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

FORM 10-K

☒ ANNUAL REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended **December 31, 2022**

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________to________

Commission File Number: 000-21344

FIRST KEYSTONE CORPORATION

(Exact name of registrant as specified in its Charter)

Pennsylvania	**23-2249083**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification Number)
111 West Front Street Berwick, Pennsylvania	**18603**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(570) 752-3671**

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

Title of each class	Trading symbol	Name of each exchange on which registered
None	N/A	N/A

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, par value $2.00 per share**

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

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes ☐ No ☒

Indicate by check mark whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes ☒ No ☐

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

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

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

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

Yes ☐ No ☒

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

The aggregate market value of the registrant's outstanding voting common stock held by non-affiliates on June 30, 2022 determined by using a per share closing price on that date of $22.05 as quoted on the Over the Counter Market, was $117,811,571.

At March 10, 2023, there were 6,019,152 shares of Common Stock, $2.00 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's 2023 definitive Proxy Statement are incorporated by reference in Part III of this Report.

FIRST KEYSTONE CORPORATION
FORM 10-K

Table of Contents

FIRST KEYSTONE CORPORATION
FORM 10-K

PART I

Forward-Looking Statements

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, which are included pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to (a) projections or statements regarding future earnings, expenses, net interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure, and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, and (c) statements of assumptions, such as economic conditions in First Keystone Corporation’s (the “Corporation”) market areas. Such forward-looking statements can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “intends”, “will”, “should”, “anticipates”, or the negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy.

Forward-looking statements are subject to certain risks and uncertainties such as local economic conditions, competitive factors, and regulatory limitations. Actual results may differ materially from those projected in the forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: ineffectiveness of the business strategy due to changes in current or future market conditions; the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks; inflation, securities market and monetary volatilities and fluctuations; the effects of economic conditions on current and future customers, particularly with regard to the negative impact of severe wide-ranging and continuing disruptions caused by the spread of Coronavirus Disease 2019 (COVID-19) and any other pandemic, epidemic or health-related crisis, and governmental responses thereto, specifically the effect of the economy on loan customers’ ability to repay loans; effects of short- and long-term federal budget and tax negotiations and their effects on economic and business conditions; possible impacts of the capital and liquidity requirements of Basel III standards and other regulatory pronouncements, regulations and rules; changes in accounting principles, policies or guidelines as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board and the Financial Accounting Standards Board, and other accounting standards setters; the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet; governmental monetary and fiscal policies, as well as legislative and regulatory changes; the effects of new laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) and their application with which the Corporation and its subsidiary must comply; information technology difficulties, including technological changes; challenges in establishing and maintaining operations in new markets; acquisitions and integration of acquired businesses; the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities; acts of war or terrorism; disruption of credit and equity markets; our ability to manage current levels of impaired assets; deposit flows; the loss of certain key officers; our ability to maintain the value and image of our brand and protect our intellectual property rights; continued relationships with major customers; the potential impact to the Corporation from continually evolving cybersecurity and other technological risks and attacks, including additional costs, reputational damage, regulatory penalties and financial losses; and the effect of general economic conditions and more specifically in the Corporation’s market area.

We caution readers not to place undue reliance on these forward-looking statements. They only reflect management’s analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances. Please carefully review the risk factors described in this document and in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K.

ITEM 1. BUSINESS

General

First Keystone Corporation (the “Corporation”) is a Pennsylvania business corporation, and a bank holding company, registered with and supervised by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The Corporation was incorporated on July 6, 1983, and commenced operations on July 2, 1984, upon consummation of the acquisition of all of the outstanding stock of First National Bank of Berwick (the predecessor to First Keystone Community Bank). The Corporation has one wholly-owned subsidiary, First Keystone Community Bank (the “Bank”), which has a commercial banking operation and trust department as its major lines of business. Since commencing operations, the Corporation’s business has consisted primarily of managing and supervising the Bank, and its principal source of income has been dividends paid by the Bank. Greater than 97% of the Corporation’s revenue and profit came from the commercial bank subsidiary for the years ended December 31, 2022 and 2021, and community banking was the only reportable segment. At December 31, 2022, the Corporation had total consolidated assets, deposits and stockholders’ equity of approximately $1.3 billion, $993 million and $120 million, respectively.

The Bank was originally organized in 1864 as a national banking association. On October 1, 2010, the Bank converted from a national banking association to a Pennsylvania chartered commercial bank under the supervision of the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (the “FDIC”).

The Bank’s deposits are insured by the FDIC to the maximum extent of the law regulated by the FDIC and the Pennsylvania Department of Banking and Securities. The Bank is subject to regulation by the Federal Reserve Board governing reserves required to be maintained against certain deposits and other matters. The Bank is also a member of the Federal Home Loan Bank of Pittsburgh (“FHLB”), which is one of the twelve regional cooperative banks comprising the system of Federal Home Loan Banks that lending institutions use to finance housing and economic development in local communities.

The Bank’s legal headquarters are located at 111 West Front Street, Berwick, Pennsylvania, from which it oversees the operations of its nineteen branch locations. These locations consist of five branches within Columbia County, eight branches within Luzerne County, one branch in Montour County, four branches within Monroe County, and one loan production office within Northampton County, Pennsylvania. A new, full-service branch is expected to open around the end of the first quarter of 2023 in Northampton County, Pennsylvania. For further information, please refer to Item 2 – Properties, and Note 11 – Commitments and Contingencies in the notes to the consolidated financial statements.

The Bank is a full service commercial bank providing a wide range of services to individuals and small to medium sized businesses in its Northeastern Pennsylvania market area. The Bank’s commercial banking activities include accepting time, demand and savings deposits and making secured and unsecured commercial, real estate, agricultural and consumer loans. Additionally, the Bank provides personal and corporate trust and agency services to individuals, corporations and others, including trust investment accounts, investment advisory services, mutual funds, estate planning, and management of pension and profit sharing plans. The Bank’s business is not seasonal in nature. The Bank has no foreign loans or highly leveraged transaction loans, as defined by the Federal Reserve Board. Substantially all of the loans in the Bank’s portfolio have been originated by the Bank. Policies adopted by the Board of Directors are the basis by which the Bank conducts its lending activities.

