These loans are sold with the agreement that a loan may be returned to the Company within 90 days of purchase, at any time in the event the Company fails to provide necessary documents related to the mortgages to the buyers, or if the Company makes false representations or warranties to the buyers. Loans sold under these agreements in 2022 and 2021 totaled $240,966,438 and $525,215,558, respectively. The Company uses the same credit policies in making loans held for sale as it does for on-balance-sheet instruments. Sales commitments are to sell loans at an agreed upon price and are generally funded within 60 days.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law, which established the Paycheck Protection Program (PPP). Under the program, the Small Business Administration (SBA) would forgive loans, in whole or in part, made by approved lenders to eligible borrowers for paycheck and other permitted purposes in accordance with the requirements of the program. These loans carry a fixed rate of 1.00% and a term of two years, if not forgiven, in whole or in part. The loans were 100% guaranteed by the SBA and as long as the borrower submitted its loan forgiveness application within ten months of completion of the covered period, the borrower was not required to make any payments until the forgiveness amount was remitted to the lender by the SBA. Institutions that participated in the program received a processing fee ranging from 1% to 5% based on the size of the loan from the SBA.

Note 4. Loans and Allowance for Loan Losses, Continued

The Company participated in both the first and second rounds of PPP in order to provide assistance to customers during the pandemic. During 2020, the Company processed 186 loans for a total of $30.2 million and received SBA lender fee income of $1.1 million. Recognizing the operational risk and complexity associated with the PPP portfolio, management made the determination that it was in the best interest of both the Company and its borrowers to sell the PPP portfolio and allow an organization with the appropriate servicing infrastructure to service these loans. The Company completed the sale of the PPP portfolio to The Loan Source Inc., together with its servicing partner, ACAP SME LLC, on August 28, 2020. At the time of sale, the Company immediately recognized the gross lender fee of $1.1 million in loan interest income and a loss on sale of $453 thousand in other noninterest expense within the consolidated statements of operations. During 2021, the Company participated in the second round of PPP, processing 262 loans for a total of $20.5 million and receiving SBA lender fee income of $1.1 million. The Company again elected to sell the PPP portfolio to The Loan Source Inc., which was completed on June 28, 2021. At the time of the sale, the Company recognized a gain on sale of $326 thousand and recognized all additional unamortized lender fees as an adjustment to loan interest income.

The following is an analysis of the allowance for loan losses by class of loans for the years ended December 31, 2022 and 2021:

	December 31, 2022						
		Real Estate Loans					
	Total	Construction	Residential	Non-Residential	Total Real Estate Loans	Commercial and Industrial	Consumer and Other
Beginning balance	$ 7,039,576	$ 545,727	$ 1,654,957	$ 2,797,228	$ 4,997,912	$ 998,690	$ 1,042,974
Provisions	480,000	(249,752)	310,032	814,834	875,114	(112,426)	(282,688)
Recoveries	346,173	220,570	83,182	-	303,752	4,892	37,529
Charge-offs	(205,955)	-	-	-	-	(100,984)	(104,971)
Ending balance	$ 7,659,794	$ 516,545	$ 2,048,171	$ 3,612,062	$ 6,176,778	$ 790,172	$ 692,844

	December 31, 2021						
		Real Estate Loans					
	Total	Construction	Residential	Non-Residential	Total Real Estate Loans	Commercial and Industrial	Consumer and Other
Beginning balance	$ 6,172,977	$ 491,065	$ 1,547,634	$ 2,351,113	$ 4,389,812	$ 695,150	$ 1,088,015
Provisions	302,700	(524,526)	101,089	446,115	22,678	281,312	(1,290)
Recoveries	702,054	579,188	6,234	-	585,422	45,049	71,583
Charge-offs	(138,155)	-	-	-	-	(22,821)	(115,334)
Ending balance	$ 7,039,576	$ 545,727	$ 1,654,957	$ 2,797,228	$ 4,997,912	$ 998,690	$ 1,042,974

Note 4. Loans and Allowance for Loan Losses, Continued

The population of loans individually reviewed for potential impairment included all troubled debt restructures ("TDR") and all non-accrual loans greater than $100,000. All TDR's and non-accrual loans of $100,000 or less are placed in a pool where a general loan pool is based on historical losses. The following is a summary of loans evaluated for impairment individually and collectively, by class, for the years ended December 31, 2022 and 2021:

	December 31, 2022						
		Real Estate Loans					
	Total	Construction	Residential	Non-Residential	Total Real Estate Loans	Commercial and Industrial	Consumer and Other
Allowance							
Evaluated for impairment							
Individually	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively	7,659,794	516,545	2,048,171	3,612,062	6,176,778	790,172	692,844
Allowance for loan losses	$ 7,659,794	$ 516,545	$ 2,048,171	$ 3,612,062	$ 6,176,778	$ 790,172	$ 692,844
Total Loans							
Evaluated for impairment							
Individually	$ 1,028,657	$ -	$ 490,123	$ 538,534	$ 1,028,657	$ -	$ -
Collectively	660,221,859	45,458,457	180,516,192	317,020,774	542,995,423	65,479,589	51,746,847
Loans receivable	$ 661,250,516	$ 45,458,457	$ 181,006,315	$ 317,559,308	$ 544,024,080	$ 65,479,589	$ 51,746,847

	December 31, 2021						
		Real Estate Loans					
	Total	Construction	Residential	Non-Residential	Total Real Estate Loans	Commercial and Industrial	Consumer and Other
Allowance							
Evaluated for impairment							
Individually	$ 375,992	$ -	$ 13,506	$ -	$ 13,506	$ 362,456	$ 30
Collectively	6,663,584	545,727	1,641,451	2,797,228	4,984,406	636,234	1,042,944
Allowance for loan losses	$ 7,039,576	$ 545,727	$ 1,654,957	$ 2,797,228	$ 4,997,912	$ 998,690	$ 1,042,974
Total Loans							
Evaluated for impairment							
Individually	$ 12,743,295	$ 2,848,774	$ 1,109,570	$ 2,529,373	$ 6,487,717	$ 6,137,270	$ 118,308
Collectively	573,702,178	48,375,689	145,652,637	252,517,029	446,545,355	54,153,485	73,003,338
Loans receivable	$ 586,445,473	$ 51,224,463	$ 146,762,207	$ 255,046,402	$ 453,033,072	$ 60,290,755	$ 73,121,646

Note 4. Loans and Allowance for Loan Losses, Continued

The following summarizes the Company's impaired loans as of December 31, 2022:

	Recorded Investment	Unpaid Principal	Related Allowance	Average Balance	Interest Income Recognized
With no related allowance recorded:					
Real estate loans					
Construction	$ -	$ -	$ -	$ -	$ -
Residential	490,123	490,123	-	519,676	34,413
Nonresidential	538,534	553,402	-	564,100	38,574
Total real estate loans	1,028,657	1,043,525	-	1,083,776	72,987
Commercial and industrial	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total	$ 1,028,657	$ 1,043,525	$ -	$ 1,083,776	$ 72,987
With an allowance recorded:					
Real estate loans					
Construction	$ -	$ -	$ -	$ -	$ -
Residential	-	-	-	-	-
Nonresidential	-	-	-	-	-
Total real estate loans	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total	$ -	$ -	$ -	$ -	$ -
Total					
Real estate loans					
Construction	$ -	$ -	$ -	$ -	$ -
Residential	490,123	490,123	-	519,676	34,413
Nonresidential	538,534	553,402	-	564,100	38,574
Total real estate loans	1,028,657	1,043,525	-	1,083,776	72,987
Commercial and industrial	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total	$ 1,028,657	$ 1,043,525	$ -	$ 1,083,776	$ 72,987

Note 4. Loans and Allowance for Loan Losses, Continued

The following summarizes the Company's impaired loans as of December 31, 2021:

	Recorded Investment	Unpaid Principal	Related Allowance	Average Balance	Interest Income Recognized
With no related allowance recorded:					
Real estate loans					
Construction	$ 2,848,774	$ 2,848,774	$ -	$ 2,837,382	$ 150,005
Residential	1,072,583	1,349,113	-	1,113,917	71,638
Nonresidential	2,529,373	2,564,596	-	2,624,785	158,797
Total real estate loans	6,450,730	6,762,483	-	6,576,084	380,440
Commercial and industrial	71,175	71,175	-	80,885	5,875
Consumer and other	115,745	147,700	-	151,590	12,543
Total	$ 6,637,650	$ 6,981,358	$ -	$ 6,808,559	$ 398,858
With an allowance recorded:					
Real estate loans					
Construction	$ -	$ -	$ -	$ -	$ -
Residential	36,987	36,987	13,506	36,987	2,813
Nonresidential	-	-	-	-	-
Total real estate loans	36,987	36,987	13,506	36,987	2,813
Commercial and industrial	6,066,095	6,066,095	362,456	6,473,467	545,256
Consumer and other	2,563	5,625	30	4,176	392
Total	$ 6,105,645	$ 6,108,707	$ 375,992	$ 6,514,630	$ 548,461
Total					
Real estate loans					
Construction	$ 2,848,774	$ 2,848,774	$ -	$ 2,837,382	$ 150,005
Residential	1,109,570	1,386,100	13,506	1,150,904	74,451
Nonresidential	2,529,373	2,564,596	-	2,624,785	158,797
Total real estate loans	6,487,717	6,799,470	13,506	6,613,071	383,253
Commercial and industrial	6,137,270	6,137,270	362,456	6,554,352	551,131
Consumer and other	118,308	153,325	30	155,766	12,935
Total	$ 12,743,295	$ 13,090,065	$ 375,992	$ 13,323,189	$ 947,319

The following is an aging analysis of the Company's loan portfolio at December 31, 2022:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Past Due > 90 Days and Accruing
Real estate loans							
Construction	$ -	$ -	$ -	$ -	$45,458,457	$ 45,458,457	$ -
Residential	-	-	-	-	181,006,315	181,006,315	-
Nonresidential	-	-	-	-	317,559,308	317,559,308	-
Total real estate loans	-	-	-	-	544,024,080	544,024,080	-
Commercial and industrial	-	54,172	75,730	129,901	65,349,688	65,479,589	-
Consumer and other	58,808	-	35,047	93,855	51,652,992	51,746,847	-
Total	$ 58,808	$ 54,172	$ 110,777	$ 223,756	$661,026,760	$ 661,250,516	$ -

Note 4. Loans and Allowance for Loan Losses, Continued

The following is an aging analysis of the Company's loan portfolio at December 31, 2021:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Past Due > 90 Days and Accruing
Real estate loans							
Construction	$ -	$ -	$ -	$ -	$51,224,463	$ 51,224,463	$ -
Residential	-	-	491,351	491,351	146,270,856	146,762,207	-
Nonresidential	-	-	-	-	255,046,402	255,046,402	-
Total real estate loans	-	-	491,351	491,351	452,541,721	453,033,072	-
Commercial and industrial	90,268	-	-	90,268	60,200,487	60,290,755	-
Consumer and other	29,272	-	-	29,272	73,092,374	73,121,646	-
Total	$ 119,540	$ -	$ 491,351	$ 610,891	$585,834,582	$ 586,445,473	$ -

The following is an analysis of the Company's nonaccrual loan portfolio recorded at December 31, 2022 and 2021:

	2022	2021
Real estate loans		
Residential	$ 68,602	$ 599,250
Nonresidential	199,406	225,993
Total real estate loans	268,008	825,243
Commercial and industrial	75,730	-
Consumer and other	129,456	106,000
Total	$ 473,194	$ 931,243

Troubled Debt Restructurings

The following table summarizes the carrying balance of troubled debt restructurings ("TDRs") as of December 31, 2022 and 2021:

	2022	2021
Performing TDRs	$ 1,296,235	$ 1,405,232
Nonperforming TDRs	142,680	205,343
Total	$ 1,438,915	$ 1,610,575

Loans classified as TDRs may be removed from this status for disclosure purposes after a specified period of time if the TDR is subsequently restructured, and the newly restructured agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, the loan is performing in accordance with the terms specified by the restructured agreement, and certain other criteria are met.

Note 4. Loans and Allowance for Loan Losses, Continued

The following is an analysis of TDRs identified during 2022:

	For the year ended December 31, 2022		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Real estate loans			
Residential	1	$ 145,152	$ 145,152
	1	$ 145,152	$ 145,152

During the year ended December 31, 2022, the Company modified one loan that was designated as a TDR due to an extension of the term and a reduction in the monthly payment amount. There were no TDRs identified during the year ended December 31, 2021. None of the loans previously identified as TDRs went into default (as defined by nonaccrual classification) during the years ended December 31, 2022 or December 31, 2021.

Credit Quality Indicators

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt, including, among other factors: current financial information, historical payment experience, credit documentation, public information, and current economic trends. The following definitions are utilized for risk ratings, which are consistent with the definitions used in supervisory guidance:

Special Mention - Loans classified as special mention have a potential weakness that deserves managements close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Note 4. Loans and Allowance for Loan Losses, Continued

The following table lists the loan guides used by the Bank as credit quality indicators and the balance in each category at December 31, 2022:

		Real Estate Loans			Total		
	Total	Construction	Residential	Non-Residential	Real Estate Loans	Commercial and Industrial	Consumer and Other
Pass	$ 652,585,645	$ 43,936,751	$ 180,272,587	$ 313,044,651	$ 537,253,989	$ 64,171,086	$ 51,160,570
Special mention	7,751,948	1,521,706	665,125	3,993,505	6,180,336	1,143,229	428,383
Substandard	912,923	-	68,603	521,152	589,755	165,274	157,894
Doubtful	-	-	-	-	-	-	-
Total	$ 661,250,516	$ 45,458,457	$ 181,006,315	$ 317,559,308	$ 544,024,080	$ 65,479,589	$ 51,746,847

The following table lists the loan guides used by the Bank as credit quality indicators and the balance in each category at December 31, 2021:

		Real Estate Loans			Total		
	Total	Construction	Residential	Non-Residential	Real Estate Loans	Commecial and Industrial	Consumer and Other
Pass	$ 570,834,629	$ 48,375,689	$ 145,335,932	$ 251,238,347	$ 444,949,968	$ 53,119,585	$ 72,765,076
Special mention	13,188,805	2,222,622	865,867	2,746,306	5,834,795	7,100,376	253,634
Substandard	2,422,039	626,152	560,408	1,061,749	2,248,309	70,794	102,936
Doubtful	-	-	-	-	-	-	-
Total	$ 586,445,473	$ 51,224,463	$ 146,762,207	$ 255,046,402	$ 453,033,072	$ 60,290,755	$ 73,121,646

The Company enters into financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other parties to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities.