At December 31, 2022, the Bank had 200 full-time employees and 9 part-time employees. In the opinion of management, the Bank enjoys a satisfactory relationship with its employees. The Bank is not a party to any collective bargaining agreement.

The Corporation’s internet website is www.firstkeystonecorp.fkc.bank and the Bank’s internet website is www.fkc.bank. None of the information or contents of our website is incorporated into this Annual Report on Form 10-K.

When we say "we", "us", "our" or the "Corporation", we mean the Corporation on a consolidated basis with the Bank.

Primary Market Areas

The Bank's primary market area reaches west from Montour County spanning east into Monroe and Northampton Counties, encompassing Columbia and Luzerne Counties. The bank's market extends north through Luzerne County and south into Northampton County. Numerous other counties are also served; eleven contiguous counties, such as Pike and Lehigh; as well other surrounding counties, for instance Union and Snyder. The area served by the Bank includes a mix of rural communities, small to mid-sized towns and cities. The current population of the Bank's primary five-county footprint has increased 2.9% since 2018 to 893,000 and is estimated to increase 0.7% to 899,000 by 2028. As of June 30, 2022, the FDIC Summary of Deposits report market share data ranked the Bank 4th in the deposit market share out of the top 25 banks in the principal four-county deposit market, with 7.3% of deposits.

The Bank's headquarters, main office, and three of its branch offices are located in Berwick, Pennsylvania. Therefore, the Bank has a very strong presence in the Borough of Berwick, a community with a current population of approximately 10,300. The Bank ranks a commanding first in deposit market share in the Berwick market with 65.9% of deposits as of June 30, 2022, based on data compiled annually by the FDIC.

In the course of attracting and retaining deposits and originating loans, the Bank faces considerable competition with various types of financial institutions. The Bank competes with 29 commercial banks, 2 savings banks, 1 savings and loan association, and 37 credit unions for traditional banking products, such as deposits and loans in its primary five-county market area. Additionally, the Bank contends with non-bank and online firms, such as consumer finance companies and financial technology companies, for loans, mutual funds and other investment alternatives for deposits. The Bank vies for deposits based on the ability to provide a range of competitively priced products, quality service, competitive rates, online services and convenient locations and hours. The challenge among its peers for loan origination generally relates to interest rates offered, products available, ease of process, quality of service, and loan origination fees charged. The economic base of the Bank's market region is developed around small business, health care, educational facilities (colleges and public schools), light manufacturing industries, travel and leisure, and agriculture.

The Bank continues to assess the market area to determine the best way to meet the financial needs of the communities it serves. Management continues to pursue new market opportunities based on a strategic plan to efficiently grow the Bank, improve earnings performance, and bring the Bank's products and services to new customers. Management strategically addresses growth opportunities versus competitive issues by formulating the new products and services to be offered, evaluating expansion opportunities of its existing footprint with new locations, as well as investing in the expertise of skilled employees. The Bank continues to succeed in serving its customers by living up to its motto, "Yesterday's Traditions. Tomorrow's Vision."

Competition - Bank

The Bank is generally competitive with national, regional and community banking financial institutions and credit unions in its service area, with respect to interest rates paid on time, savings and interest-bearing checking deposits, service charges assessed and interest rates charged on loans. The Bank's major competitors in Columbia, Luzerne, Montour, Monroe, Northampton, and Lehigh Counties are:

- AgChoice Farm Credit
- Citizens Bank
- Community Bank, N.A.
- Dime Bank
- Embassy Bank
- ESSA Bank & Trust
- Fidelity Deposit and Discount Bank
- First Columbia Bank & Trust Co.
- First National Bank of PA (FNB of PA)
- First Northern Bank & Trust
- FNCB Bank
- Fulton Bank
- Honesdale National Bank
- Jersey Shore State Bank
- Luzerne Bank
- M & T Bank
- NBT Bank, N.A
- Peoples Security Bank
- Service 1st Federal Credit Union
- Susquehanna Community Bank
- Wayne Bank

Concentration

The Corporation and the Bank are not dependent on deposits nor exposed by loan concentrations to a single customer or to a small group of customers, such that the loss of any one or more would not have a materially adverse effect on the financial condition of the Corporation or the Bank. The Corporation has been successful in attracting municipal deposits, which make up 23.0% of total deposits at December 31, 2022. The largest deposit customer consisted of a municipality with deposit balances amounting to 5.9% of total deposits. The Corporation currently has the ability to utilize liquidity tools, such as wholesale borrowings or brokered deposits, to replace reductions in municipal deposits. The customers' ability to repay their loans is generally dependent on the real estate market and general economic conditions prevailing in Pennsylvania, among other factors.

Supervision and Regulation

The Corporation is subject to the jurisdiction of the Securities and Exchange Commission (the "SEC") and of state securities laws for matters relating to the offering and sale of its securities. The Corporation is currently subject to the SEC's rules and regulations relating to companies whose shares are registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended.

The Corporation is also subject to the provisions of the Bank Holding Company Act of 1956, as amended, and to supervision by the Federal Reserve Board. The Bank Holding Company Act requires the Corporation to secure the prior approval of the Federal Reserve Board before it owns or controls, directly or indirectly, more than 5% of the voting shares of substantially all of the assets of any institution, including another bank.

The Bank Holding Company Act also prohibits acquisition of control of a bank holding company, such as the Corporation, without prior notice to the Federal Reserve Board. Control is defined for this purpose as the power, directly or indirectly, to direct the management or policies of a bank holding company or to vote 25% (or 10%, if no other person or persons acting on concert, holds a greater percentage of the common stock) or more of the Corporation's common stock.

The Corporation is required to file an annual report with the Federal Reserve Board and any additional information that the Federal Reserve Board may require pursuant to the Bank Holding Company Act. The Federal Reserve Board may also make examinations of the Corporation and any or all of its subsidiaries.

The Bank is subject to federal and state statutes applicable to banks chartered under the banking laws of Pennsylvania and to banks whose deposits are insured by the FDIC. The Bank is subject to supervision, regulation and examination by the Pennsylvania Department of Banking and Securities, the FDIC and the Consumer Financial Protection Bureau.

Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, loans a bank makes and collateral it takes, and the activities of a bank with respect to mergers and consolidations and the establishment of branches.

As a subsidiary of a bank holding company, the Bank is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or its subsidiaries, on investments in the stock or other securities of the bank holding company or its subsidiaries and on taking such stock or securities as collateral for loans. The Federal Reserve Act and Federal Reserve Board regulations also place certain limitations and reporting requirements on extensions of credit by a bank to principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulations may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

Permitted Non-Banking Activities

The Federal Reserve Board permits bank holding companies to engage in non-banking activities so closely related to banking, managing or controlling banks as to be a proper incident thereto. The Corporation does not at this time engage in any of these non-banking activities, nor does the Corporation have any current plans to engage in any other permissible activities in the foreseeable future.

Legislation and Regulatory Changes

From time to time, various types of federal and state legislation have been proposed that could result in additional regulations of, and restrictions on, the business of the Bank. It cannot be predicted whether any such legislation will be adopted or how such legislation would affect the business of the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Bank's business is particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business.

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities or affecting the competitive balance between banks and other financial institutions. No prediction can be made as to the likelihood of any major changes or the impact such changes might have on the Corporation and the Bank. Certain changes of potential significance to the Corporation which have been enacted recently and others which are currently under consideration by Congress or various regulatory agencies are discussed below.

Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA")

The FDICIA established five different levels of capitalization of financial institutions, with "prompt corrective actions" and significant operational restrictions imposed on institutions that are capital deficient under the categories. The five categories are:

- well capitalized
- adequately capitalized
- undercapitalized
- significantly undercapitalized, and
- critically undercapitalized.

To be considered well capitalized, an institution must have a total risk-based capital ratio of at least 10%, a tier 1 risk-based capital ratio of at least 8%, a common equity tier 1 risk-based capital ratio of at least 6.5%, a leverage capital ratio of at least 5%, and must not be subject to any order or directive requiring the institution to improve its capital level. An institution falls within the adequately capitalized category if it has a total risk-based capital ratio of at least 8%, a tier 1 risk-based capital ratio of at least 6%, a common equity tier 1 risk-based capital ratio of at least 4.5%, and a leverage capital ratio of at least 4%. Institutions with lower capital levels are deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, depending on their actual capital levels. In addition, the appropriate federal regulatory agency may downgrade an institution to the next lower capital category upon a determination that the institution is in an unsafe or unsound condition, or is engaged in an unsafe or unsound practice. Institutions are required under the FDICIA to closely monitor their capital levels and to notify their appropriate regulatory agency of any basis for a change in capital category. On December 31, 2022, the Corporation and the Bank exceeded the minimum capital levels of the well capitalized category. See Note 13 — Regulatory Matters.

Regulatory oversight of an institution becomes more stringent with each lower capital category, with certain "prompt corrective actions" imposed depending on the level of capital deficiency.

Other Provisions of the FDICIA

Each depository institution must submit audited financial statements to its primary regulator and the FDIC, whose reports are made publicly available. In addition, the audit committee of each depository institution must consist of outside directors and the audit committee at "large institutions" (as defined by FDIC regulation) must include members with banking or financial management expertise. The audit committee at "large institutions" must also have access to independent outside counsel. In addition, an institution must notify the FDIC and the institution's primary regulator of any change in the institution's independent auditor, and annual management letters must be provided to the FDIC and the depository institution's primary regulator. The regulations define a "large institution" as one with over $500 million in assets, which does include the Bank. Also, under the rule, an institution's independent public accountant must examine the institution's internal controls over financial reporting and perform agreed-upon procedures to test compliance with laws and regulations concerning safety and soundness.

Under the FDICIA, each federal banking agency must prescribe certain safety and soundness standards for depository institutions and their holding companies. Three types of standards must be prescribed:

- asset quality, earnings, and stock valuation
- operational and managerial, and
- compensation.

Such standards would include a ratio of classified assets to capital, minimum earnings, and, to the extent feasible, a minimum ratio of market value to book value for publicly traded securities of such institutions and holding companies. Operational and managerial standards must relate to:

- internal controls, information systems and internal audit systems
- loan documentation
- credit underwriting
- interest rate exposure
- asset growth, and
- compensation, fees and benefits.

The FDICIA also sets forth Truth in Savings disclosure and advertising requirements applicable to all depository institutions.

Real Estate Lending Standards. Pursuant to the FDICIA, federal banking agencies adopted real estate lending guidelines which would set loan-to-value ("LTV") ratios for different types of real estate loans. The LTV ratio is generally defined as the total loan amount divided by the appraised value of the property at the time the loan is originated. If the institution does not hold a first lien position, the total loan amount would be combined with the amount of all superior liens when calculating the ratio. In addition to establishing the LTV ratios, the guidelines require all real estate loans to be based upon proper loan documentation and a recent appraisal or certificate of inspection of the property.

Regulatory Capital Requirements

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) were required to comply by January 1, 2014. The final rules call for the following capital requirements:

- A minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5%.

- A minimum ratio of tier 1 capital to risk-weighted assets of 6%.
- A minimum ratio of total capital to risk-weighted assets of 8%.
- A minimum leverage ratio of 4%.