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

Note 4. Loans and Allowance for Loan Losses, Continued

The following table summarizes the Company's off-balance sheet financial instruments whose contract amounts represent credit risk for the years ended December 31:

	2022	2021
Commitments to extend credit	$ 134,683,093	$ 100,340,929
Standby letters of credit	2,639,724	2,224,976

Acquired Loans:

Loans acquired through acquisitions are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. Discounts on loans that are not considered impaired at acquisition are recorded as an accretable discount and are accreted into interest income over the terms of the related loans. The remaining balance of acquired non-PCI loans was $3.2 million and $5.4 million with remaining accretable yield of $62 thousand and $101 thousand at December 31, 2022 and 2021, respectively. For acquired loans that are considered impaired at the time of acquisition (PCI), the difference between the contractually required payments and expected cash flows is recorded as a nonaccretable discount.

The following table presents changes in the carrying value of PCI loans for the years ended December 31, 2022 and 2021:

	2022	2021
Balance at beginning of period	$ 2,094,575	$ 5,307,572
Change due to payments received and accretion	(719,334)	(3,226,477)
Advances	175,729	13,480
Balance at end of period	$ 1,550,970	$ 2,094,575

The following table presents changes in the nonaccretable yield for PCI loans for the year ended December 31, 2022 and 2021:

	2022	2021
Balance at beginning of period	$ 278,362	$ 476,947
Reclassification to accretable yield	(107,011)	(199,365)
Change due to recoveries (charge-offs)	-	780
Balance at end of period	$ 171,351	$ 278,362

The following table presents changes in the accretable yield for PCI loans for the year ended December 31, 2022 and 2021:

	2022	2021
Balance at beginning of period	$ 431,412	$ 372,293
Reclassification from nonaccretable yield	107,011	199,365
Accretion, net cash basis interest collections	(264,388)	(140,246)
Balance at end of period	$ 274,035	$ 431,412

Note 4. Loans and Allowance for Loan Losses, Continued

The Company did not include acquired loans within the calculation of allowance for loan losses as of December 31, 2022 and 2021, as the remaining discount was in excess of calculated allowance on those loans.

Note 5. Premises, Furniture and Equipment

Premises, furniture and equipment consisted of the following for the years ended December 31:

	2022	2021
Land	$ 8,632,700	$ 8,632,700
Buildings	16,895,393	16,658,305
Leasehold improvements	2,249,098	2,195,783
Furniture and equipment	11,146,395	10,440,335
Construction in progress	828,763	831,950
Total	39,752,349	38,759,073
Less, accumulated depreciation	(16,940,899)	(15,954,067)
Premises and equipment, net	$ 22,811,450	$ 22,805,006

Depreciation expense for the years ended December 31, 2022 and 2021 amounted to $1,112,170 and $935,042, respectively.

At December 31, 2022 and 2021, construction in progress consists mainly of architect fees and site work for potential new branches. As of December 31, 2022, there were no material commitments outstanding for the construction or purchase of premises, furniture and equipment.

Note 6. Other Real Estate Owned

Transactions in other real estate owned for the years ended December 31, 2022 and 2021 are summarized below:

	2022	2021
Beginning balance	$ 135,000	$ 164,295
Additions	-	-
Sales	(135,000)	-
Write downs	-	(29,295)
Ending balance	$ -	$ 135,000

The Company recognized a loss on the sale of other real estate owned of $15,838 for the year ended December 31, 2022. The Company did not sell any other real estate owned during the year ended December 31, 2021.

Note 7. Mortgage Servicing Rights

The Company retains the right to service the residential mortgage loans that it sells to the Federal National Mortgage Association ("FNMA") and Freddie Mac ("FHLMC") and recognizes those rights as an asset on the consolidated balance sheets.

The Company's servicing assets are initially measured at fair value and are subsequently measured using either the fair value method or the amortization method, depending on the asset class, which has been determined to be vintage (or loan origination) year. Vintage year classes prior to 2020 are measured using the fair value method while subsequent vintage year classes are measured using the amortization method. MSRs accounted for under the amortization method are subsequently accounted for at lower of cost or fair value, net of accumulated amortization, which is recorded in proportion to, and over the period of, net servicing income. Any changes in fair value during the period for MSRs carried under the fair value method, as well as amortization and impairment of MSRs under the amortization method, are recorded in mortgage banking income in the consolidated statements of operations.

The following table presents the activity for MSRs accounted for using the amortization method for the years ended December 31, 2022 and 2021:

	2022	2021
Balances, beginning of year	$ 9,681,076	$ 6,357,700
Amount capitalized	2,370,641	5,210,500
Sales proceeds, net	(4,939,834)	-
Amount amortized	(1,312,916)	(1,887,124)
Balances, end of year	$ 5,798,967	$ 9,681,076

The following table presents the activity for MSRs accounted for using the fair value method for the years ended December 31, 2022 and 2021:

	2022	2021
Balances, beginning of year	$ 4,376,021	$ 5,662,912
Changes in fair value (1)	1,251,171	996,049
Changes in unpaid principal balance (2)	(984,737)	(2,282,940)
Balances, end of year	$ 4,642,455	$ 4,376,021

(1) Represents changes in value primarily due to market driven changes in interest rates and prepayment speeds.
(2) Represents changes in value of the MSRs due to i) passage of time, including the impact from both regularly scheduled loan principal payments and partial paydowns, and ii) loans that paid off fully during the period.

The fair value of MSRs is highly sensitive to changes in assumptions and fair value is determined by estimating the present value of the asset's future cash flows utilizing market-based prepayment rates, discount rates and other assumptions validated through comparison to trade information, industry surveys, and with the use of independent third party appraisals. Changes in prepayment speed assumptions have the most significant impact on the fair value of MSRs. Generally, as interest rates decline, mortgage loan prepayments accelerate due to

Note 7. Mortgage Servicing Rights, Continued

increased refinance activity, which results in a decrease in the fair value of the MSRs. Measurement of fair value is limited to the conditions existing and the assumptions utilized as of a particular point in time, and those assumptions may not be appropriate if they are applied at a different time.

At December 31, 2022 and 2021, the aggregate amount of loans serviced by the Company for the benefit of others totaled $0.9 billion and $1.4 billion respectively.