In addition, the final rules establish a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016. The capital level required to avoid restrictions on elective distributions applicable to the Bank were as follows:

- A common equity tier 1 capital ratio of 7%.
- A tier 1 risk-based capital ratio of 8.5%.
- A total risk-based capital ratio of 10.5%.

As of December 31, 2022, the Bank maintained capital ratios above the required capital conservation buffer.

Under the initially proposed rules, accumulated other comprehensive income ("AOCI") would have been included in a banking organization's common equity tier 1 capital. The final rules allow community banks to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The Bank elected to opt-out of this item with the filing of the March 31, 2015 Call Report.

The Corporation has assessed the impact of these changes on the regulatory ratios of the Corporation and the Bank on the capital, operations, liquidity and earnings of the Corporation and Bank, and concluded that the new rules did not have a material negative effect.

Federal Reserve Bank Small Bank Holding Company Policy

Effective in August 2018, the Federal Reserve Board issued an interim final rule that expanded applicability of the Board's small bank holding company policy statement. The interim final rule raised the policy statement's asset threshold from $1 billion to $3 billion in total consolidated assets for a bank holding company or savings and loan holding company that: (1) is not engaged in significant nonbanking activities; (2) does not conduct significant off-balance sheet activities; and (3) does not have a material amount of debt or equity securities, other than trust-preferred securities, outstanding. The interim final rule provides that, if warranted for supervisory purposes, the Federal Reserve may exclude a company from the threshold increase. Management believes the Corporation meets the conditions of the Federal Reserve's small bank holding company policy statement and is therefore excluded from consolidated capital requirements at December 31, 2022; however, the Bank remains subject to regulatory capital requirements administered by the federal banking agencies.

Effect of Government Monetary Policies

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies.

The Federal Reserve Board has had, and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order to, among other things, curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulations of, among other things, the discount rate on borrowings of member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies

Effects of Inflation

Inflation has some impact on the Bank's operating costs. Unlike industrial companies, however, substantially all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Bank's performance than the general levels of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

Environmental Regulation

There are several federal and state statutes that regulate the obligations and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from its own actions, a bank may be held liable, under certain circumstances, for the actions of its borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by the bank. Further, the liability has the potential to far exceed the original amount of the loan issued by the Bank. Currently, neither the Corporation nor the Bank is a party to any pending legal proceeding pursuant to any environmental statute, nor are the Corporation and the Bank aware of any circumstances that may give rise to liability under any such statute.

Interest Rate Risk

Federal banking agency regulations specify that the Bank's capital adequacy include an assessment of the Bank's interest rate risk exposure. The standards for measuring the adequacy and effectiveness of a banking organization's Interest Rate Risk ("IRR") management includes a measurement of Board of Directors and senior management oversight, and a determination of whether a banking organization's procedures for comprehensive risk management are appropriate to the circumstances of the specific banking organization. The Bank has internal IRR models that are used to measure and monitor IRR. Additionally, the regulatory agencies have been assessing IRR on an informal basis for several years. For these reasons, the Corporation does not expect the addition of IRR evaluation to the agencies' capital guidelines to result in significant changes in capital requirements for the Bank.

The Gramm-Leach-Bliley Act of 1999

In 1999, the Gramm-Leach-Bliley Act became law, which is also known as the Financial Services Modernization Act. The act repealed some Depression-era banking laws and permits banks, insurance companies and securities firms to engage in each others' businesses after complying with certain conditions and regulations. The act grants to community banks the power to enter new financial markets as a matter of right that larger institutions have managed to do on an ad hoc basis. At this time, the Corporation has no plans to pursue these additional possibilities.

The Sarbanes-Oxley Act

In 2002, the Sarbanes-Oxley Act became law. The Act was in response to public concerns regarding corporate accountability in connection with recent high visibility accounting scandals. The stated goals of the Sarbanes-Oxley Act are:

- To increase corporate responsibility;
- To provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies; and
- To protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act generally applies to all companies, both U.S. and non-U.S., that file periodic reports with the SEC under the Exchange Act. The legislation includes provisions, among other things:

- Governing the services that can be provided by a public company's independent auditors and the procedures for approving such services;
- Requiring the chief executive officer and chief financial officer to certify certain matters relating to the company's periodic filings under the Exchange Act;

- Requiring expedited filings of reports by insiders of their securities transactions and containing other provisions relating to insider conflicts of interest;
- Increasing disclosure requirements relating to critical financial accounting policies and their application;
- Increasing penalties for securities law violations; and
- Creating a public accounting oversight board, a regulatory body subject to SEC jurisdiction with broad powers to set auditing, quality control and ethics standards for accounting firms.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") became law in July 2010. Dodd-Frank is intended to affect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gave federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank additionally created a new independent federal regulator to administer federal consumer protection laws. Dodd-Frank continues to have a significant impact on our business operations as its provisions are amended and requirements are clarified. Community banks have seen an increase in operating and compliance costs and interest expense. Among the provisions that have affected us are the following:

Holding Company Capital Requirements. Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank holding company with less than $15 billion in assets. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

Deposit Insurance. Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, and extended unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank required the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Effective one year from the date of enactment, Dodd-Frank eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance. Dodd-Frank requires publicly traded companies to give stockholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on "golden parachute" payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The SEC has finalized the rules implementing these requirements which took effect on January 21, 2011. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1 billion, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Prohibition Against Charter Conversions of Troubled Institutions. Effective one year after enactment, Dodd-Frank prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating thereto.

Interstate Branching. Dodd-Frank authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

Limits on Interstate Acquisitions and Mergers. Dodd-Frank precludes a bank holding company from engaging in an interstate acquisition — the acquisition of a bank outside its home state — unless the bank holding company is both well capitalized and well managed. Furthermore, a bank may not engage in an interstate merger with another bank headquartered in another state unless the surviving institution will be well capitalized and well managed. The previous standard in both cases was adequately capitalized and adequately managed.

Limits on Interchange Fees. Dodd-Frank amends the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. On June 29, 2011, the Federal Reserve Board set the interchange rate cap at $0.21 per transaction. While the restrictions on interchange fees do not affect banks with assets less than $10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks.

Consumer Financial Protection Bureau. Dodd-Frank created the independent federal agency called the Consumer Financial Protection Bureau ("CFPB"), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, Dodd-Frank will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

Department of Defense Military Lending Rule

In 2015, the U.S. Department of Defense issued a final rule which restricts pricing and terms of certain credit extended to active duty military personnel and their families. This rule, which was implemented effective October 3, 2016, caps the interest rate on certain credit extensions to an annual percentage rate of 36% and restricts other fees. The rule requires financial institutions to verify whether customers are military personnel subject to the rule. The impact of this final rule, and any subsequent amendments thereto, on the Corporation's lending activities and the Corporation's statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential side effects on the Corporation's business.

Available Information

The Corporation's common stock is registered under Section 12(g) of the Exchange Act. The Corporation is subject to the informational requirements of the Exchange Act, and, accordingly, files reports, proxy statements and other information with the SEC. The Corporation is an electronic filer with the SEC. The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's internet site address is www.sec.gov.

A copy of the Corporation’s Annual Report on Form 10-K may be obtained without charge at www.fkyscorp.com. This reference to the Corporation’s Internet address shall not, under any circumstances, be deemed to incorporate the information available at such Internet address into this Form 10-K or other SEC filings.

ITEM 1A. RISK FACTORS

Investments in the Corporation’s common stock involve risk. The market price of the Corporation’s common stock may fluctuate significantly in response to a number of factors, including:

Business Risks

The Corporation is subject to interest rate risk.

The Corporation’s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Corporation’s control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Corporation receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Corporation’s ability to originate loans and obtain deposits, (ii) the fair value of the Corporation’s financial assets and liabilities, and (iii) the average duration of the Corporation’s mortgage-backed and asset-backed securities portfolios. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Corporation’s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Corporation’s results of operations, any substantial, unexpected, or prolonged change in market interest rates could have a material adverse effect on the Corporation’s financial condition and results of operations.

The Corporation is subject to lending risk.

As of December 31, 2022, approximately 81.4% of the Corporation’s loan portfolio consisted of Commercial and Industrial loans and Commercial Real Estate loans (including construction loans), which both include a tax-free component. These types of loans are generally viewed as having more risk of default than Residential Real Estate loans or Consumer loans. Commercial and Industrial and Commercial Real Estate loans are also typically larger than Residential Real Estate loans and Consumer loans. Because the Corporation’s loan portfolio contains a significant number of Commercial and Industrial and Commercial Real Estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Corporation’s financial condition and results of operations.

If the Corporation’s Allowance for Loan Losses is not sufficient to cover actual loan losses, earnings could decrease.

The Corporation’s loan customers may not repay their loans according to the terms of their loans, and the collateral securing the payment of their loans may be insufficient to assure repayment. The Corporation may experience significant credit losses, which could have a material adverse effect on its operating results. In determining the amount of the allowance for loan losses, the Corporation reviews its loans and loss and delinquency experience and evaluates economic conditions. If the Corporation’s assumptions prove to be incorrect, the allowance for loan losses may not cover inherent losses in its loan portfolio at the date of the financial statements. Material additions to the Corporation’s allowance would materially decrease net income. At December 31, 2022, the allowance for loan losses totaled $8.3 million, representing 1.01% of average total loans.

Although the Corporation believes its underwriting standards are sufficient to manage normal lending risks, it is difficult to assess the future performance of the loan portfolio due to ongoing new originations. The Corporation cannot assure that non-performing loans will not increase or that non-performing or delinquent loans will not adversely affect future performance.

In addition, federal regulators periodically review the Corporation’s allowance for loan losses and may require it to increase the allowance for loan losses or recognize further loan charge-offs. Any increase in the allowance for loan losses or loan charge-offs as required by these regulatory agencies could have a material adverse effect on the results of operations and financial condition.

A new accounting standard will result in a significant change in how the Corporation recognizes credit losses and may have a material impact on the Corporation’s financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board (“FASB”) issued an accounting standard update, “Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments,” which replaces the current “incurred loss” model for recognizing credit losses with an “expected loss” model referred to as the Current Expected Credit Loss (“CECL”) model. The new CECL standard became effective on January 1, 2023 for interim periods within that year, for certain companies, including those companies that quality as a smaller reporting company under SEC rules. The Corporation currently expects to continue to qualify as a smaller reporting company for a period of time. Under the CECL model, the Corporation will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, as the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the “incurred loss” model required under current generally accepted accounting principles (“GAAP”), which delays recognition until it is probable a loss has been incurred. The adoption of the CECL model will materially affect how the allowance for loan losses is determined and the Corporation expects to recognize a one-time-cumulative adjustment to the allowance for loan losses at the beginning of the reporting period in which the new standard is effective. Moreover, the CECL model may create more volatility in the level of the allowance for loan losses depending on various factors, such as changes in the size of the loan portfolio and the composition of the portfolio, as well as the uncertainty of macroeconomic forecasts over longer time horizons. If the Corporation is required to materially increase its allowance for loan losses for any reason, such increase could adversely affect its business, financial condition, and results of operations. The Corporation is performing ongoing analysis to evaluate the provisions of this standard to determine the impact that it will have on the Corporation’s consolidated financial statements and has taken steps to prepare for the implementation, such as: forming an internal committee, gathering pertinent data, consulting with outside professionals to perform data and model validation analyses, subscribing to a new software system, running existing and new methodologies concurrently through the period of implementation, and comparing and analyzing the results of both existing and new methodologies.

The Corporation’s information systems may experience an interruption or breach in security.