The characteristics and sensitivity analysis of the MSRs are included in the following table as of December 31, 2022 and 2021.

	2022	2021
Composition of residential loans serviced for others		
Fixed-rate mortgage loans	100.00%	100.00%
Weighted average expected life	7.7 years	7.1 years
Constant prepayment rate ("CPR")	7.65%	8.80%
Weighted average discount rate	8.53%	8.53%

Note 8. Derivatives

The derivative positions of the Company for the years ended December 31, 2022 and 2021 are reported as other assets and liabilities and are as follows:

	2022		2021	
Derivative assets (liabilities):	Fair value	Notional value	Fair value	Notional value
Mortgage loan interest rate lock commitments	$ 56,402	$ 7,320,976	$ 824,481	$ 41,946,942
Mortgage loan forward sales commitments	35,000	8,000,000	(7,695)	33,250,000
U.S. Treasury futures contracts	-	-	21,914	5,500,000

The Company uses derivatives primarily to minimize interest rate risk related to its pipeline of loan interest rate lock commitments issued on residential mortgage loans in the process of origination for sale or loans held for sale. The Company's derivative positions are classified as trading assets and liabilities, and as such, the changes in the fair market value of the derivative positions are recognized in the consolidated statements of operations within mortgage banking income. During 2022, the Company unwound all outstanding U.S. Treasury futures contracts, which were previously used to hedge against changes in the value of the mortgage servicing rights measured under the fair value method.

Note 9. Core Deposit Intangible

The following table presents information about our intangible assets as of December 31:

	2022		2021	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Core deposit intangibles	$ 880,000	$ 732,906	$ 880,000	$ 635,526

Based on the core deposit intangibles as of December 31, 2022, the following table presents the aggregate amortization expense for each of the succeeding years ending December 31:

	Amount
2023	$ 72,777
2024	48,177
2025	23,576
2026	2,564
Total	$ 147,094

Amortization expense of $97,380 and $121,980 related to the core deposit intangibles was recognized in 2022 and 2021, respectively, and was recorded within other noninterest expense.

Note 10. Deposits

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

Maturing In:	Amount
2023	$ 72,025,313
2024	13,954,583
2025	5,902,224
2026	11,157,237
2027	661,714
Total	$ 103,701,071

Included in total time deposits at December 31, 2022 and 2021, respectively, were brokered time deposits of $25,483,000 and $15,398,000. Interest expense on time deposits that meet or exceed the FDIC insurance limit of $250,000 was $204,579 and $277,507 for the years ended December 31, 2022 and 2021, respectively.

Note 11. Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase generally mature on a one to thirty day basis. Under the terms of the repurchase agreement, the Company sells an interest in securities issued by United States Government agencies and agrees to repurchase the same securities the following business day. Information concerning securities sold under agreements to repurchase is summarized as follows at December 31:

	2022	2021
Balance at December 31	$ 7,367,861	$ 11,372,325
Maximum month-end balance during the year	13,805,033	11,372,325
Average balance during the year	10,128,626	7,738,616
Average interest rate at the end of the year	0.15%	0.14%
Average interest rate during the year	0.17%	0.14%

At December 31, 2022 and 2021, investment securities with a par value of $10,392,607 and $12,353,259 and a fair market value of $8,880,434 and $12,873,989, respectively, were pledged as collateral for the underlying agreements.

Note 12. Federal Home Loan Bank Advances

Federal Home Loan Bank advances consisted of the following at December 31:

	Interest Rate	2022	2021
Fixed rate			
January 25, 2023	4.23%	$ 20,000,000	$ -
January 27, 2023	4.23%	10,000,000	-
September 20, 2029	1.62%	-	10,000,000
		$ 30,000,000	$ 10,000,000

At December 31, 2022 and 2021, the Company has pledged certain loans totaling $240,843,061 and $192,090,005, respectively, as collateral to secure its borrowings from the FHLB. Additionally, the Company's FHLB stock is pledged to secure the borrowings.

Note 13. Junior Subordinated Debentures

On June 30, 2005, the Trust (a non-consolidated subsidiary) issued $10,000,000 in trust preferred securities (callable without penalty) with a maturity of November 23, 2035. Interest on these securities is payable quarterly at three-month LIBOR ("London Interbank Offered Rate") plus 1.83%. In accordance with generally accepted accounting principles, the Trust has not been consolidated in these financial statements. The Company received from the trust the $10,000,000 proceeds from the issuance of the securities and the $310,000 initial proceeds from the capital investment in the Trust, and accordingly has shown the funds due to the trust as $10,310,000 junior subordinated debentures. Current regulations allow the entire amount of junior subordinated debentures to be included in the calculation of regulatory capital. As of December 31, 2022 and 2021, the Company had accrued and unpaid interest totaling $72,870 and $22,300, respectively.

Note 14. Borrowings

On August 5, 2016, the Company entered into subordinated debt agreements with eight financial institutions totaling $5,000,000. The debt initially bore interest at a fixed rate of 7.00% per annum until August 5, 2021 and then variable at three-month LIBOR plus 5.86%, payable quarterly with principal and unpaid interest due at maturity, August 5, 2026. On August 5, 2021, the Company redeemed all $5,000,000 of these subordinated notes, including any accrued but unpaid interest.

On June 2, 2020, the Company entered into subordinated debt agreements with eight financial institutions totaling $5,500,000. The debt initially bears interest at a fixed rate of 5.875% per annum until June 1, 2025 and then variable at three-month SOFR ("Secured Overnight Financing Rate") plus 5.51%, payable quarterly with principal and unpaid interest due at maturity, June 1, 2030.

On September 22, 2021, the Company entered into subordinated debt agreements with eleven financial institutions totaling $10,000,000. The debt initially bears interest at a fixed rate of 3.375% per annum until October 1, 2026 and then variable at three-month SOFR plus 2.45%, payable quarterly with principal and unpaid interest due at maturity, October 1, 2031. The Company recorded $158,732 in debt issuance costs associated with the subordinated debt, which is recorded net within subordinated debentures and will be amortized over five years. At December 31, 2022, remaining debt issuance costs to be amortized totaled $119,049.

Note 15. Shareholders' Equity

Common Stock - The following is a summary of the changes in common stock outstanding for the years ended December 31, 2022 and 2021.

	2022	2021
Common shares outstanding at beginning of the period	8,258,410	8,329,732
Conversion of Series D preferred stock to common stock	1,000	1,200
Purchase of treasury stock	(55,253)	(300,374)
Restricted stock issued	46,033	260,401
Additional shares granted	7,918	34,477
Forfeiture of restricted shares	(117,797)	(67,026)
Common shares outstanding at end of the period	8,140,311	8,258,410

Preferred Stock - The Company's Articles of Incorporation authorizes the issuance of a class of 10,000,000 shares of preferred stock, having no par value. Subject to certain conditions, the Company's Board of Directors is authorized to issue preferred stock without shareholder approval. Under the Articles of Incorporation, the Board of Directors is authorized to determine the terms of one or more series of preferred stock, including the preferences, rights, and limitations of each series.