The Corporation relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Corporation’s customer relationship management, general ledger, deposit, loan and other systems. The Corporation has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems; however, there can be no assurance that any such failures, interruptions or security breaches will not occur. While the Corporation maintains insurance coverage that may, subject to policy terms and conditions including significant self-insured deductibles, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses. The occurrence of any failures, interruptions or security breaches of the Corporation’s information systems could damage the Corporation’s reputation, adversely affecting customer or investor confidence, result in a loss of customer business, subject the Corporation to additional regulatory scrutiny and possible regulatory penalties, or expose the Corporation to civil litigation and possible financial liability, any of which could have a material adverse effect on the Corporation's financial condition and results of operations.

Severe weather, natural disasters, disease pandemics and epidemics, acts of war or terrorism and other external events could significantly impact the Corporation's business.

Severe weather, natural disasters, disease pandemics and epidemics, acts of war or terrorism and other adverse external events could have a significant impact on the Corporation's ability to conduct business. Such events could affect the stability of the Corporation's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Corporation to incur additional expenses. Severe weather, natural disasters, disease pandemics and epidemics, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on the Corporation's business, which, in turn, could have a material adverse effect on the Corporation's financial condition and results of operations. Geopolitical instability or conflicts may result in trade disruptions, sanctions, and other market volatility which could lead to global inflationary pressures, etc. that could adversely affect the Corporation or its customers.

The Corporation operates in a highly competitive industry.

The Corporation faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources and greater technology. Such competitors primarily include national, regional and community banks within the various markets in which the Corporation operates. The Corporation also faces competition from many other types of financial institutions, including, without limitation, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as online account opening, automatic transfer and automatic payment systems. Many of the Corporation's competitors have fewer regulatory constraints and may have lower cost structures.

The Corporation's ability to compete successfully depends on a number of factors, including, among other things:

- The ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- The ability to expand the Corporation's market position;
- The scope, relevance and pricing of products and services offered to meet customer needs and demands;
- The rate at which the Corporation introduces new products and services relative to its competitors;
- Customer satisfaction with the Corporation's level of service; and
- Industry and general economic trends.

Failure to perform in any of these areas could significantly weaken the Corporation's competitive position, which could adversely affect the Corporation's growth and profitability, which, in turn, could have a material adverse effect on the Corporation's financial condition and results of operations.

New lines of business or new products and services may subject the Corporation to additional risks.

From time-to-time, the Corporation may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, the Corporation may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Corporation's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Corporation's business, results of operations and financial condition.

The Basel III capital requirements may require the Corporation to maintain higher levels of capital, which could reduce its profitability.

Basel III targets higher levels of base capital, certain capital buffers and a migration toward common equity as the key source of regulatory capital. Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. Although Basel III is implemented, regulatory viewpoints could change or require additional capital to support the Corporation's business risk profile. If the Corporation and the Bank are required to maintain higher levels of capital, the Corporation and the Bank may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to the Corporation and the Bank and adversely impact its financial condition and results of operations.

If the Corporation concludes that the decline in value of any of its securities is other than temporary, the Corporation will be required to write down the credit-related portion of the impairment of that security through a charge to earnings.

Management reviews its securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of its investment securities has declined below its carrying value, management is required to assess whether the decline is other than temporary. If management concludes that the decline is other than temporary, management will be required to write down the credit-related portion of the impairment of that security through a charge to earnings. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, the impairment disclosed may not accurately reflect the actual impairment in the future.

Recent and future bank failures may adversely affect the national, regional, and local business environment, results of operation, and capital.

Recent and future bank failures may have a profound impact on the national, regional, and local business environment in which the Bank operates. These impacts can range from business disruptions to adversely affecting their customers and customers withdrawing their deposits from the Bank. Management currently does expect that one result of the events in connection with the closure of Silicon Valley Bank in California and Signature Bank in New York by regulators is that FDIC assessments will more likely than not increase as a cost of doing business to the Bank. These possible impacts may adversely affect the Bank's future operating results, including net income, and negatively impact capital. While the Bank currently does not expect the Government takeovers of Silicon Valley Bank and Signature Bank to have such a negative effect, the Bank continues to monitor the ongoing events concerning these two banks and any future banks failures if and when they may occur.

Risks Related to the COVID-19 Pandemic

Public health crisis such as epidemics or pandemics could materially and adversely impact our business.

The COVID-19 pandemic has negatively impacted the global, national and local economies, disrupted global and national supply chains, lowered equity market valuations, created significant volatility and disruption in financial markets, and increased unemployment levels. In addition, the pandemic resulted in temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities and may result in the same or similar restrictions in the future. As a result, the demand for our products and services has been and may continue to be significantly impacted, which could adversely affect our revenue and results of operations. Furthermore, the lagging impacts of the pandemic could result in the recognition of credit losses in our loan portfolios, and additions to our allowance for credit losses, particularly if businesses remain restricted or are required to close again, the impact on the global, national and local economies worsen, or more customers draw on their lines of credit or seek additional loans to help finance their businesses. Similarly, because of changing economic and market conditions affecting issuers, we may be required to recognize impairments on the securities we hold as well as reductions in other comprehensive income. Our business operations may also be disrupted if significant portions of our workforce are unable to work effectively, including because of illness, quarantines, government actions, or other restrictions in connection with the pandemic. The extent to which the COVID-19 pandemic impacts our business, results of operations, and financial conditions, as well as our regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic.

We continue to closely monitor the COVID-19 pandemic and related risks as they evolve. The magnitude, duration and likelihood of the current outbreak of COVID-19, further outbreaks of COVID-19, future actions taken by governmental authorities and/or other third parties in response to the COVID-19 pandemic, and its future direct and indirect effects on the global, national and local economy and our business and results of operation are highly uncertain. The COVID-19 pandemic may cause prolonged global or national recessionary economic conditions or longer lasting effects on economic conditions than currently exist, which could have a material adverse effect on our business, results of operations and financial condition.