The Company's Series D Preferred Stock ("Series D Shares") is a fixed rate non-cumulative perpetual preferred stock, created July 16, 2015, with the authorized issuance of 70,000 shares. The Series D shares were created for the purpose of converting Common Stockholders with 200 shares or less to Series D Shares. The Series D Shares have no voting rights, and in the event dividends are declared on Common Stock, will be entitled to 4% more than those paid on the Common Stock. Series D Shares will, with respect to ranking to include but not limited to dividends and rights upon liquidation, be senior to all Common Stock.

Note 15. Shareholders' Equity, Continued

On September 22, 2017, the Company issued 410,499 shares of Series E Preferred Stock ("Series E Shares"). The Series E Shares were created in conjunction with the Company's 2017 common stock issuance. The Series E Shares have no voting rights, and are entitled to receive dividends as declared in the same per share amount as common stock. During 2018, the Series E Shares were converted to 410,499 shares of non-voting common stock. During 2021, the 410,499 shares of non-voting common stock were converted into voting shares of common stock.

Restrictions on Shareholders' Equity - South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to the Company are payable only from the undivided profits of the Bank. At December 31, 2022, the Bank had undivided profits of $39,852,072. The Bank is authorized to dividend 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Commissioner of Banks provided that the Bank received a composite CAMELS rating of one or two at the last Federal or State regulatory examination. Under Federal Reserve regulations, the amounts of loans or advances from the Bank to the parent company are also restricted.

Note 16. Income Taxes

Income tax provision for the years ended December 31, 2022 and 2021 is summarized as follows:

	2022	2021
Provision		
Current income tax expense		
Federal	$ 1,516,652	$ 1,316,786
State	109,928	70,049
Total current	1,626,580	1,386,835
Deferred income tax expense (benefit)		
Federal	13,700	(255,927)
State	(54,328)	(84,003)
Total deferred	(40,628)	(339,930)
Change in valuation allowance	54,328	84,003
Total income tax expense	$ 1,640,280	$ 1,130,908

Note 16. Income Taxes, Continued

The components of deferred tax assets and deferred tax liabilities as of December 31, are as follows:

	2022	2021
Deferred tax assets:		
Allowance for loan losses	$ 1,482,227	$ 1,334,083
Net operating losses	3,920,899	3,905,592
Non-accrual interest	3,092	17,783
Deferred compensation	754,245	708,005
Purchase accounting on acquisition	77,332	112,122
Leases	46,173	30,960
Unrealized losses on securities available-for-sale	4,560,070	45,679
Other	146,244	139,232
Gross deferred tax assets	10,990,282	6,293,456
Less, valuation allowance	(835,811)	(781,483)
Net deferred tax assets	10,154,471	5,511,973
Deferred tax liabilities:		
Prepaid expenses	19,552	19,552
Accumulated depreciation	148,520	21,379
Mark to market adjustments	994,110	1,095,721
Deferred loan origination costs	363,384	247,107
Total gross deferred tax liabilities	1,525,566	1,383,759
Net deferred tax assets recognized	$ 8,628,905	$ 4,128,214

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the net deferred tax assets to net realizable value. As of December 31, 2022, management has determined that it is more likely than not that the majority of the deferred tax asset from continuing operations will be realized. In 2022, the balance in the valuation allowance changed by $54,328. The remaining valuation allowance relates to the parent company's state operating loss carryforwards for which realizability is uncertain.

The Company has federal net operating losses of $14,767,644 and $14,980,339 for the years ended December 31, 2022 and 2021, respectively. Net operating losses of $3,768,740 expire at various times from 2029-2037, with the remainder having no expiration date. The Company's ability to benefit from the use of net operating loss carryforwards of $14,767,644 is limited annually under Section 382 of the Internal Revenue Code. The Company has state net operating losses of $20,751,748 and $19,233,440 for the years ended December 31, 2022 and 2021, respectively. State net operating losses of $9,501,898 expire at various times from 2023-2037, with the remainder having no expiration date.

Note 16. Income Taxes, Continued

A reconciliation between the income tax expense and the amount computed by applying the federal statutory rate of 21% to income before income taxes for the years ended December 31, 2022 and 2021 follows:

	2022	2021
Tax expense at statutory rate	$ 1,589,971	$ 1,345,606
State income tax expense (benefit), net of federal income tax benefit	43,924	(11,024)
Tax-exempt interest income	(23,991)	(28,559)
Disallowed interest expense	725	597
Life insurance surrender value	(75,573)	(78,556)
Excess tax benefit of stock-based compensation	(44,859)	(239,865)
Change in valuation allowance	54,328	84,003
Other, net	95,755	58,706
Total	$ 1,640,280	$ 1,130,908

The Company had analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions. Tax returns for 2019 and subsequent years are subject to review by taxing authorities.

Note 17. Related Party Transactions

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) are loan customers of the Company. In compliance with relevant law and regulations, the Company's related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not related to the lender and do not involve more than the normal risk of collectability. As of December 31, 2022 and 2021, the Company had related party loans totaling $560,195 and $1,030,108, respectively.

Deposits from directors and executive officers and their related interests totaled $6,873,006 and $7,289,077 at December 31, 2022 and 2021, respectively.

Note 18. Commitments and Contingencies

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2022, management and legal counsel are not aware of any pending or threatened litigation or unasserted claims or assessments that could result in losses, if any, that would be material to the consolidated financial statements.

The Company has operating leases on eight of its facilities that are accounted for under ASC 842. The Company had operating right-of-use assets of $5,977,748 and $6,634,220 as of December 31, 2022 and 2021, respectively. The Company had lease liabilities of $6,197,620 and $6,781,650 as of December 31, 2022 and 2021, respectively.

Rental expense under the leases for the years ended December 31, 2022 and 2021 was $1,025,162 and $1,018,203, respectively, and was recorded within occupancy and equipment expense in the consolidated statements of operations.

Note 18. Commitments and Contingencies, Continued

The weighted average remaining lease term as of December 31, 2022 is 10.5 years and the weighted average discount rate used is 2.85%. The following table shows future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2022:

2023	$	797,739
2024		787,965
2025		747,704
2026		674,042
2027		679,104
Thereafter		3,241,941
Total undiscounted lease payments		6,928,495
Less effect of discounting		(730,875)
Present value of estimate lease payments (lease liability)	$	6,197,620

Note 19. Equity Incentive Plan

During 2021, shareholders of the Company approved the 2021 Equity Incentive Plan (the “2021 Plan") under which an aggregate of 600,000 shares of common stock have been reserved for issuance as stock-based awards, including stock options, restricted stock, restricted stock units, and other stock-based awards. The maximum aggregate shares subject to options is restricted to 80,000 in any calendar year to any one participant. Options may be granted for a term of up to ten years from the effective date of the grant. The aggregate number of shares subject to awards of restricted stock and other stock-based awards is restricted to 50,000 in any calendar year to any one participant. At the time of adoption of the 2021 Plan, the Company sunset two equity incentive pools, the 2017 Equity Incentive Plan (the “2017 Plan”) and a Restricted Stock Reserve. The 2021 Plan, the 2017 Plan, and the Restricted Stock Reserve are referred to collectively as the “Plans.” At December 31, 2022, there were 500,460 shares available for grant under the 2021 Plan and no shares available for grant under the 2017 Plan or Restricted Stock Reserve.

The Company can issue restricted shares as of the grant date either by the issuance of share certificate(s) evidencing restricted shares or by documenting the issuance in uncertificated or book entry form on the Company's stock records. Except as provided by the Plans, the employee does not have the right to make or permit to exist any transfer or hypothecation of any restricted shares. When restricted shares vest, the employee must either pay the Company within two business days the amount of all tax withholding obligations imposed on the Company or make an election pursuant to Section 83(b) of the Internal Revenue Code to pay taxes at grant date.

Restricted shares may be subject to one or more employment, performance, or other conditions established at the time of grant. Under the terms of the Plans, the restricted shares will vest completely based on the individual grant’s vesting period, which is between three and ten years. The shares are forfeited entirely if the participant terminates employment for any reason other than changes in control or death or disability. Any shares of restricted stock that are forfeited will again become available for issuance under the Plans. An employee or director has the right to vote the shares of restricted stock after grant until they are forfeited. Compensation cost for restricted stock is equal to the market value of the shares at the date of the award and is amortized to compensation expense over the vesting period. Dividends, if any, will be paid on awarded but unvested stock.

Note 19. Equity Incentive Plan, Continued

Nonvested restricted stock for the years ended December 31, 2022 and 2021 is summarized in the following table.

	2022		2021	
	Shares	Weighted-Average Grant-Date Fair Value	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1	453,719	$ 7.36	423,014	$ 5.24
Granted	46,033	9.64	260,401	7.88
Vested	(58,593)	6.87	(162,670)	2.77
Forfeited	(100,771)	7.19	(67,026)	7.16
Nonvested at December 31	340,388	$ 7.80	453,719	7.36

The vesting schedule for these shares as of December 31, 2022 is as follows:

	Shares
2023	$ 52,531
2024	72,849
2025	41,159
2026	87,150
2027 and thereafter	86,700
Total	$ 340,388

The Company recognized stock-based compensation costs related to restricted stock of $493,519 and $483,835 for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, there was $2,133,754 of total unrecognized compensation cost related to the nonvested restricted stock that will be recognized over the remainder of their vesting schedule.

No stock options were granted during the years ended December 31, 2022 and 2021. Activity related to stock options is summarized in the following table.

	Options	Weighted-Average Remaining Life (Years)	Weighted-Average Exercise Price
Outstanding at December 31, 2021	169,440	1.80	$ 7.27
Granted	-	-	-
Exercised	-	-	-
Forfeited	-	-	-
Outstanding at December 31, 2022	169,440	1.80	7.27
Options exercisable as of December 31, 2022	150,308	1.80	7.27

The Company recognized stock-based compensation costs related to stock options of $54,623 and $83,071 for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, there was $23,946 of total

Note 19. Equity Incentive Plan, Continued

unrecognized compensation cost related to the outstanding stock options that will be recognized over the remainder of their vesting schedule.

The company from time-to-time also grants performance and/or time restricted stock units ("RSUs") to key employees. These awards help align the interests of these employees with the interests of the shareholders of the Company by providing economic value directly related to the performance of the Company. Dividends are not paid in respect to the awards and the holder does not have the right to vote the shares during the vesting period. The value of the RSUs awarded is established as the fair market value of the stock at the time of the grant. The Company recognizes expenses on a straight-line basis typically over the vesting period the performance and/or time target is to be achieved.

Nonvested RSUs for the year December 31, 2022 is summarized in the following table.

	2022	
	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1	-	$ -
Granted	35,000	9.08
Vested	-	-
Forfeited	-	-
Nonvested at December 31	35,000	$ 9.08

The vesting schedule for these shares as of December 31, 2022 is as follows:

	Shares
2023	$ 7,000
2024	7,000
2025	7,000
2026	7,000
2027	7,000
Total	$ 35,000

There was no RSU activity during 2021. The Company recognized stock-based compensation costs related to restricted stock units of $15,925 for the year ended December 31, 2022. As of December 31, 2022, there was $301,875 of total unrecognized compensation cost related to nonvested RSUs that will be recognized over a weighted-average period of 5 years.

Note 20. Income Per Common Share

Net income available to common shareholders represents net income adjusted for preferred dividends including dividends declared, accretions of discounts and amortization of premiums on preferred stock issuances and cumulative dividends related to the current dividend period that have not been declared as of period end.

The following is a summary of the income per common share calculations for the years ended December 31, 2022 and 2021.

	2022	2021
Income available to common shareholders		
Net income	$ 5,931,012	$ 5,276,738
Preferred stock dividends	-	-
Net income available to common shareholders	$ 5,931,012	$ 5,276,738
Basic income per common share:		
Net income available to common shareholders	$ 5,931,012	$ 5,276,738
Average common shares outstanding - basic	7,779,396	7,749,029
Basic income per common share	$ 0.76	$ 0.68
Diluted income per common share:		
Net income available to common shareholders	$ 5,931,012	$ 5,276,738
Average common shares outstanding - basic	7,779,396	7,749,029
Dilutive potential common shares	347,752	393,072
Average common shares outstanding - diluted	8,127,148	8,142,101
Diluted income per common share	$ 0.73	$ 0.65

Note 21. Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 (“CET1”), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the Bank consists of common shareholders’ equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

Note 21. Regulatory Matters, Continued

The Bank is also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. The Bank is required to maintain a required minimum leverage ratio of 4%.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank is required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer is required to consist solely of CET1, but the buffer applies to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer began to be phased in incrementally over time, beginning January 1, 2016 at 0.625% and was fully effective on January 1, 2019, consisting of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements at December 31, 2022 and 2021.

(Dollars in Thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2022						
The Bank						
Total capital (to risk-weighted assets)	$ 102,986	13.43%	$ 61,356	8.00%	$ 76,696	10.00%
Tier 1 capital (to risk-weighted assets)	95,319	12.43%	46,017	6.00%	61,356	8.00%
Tier 1 capital (to average assets)	95,319	10.37%	36,770	4.00%	45,963	5.00%
Common Equity Tier 1 Capital (to risk-weighted assets)	95,319	12.43%	34,513	4.50%	49,852	6.50%
December 31, 2021						
The Bank						
Total capital (to risk-weighted assets)	$ 95,219	14.05%	$ 54,209	8.00%	$ 67,761	10.00%
Tier 1 capital (to risk-weighted assets)	88,168	13.01%	40,657	6.00%	54,209	8.00%
Tier 1 capital (to average assets)	88,168	9.66%	36,519	4.00%	45,648	5.00%
Common Equity Tier 1 Capital (to risk-weighted assets)	88,168	13.01%	30,492	4.50%	44,045	6.50%

Note 22. Unused Lines of Credit

The Company had available at December 31, 2022 one unsecured line of credit, which was unused, to purchase up to $10,000,000 of federal funds. Also, as of December 31, 2022, the Company had the ability to borrow funds from the FHLB of up to $189,601,817. At that date, $30,000,000 had been advanced.