Due to the Corporation's participation in the U.S. Small Business Administration ("SBA") Paycheck Protection Program ("PPP"), the Corporation is subject to additional risks of litigation from its clients or other parties regarding the processing of loans for the PPP and risks that the SBA may not fund some or all of PPP loan guaranties.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted, which included a $349 billion loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals could apply for loans from existing SBA lenders and other approved regulated lenders. The Corporation participated as a lender in the PPP. Because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there was some ambiguity in the laws, rules and guidance regarding the operation of the PPP along with the continually evolving nature of SBA the rules, interpretations and guidelines concerning this program, which exposes us to risks relating to the noncompliance with the PPP. Since the launch of the PPP, several large banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP. As such, we may be exposed to the risk of litigation, from both clients and non-clients that approached the Corporation regarding PPP loans, regarding its process and procedures used in processing applications for the PPP. If any such litigation is filed against us and is not resolved in a manner favorable to us, it may result in significant financial liability or adversely affect our reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP related litigation could have a material adverse impact on our business, financial condition and results of operations.

The Corporation also has credit risk for PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, underwritten, certified by the borrower, funded, or serviced by the Corporation, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, certified by the borrower, funded, or serviced by the Bank, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

Economic and Strategic Risks

The changes in control of the United States government and issues relating to debt and the deficit may adversely affect the Corporation.

Changes in elected officials in the federal government could result in significant changes (or uncertainty) in governmental policies, regulatory environments, spending sentiment and many other factors and conditions, some of which could adversely impact the Corporation's business, financial condition and results of operations.

In addition, as a result of past difficulties of the federal government to reach agreement over federal debt and the ongoing issues connected with the debt ceiling, certain rating agencies placed the United States government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which the Corporation invests and receives lines of credit on negative watch and a downgrade of the United States' credit rating would trigger a similar downgrade in the credit rating of these government sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may also be downgraded should the United States credit rating be downgraded. The impact that a credit rating downgrade may have on the national and local economy could have an adverse effect on the Corporation's financial condition and results of operations.

The Corporation's profitability depends significantly on economic conditions in the Commonwealth of Pennsylvania.

The Corporation's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania and the specific local markets in which the Corporation operates. Unlike larger national or other regional banks that are more geographically diversified, the Corporation provides banking and financial services to customers primarily in Columbia, Luzerne, Montour, Monroe, Northampton and Lehigh counties. The local economic conditions in these areas have a significant impact on the demand for the Corporation's products and services as well as the ability of the Corporation's customers to repay loans, the value of the collateral securing loans and the stability of the Corporation's deposit funding sources. Also, a significant decline in general economic conditions caused by inflation, recession, acts of terrorism, outbreaks and hostilities or other international or domestic occurrences, unemployment, changes in the securities markets, or other factors, could impact the local economic conditions and, in turn, have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation's future acquisitions could dilute stockholders' ownership and may cause the Corporation to become more susceptible to adverse economic events.

The Corporation may use its common stock to acquire other companies or make investments in banks and other complementary businesses in the future. The Corporation may issue additional shares of common stock to pay for future acquisitions, which would dilute stockholders' ownership interest in the Corporation. Future business acquisitions could be material to the Corporation, and the degree of success achieved in acquiring and integrating these businesses into the Corporation could have a material effect on the value of the Corporation's common stock. In addition, any acquisition could require the Corporation to use substantial cash or other liquid assets or to incur debt. In those events, the Corporation could become more susceptible to economic downturns and competitive pressures.

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

The Corporation's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Corporation can be intense and the Corporation may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Corporation's key personnel could have a material adverse impact on the Corporation's business because of their skills, knowledge of the Corporation's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

The Corporation is subject to extensive government regulation and supervision.

The Corporation, primarily through the Bank, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Corporation's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies could affect the Corporation in substantial and unpredictable ways. Such changes could subject the Corporation to additional costs, limit the types of financial services and products the Corporation may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Corporation's business, financial condition and results of operations.

The Corporation is subject to claims and litigation pertaining to fiduciary responsibility.

From time to time, customers make claims and take legal action pertaining to the Corporation's performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Corporation's performance of its fiduciary responsibilities are founded or unfounded, and if such claims and legal actions are not resolved in a manner favorable to the Corporation, they may result in significant financial liability and/or adversely affect the market perception of the Corporation and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Corporation's financial condition and results of operations.

The trading volume in the Corporation's common stock is less than that of other larger financial services companies.

The Corporation's common stock is not currently listed on a national stock exchange, but traded on the Over the Counter Market. As a result, trading volume is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Corporation's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Corporation has no control. Given the lower trading volume of the Corporation's common stock, significant sales of the Corporation's common stock, or the expectation of these sales, could cause the Corporation's stock price to fall.

The Corporation's controls and procedures may fail or be circumvented.

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

The Corporation continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Corporation's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Corporation's operations. Many of the Corporation's competitors have substantially greater resources to invest in technological improvements. The Corporation may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Corporation's business and, in turn, the Corporation's financial condition and results of operations.

The Corporation may need or be compelled to raise additional capital in the future, but that capital may not be available when it is needed and on terms favorable to current shareholders.

Federal banking regulators require the Corporation and Bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation and banking regulatory agencies. In addition, capital levels are also determined by the Corporation's management and board of directors, based on capital levels that they believe are necessary to support the Corporation's business operations. The Corporation is evaluating its present and future capital requirements and needs, is developing a comprehensive capital plan and is analyzing capital raising alternatives, methods and options. Even if the Corporation succeeds in meeting the current regulatory capital requirements, the Corporation may need to raise additional capital in the near future to support possible loan losses during future periods or to meet future regulatory capital requirements.