Note 23. Fair Value Measurements

Generally accepted accounting principles ("GAAP") provide a framework for measuring and disclosing fair value that requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of the lower of cost or market accounting or the writing down of individual assets.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Securities Available-for-Sale and Marketable Equity Securities - Securities available-for-sale and marketable equity securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Note 23. Fair Value Measurements, Continued

Mortgage Loans Held for Sale - Mortgage loans held for sale are comprised of loans originated for sale in the ordinary course of business. The fair value of mortgage loans originated for sale in the secondary market is based on purchase commitments or quoted prices for the same or similar loans and are classified as recurring Level 2. There were no loans held for sale requiring fair value adjustments at December 31, 2022 and 2021.

Mortgage Servicing Rights – Fair Value Method - Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The assumptions used in the discounted cash flow model are those that market participants would use in estimating future net servicing income. Assumptions in the valuation of mortgage servicing rights may include estimated loan repayment rates, the discount rate, servicing costs, and the timing of cash flows, among other factors. The Company measures mortgage servicing rights accounted for using the fair value method as recurring Level 3.

Derivatives - The Company's valuation techniques and inputs to internally-developed models depend on the type of derivative and nature of the underlying rate, price or index upon which the derivative's value is based. Key inputs can include yield curves, credit curves, foreign-exchange rates, prepayment rates, volatility measurements and correlation of such inputs. Where model inputs can be observed in a liquid market and the model does not require significant judgment, such derivatives are typically classified as Level 2 of the fair value hierarchy. Examples of derivatives classified as Level 2 include interest rate lock commitments written for the residential mortgage loans that the Company intends to sell. When instruments are traded in less liquid markets and significant inputs are unobservable, such derivatives are classified as Level 3. Additionally, significant judgments are required when classifying financial instruments within the fair value hierarchy, particularly between Level 2 and 3, as is the case for certain derivatives.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy at December 31, 2022 and 2021.

	December 31, 2022			
	Total	Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Treasury securities	$ 30,807,969	$ -	$ 30,807,969	$ -
U.S. agency securities	5,375,186	-	5,375,186	-
Municipal securities	32,179,361	-	32,179,361	-
Mortgage-backed securities	67,212,754	-	67,212,754	-
Corporate bonds	7,424,698	-	7,424,698	-
Collateralized loan obligations	19,096,880	-	19,096,880	-
Total available-for-sale securities	162,096,848	-	162,096,848	-
Marketable equity securities	133,715	-	133,715	-
Mortgage servicing rights	4,642,455	-	-	4,642,455
Derivative assets:				
Mortgage loan interest rate lock commitments	56,402	-	56,402	-
Mortgage loan forward sales commitments	35,000	-	35,000	-
	$ 166,964,420	$ -	$ 162,321,965	$ 4,642,455

Note 23. Fair Value Measurements, Continued

	December 31, 2021			
	Total	Level 1	Level 2	Level 3
Available-for-sale securities:				
U.S. Treasury securities	$ 6,835,455	$ -	$ 6,835,455	$ -
U.S. agency securities	8,022,535	-	8,022,535	
Municipal securities	19,289,275	-	19,289,275	-
Mortgage-backed securities	45,079,705	-	45,079,705	-
Corporate bonds	2,552,290	-	2,552,290	-
Total available-for-sale securities	81,779,260	-	81,779,260	-
Marketable equity securities	137,859	-	137,859	-
Mortgage servicing rights	4,376,021	-	-	4,376,021
Derivative assets (liabilities):				
Mortgage loan interest rate lock commitments	824,481	-	824,481	-
Mortgage loan forward sales commitments	(7,695)	-	(7,695)	-
U.S. Treasury futures contracts	21,914	-	21,914	-
	$ 87,131,840	$ -	$ 82,755,819	$ 4,376,021

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows:

	Mortgage Servicing Rights
Balance, December 31, 2020	$ 5,662,912
Changes in fair value recognized in earnings (1)	996,049
Settlements (2)	(2,282,940)
Balance, December 31, 2021	4,376,021
Changes in fair value recognized in earnings (1)	1,251,171
Settlements (2)	(984,737)
Balance, December 31, 2022	$ 4,642,455

(1) Represents changes in value primarily due to market driven changes in interest rates and prepayment speeds.
(2) Represents changes in value of the MSRs due to i) passage of time, including the impact from both regularly scheduled loan principal payments and partial paydowns, and ii) loans that paid off fully during the period.

Note 23. Fair Value Measurements, Continued

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2022 and December 31, 2021, aggregated by level in the fair value hierarchy within which those measurements fall.

	Total	Level 1	Level 2	Level 3
December 31, 2022				
Impaired loans	$ 1,028,657	$ -	$ -	$ 1,028,657
Mortgage servicing rights	5,798,967	-	-	5,798,967
Total	$ 6,827,624	$ -	$ -	$ 6,827,624

	Total	Level 1	Level 2	Level 3
December 31, 2021				
Impaired loans	$ 12,367,303	$ -	$ -	$ 12,367,303
Other real estate owned	135,000	-	-	135,000
Mortgage servicing rights	9,681,076	-	-	9,681,076
Total	$ 22,183,379	$ -	$ -	$ 22,183,379

Impaired Loans - Loans that are considered impaired are recorded at fair value on a nonrecurring basis. Once a loan is considered impaired, the fair value is measured using one of several methods, including collateral liquidation value, market value of similar debt or discounted cash flows. Those impaired loans not requiring a specific charge against the allowance represent loans for which the fair value of the expected repayments or collateral meet or exceed the recorded investment in the loan. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs.

Other Real Estate Owned - Foreclosed assets are adjusted to fair value upon transfer of the loans to OREO. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on a current appraised value or when a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Mortgage Servicing Rights – Amortization Method - Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The assumptions used in the discounted cash flow model are those that market participants would use in estimating future net servicing income. Assumptions in the valuation of mortgage servicing rights may include estimated loan repayment rates, the discount rate, servicing costs, and the timing of cash flows, among other factors. The Company measures mortgage servicing rights accounted for using the amortization method as nonrecurring Level 3.

Note 23. Fair Value Measurements, Continued

The Company had no liabilities measured at fair value on a non-recurring basis.

For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of December 31, 2022 and December 31, 2021, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value as of December 31, 2022		Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired loans	$	1,028,657	Appraisal Value/Comparison Sales	Appraisals and/or sales of comparable properties	Appraisals discounted 5% to 20% for sales commissions and other holding cost
Mortgage servicing rights	$	5,798,967	Discounted cash flows	Comparable sales	Weighted average discount rate – 9% Constant prepayment rate – 6.5%

	Fair Value as of December 31, 2021		Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired loans	$	12,367,303	Appraisal Value/Comparison Sales	Appraisals and/or sales of comparable properties	Appraisals discounted 5% to 20% for sales commissions and other holding cost
Other real estate owned	$	135,000	Appraisal Value/Comparison Sales	Appraisals and/or sales of comparable properties	Appraisals discounted 10% to 20% for sales commissions and other holding cost
Mortgage servicing rights	$	9,681,076	Discounted cash flows	Comparable sales	Weighted average discount rate – 9% Constant prepayment rate – 10%

Note 23. Fair Value Measurements, Continued

Fair Value of Financial Instruments

The following table includes the estimated fair value of the Company's financial assets and financial liabilities. The methodologies for estimating the fair value of financial assets and financial liabilities measured on a recurring and nonrecurring basis are discussed above. The methodologies for estimating the fair value for other financial assets and financial liabilities are discussed below. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation techniques may have a material effect on the estimated fair value amounts at December 31, 2022 and 2021.

	December 31,			
	2022		2021	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 33,797,310	$ 33,797,310	$ 150,123,960	$ 150,123,960
Mortgage loans held for sale	7,940,056	7,940,056	23,844,303	23,844,303
Loans held for investment, net	653,590,722	623,018,294	579,405,897	572,938,680
Nonmarketable equity securities	1,787,200	1,787,200	837,000	837,000
Deposits	798,183,843	796,890,613	780,833,323	780,115,119
Securities sold under agreement to repurchase	7,367,861	7,367,861	11,372,325	11,372,325
Federal Home Loan Bank advances	30,000,000	30,000,000	10,000,000	9,799,455
Subordinated debentures	25,690,951	22,827,166	25,659,205	25,783,835

Cash and cash equivalents
The carrying amount approximates fair value for these instruments.

Loans held for sale
Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential real estate loans originated for sale to qualified third parties. Fair value is based upon the contractual price to be received from these third parties, which may be different than cost.

Loans held for investment
Fair values are estimated for portfolios of loans with similar financial characteristics if collateral-dependent. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect observable market information incorporating the credit, liquidity, yield and other risks inherent in the loan. The estimate of maturity is based upon the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of the current economic and lending conditions.

Note 23. Fair Value Measurements, Continued

Fair value for significant non-performing loans is generally based upon recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discounted rates are judgmentally determined using available market information and specific borrower information.

Nonmarketable equity securities
Nonmarketable equity securities are carried at original cost basis, as cost approximates fair value and there is no ready market for such investments.

Deposits
The fair value of deposits with no stated maturity date, such as noninterest-bearing demand deposits, savings and money market and checking accounts, is based on the carrying value. The fair value of time deposits is based upon the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Subordinated debentures
The fair value of subordinated debentures is estimated by using discounted cash flow analyses based on incremental borrowing rates for similar types of instruments.

Federal Home Loan Bank advances
Fair value is estimated based on discounted cash flows using current market rates for borrowing with similar terms.

Other borrowings
The fair value of federal funds purchased and securities under agreements to repurchase approximate the carrying amount because of the short maturity of these borrowings.

Note 24. First Reliance Bancshares, Inc. (Parent Company Only)

Condensed Balance Sheets

	December 31, 2022	December 31, 2021
Assets		
Cash	$ 3,867,380	$ 4,496,727
Investment in banking subsidiary	82,867,930	89,763,094
Marketable equity securities	133,715	137,859
Nonmarketable equity securities	58,100	58,100
Investment in trust	310,000	310,000
Deferred tax asset	2,001,469	2,023,124
Total assets	$ 89,238,594	$ 96,788,904
Liabilities		
Junior subordinated debentures	$ 10,310,000	$ 10,310,000
Subordinated debentures	15,380,951	15,349,205
Accrued salary benefits	110,924	233,814
Accrued interest payable	140,855	94,234
Total liabilities	25,942,730	25,987,253
Shareholders' equity	63,295,864	70,801,651
Total liabilities and shareholders' equity	$ 89,238,594	$ 96,788,904

Condensed Statements of Operations

	For the years ended December 31, 2022	For the years ended December 31, 2021
Income		
Interest income	$ 9,808	$ 6,277
(Loss) gain on change in fair value of marketable equity securities	(4,144)	8,435
Total income	5,664	14,712
Expenses		
Interest expense	1,072,846	808,249
Salaries and employee benefits	252,642	356,286
Equipment expense	-	8,719
Other expenses	43,356	69,483
Total expenses	1,368,844	1,242,737
Loss before income taxes and equity in undistributed income of banking subsidiary	(1,363,180)	(1,228,025)
Equity in undistributed earnings of banking subsidiary	7,020,265	6,059,573
Net income before income taxes	5,657,085	4,831,548
Income tax benefit	273,927	445,190
Net income	$ 5,931,012	$ 5,276,738

Note 24. First Reliance Bancshares, Inc. (Parent Company Only), Continued

Condensed Statements of Cash Flows

	For the years ended December 31, 2022	2021
Cash flows from operating activities		
Net income	$ 5,931,012	$ 5,276,738
Adjustments to reconcile net income to net cash used in operating activities:		
Deferred income taxes, net of allowance	21,655	39,726
Net equity in undistributed earnings of banking subsidiary	(7,020,265)	(6,059,573)
Amortization of debt issuance costs	31,746	20,939
Loss (gain) on change in fair value of marketable equity securities	4,144	(8,435)
Stock based compensation expense	54,623	83,071
Decrease in other assets	-	28,069
Increase (decrease) in accrued interest payable	46,621	(85,342)
(Decrease) increase in accrued salary benefits	(122,890)	119,332
Net cash used in operating activities	(1,053,354)	(585,475)
Cash flows from by investing activities		
Purchase of marketable equity securities	-	(100,000)
Investment in subsidiary	-	(3,000,000)
Net cash used in investing activities	-	(3,100,000)
Cash flows from financing activities		
Issuance of subordinated debentures, net of issuance costs	-	9,841,268
Redemption of subordinated debentures	-	(5,000,000)
Issuance of common stock	56,775	1,803,222
Decrease (increase) in nonvested restricted stock	547,110	(1,181,798)
Purchase of treasury stock	(179,878)	(2,642,544)
Net cash provided by financing activities	424,007	2,820,148
Net decrease in cash	(629,347)	(865,327)
Cash and cash equivalents, beginning of year	4,496,727	5,362,054
Cash and cash equivalents, ending of year	$ 3,867,380	$ 4,496,727

Note 25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

In relation to current economic conditions, management has monitored deposit concentrations through the date the financial statements were issued noting no significant changes to concentrations. Net deposit balances have grown by $27.7 million from December 31, 2022. In addition, there has been no significant deposit deterioration through March 29, 2023.

The Company has disclosed its investment portfolio position in Note 3. There has been no significant deterioration in the investment portfolio through the date the consolidated financial statements were issued. In addition the Company has not transferred or sold any of its investment portfolio since December 31, 2022.

Management has reviewed the events occurring through March 29, 2023 and no additional subsequent events occurred requiring accrual or disclosure.

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