Further, the Corporation's regulators may require it to increase its capital levels. If the Corporation raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and would likely dilute the per-share book value and earnings per share of its common stock. Furthermore, it may have an adverse impact on the Corporation's stock price. New investors may also have rights, preferences and privileges senior to the Corporation's current shareholders, which may adversely impact its current shareholders. The Corporation's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. Accordingly, the Corporation cannot assure the shareholders of its ability to raise additional capital on terms and time frames acceptable to it or to raise additional capital at all. If the Corporation cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect the Corporation's operations, financial condition and results of operations.

The Corporation is subject to environmental liability risk associated with lending activities.

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

The Corporation's ability to pay dividends is subject to limitations.

The Corporation is a bank holding company and its operations are conducted by the Bank, which is a separate and distinct legal entity. Substantially all of the Corporation's assets are held by the Bank.

The Corporation's ability to pay dividends depends on its receipt of dividends from the Bank, its primary source of dividends. Dividend payments from the Bank are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. There is no assurance that the Bank will be able to pay dividends in the future or that the Corporation will generate adequate cash flow to pay dividends in the future. The Corporation's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

Pennsylvania Business Corporation Law and various anti-takeover provisions under its Articles of Incorporation and Bylaws could impede the takeover of the Corporation.

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire the Corporation, even if the acquisition would be advantageous to shareholders. In addition, the Corporation has various anti-takeover measures in place under its Articles of Incorporation and Bylaws, including a staggered board of directors and the absence of cumulative voting. Any one or more of these measures may impede the takeover of the Corporation without the approval of its Board of Directors and may prevent its shareholders from taking part in a transaction in which they could realize a premium over the current market price of its common stock.

The Corporation's banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect its earnings.

Since the Great Recession, poor economic conditions and the resulting bank failures increased the costs of the FDIC and depleted its deposit insurance fund. In more recent history, the FDIC fund position has improved and the cost basis has been updated which in some cases can result in decreased costs of the insurance fund. Additional bank failures may prompt the FDIC to increase its premiums above the recently increased levels or to issue special assessments. The Corporation is generally unable to control the amount of premiums or special assessments that its subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on the Corporation's results of operations, financial condition, and its ability to continue to pay dividends on its common stock at the current rate or at all.

The increasing use of social media platforms presents new risks and challenges and our inability or failure to recognize, respond to and effectively manage the accelerated impact of social media could materially adversely impact our business.

There has been a marked increase in the use of social media platforms, including weblogs (blogs), social media websites, and other forms of Internet-based communications which allow individuals access to a broad audience of consumers and other interested persons. Social media practices in the banking industry are evolving, which creates uncertainty and risk of noncompliance with regulations applicable to our business. Consumers value readily available information concerning businesses and their goods and services and often act on such information without further investigation and without regard to its accuracy. Many social media platforms immediately publish the content their subscribers and participants post, often without filters or checks on accuracy of the content posted. Information posted on such platforms at any time may be adverse to our interests and/or may be inaccurate. The dissemination of information online could harm our business, prospects, financial condition, and results of operations, regardless of the information's accuracy. The harm may be immediate without affording us an opportunity for redress or correction.

Other risks associated with the use of social media include improper disclosure of proprietary information, negative comments about our business, exposure of personally identifiable information, fraud, out-of-date information, and improper use by employees and customers. The inappropriate use of social media by our customers or employees could result in negative consequences including remediation costs including training for employees, additional regulatory scrutiny and possible regulatory penalties, litigation or negative publicity that could damage our reputation adversely affecting customer or investor confidence.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Corporation and its subsidiary occupy nineteen branch properties in Columbia, Luzerne, Montour, Monroe and Northampton Counties in Pennsylvania, which are used principally as banking offices. As of December 31, 2022, the Corporation and its subsidiary bank owned 18 properties and leased 4 properties.

ITEM 3. LEGAL PROCEEDINGS

The Corporation and/or the Bank are defendants in various legal proceedings arising in the ordinary course of their business. However, in the opinion of management of the Corporation and the Bank, there are no proceedings pending to which the Corporation and the Bank is a party or to which their property is subject, which, if determined adversely to the Corporation and the Bank, would be material in relation to the Corporation's and Bank's individual profits or financial condition, nor are there any proceedings pending other than ordinary routine litigation incident to the business of the Corporation and the Bank. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation and the Bank by government authorities or others.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation’s common stock is traded in the over-the-counter market on the OTC Market under the symbol “FKYS”. The following table sets forth:

- The quarterly high and low prices for a share of the Corporation’s common stock during the periods indicated as reported to the management of the Corporation;
- Quarterly dividends on a share of the common stock paid with respect to each quarter since January 1, 2021; and
- The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

	MARKET VALUE OF COMMON STOCK		
2022	High	Low	Per Share Dividend Paid
First quarter	**$ 26.00**	**$ 24.00**	**$ 0.28**
Second quarter	**$ 25.95**	**$ 22.05**	**$ 0.28**
Third quarter	**$ 23.50**	**$ 20.95**	**$ 0.28**
Fourth quarter	**$ 22.75**	**$ 19.05**	**$ 0.28**
2021	High	Low	Dividend Paid
First quarter	$ 25.20	$ 19.50	$ 0.28
Second quarter	$ 32.50	$ 23.03	$ 0.27
Third quarter	$ 26.50	$ 24.05	$ 0.28
Fourth quarter	$ 25.00	$ 23.25	$ 0.29

As of December 31, 2022, the Corporation had approximately 906 shareholders of record.

The Corporation has paid dividends since commencement of business in 1984. It is the present intention of the Corporation’s Board of Directors to continue the dividend payment policy. Stock value, cost and availability of external capital, and the Corporation’s present and anticipated capital needs are weighed in the process of making a responsible decision. Further dividends must necessarily depend upon earnings, financial condition, appropriate legal restrictions and other factors relevant at the time the Board of Directors of the Corporation considers its dividend policy. Cash available for dividend distributions to shareholders of the Corporation must initially come from dividends paid by the Bank to the Corporation. Therefore, the restrictions on the Bank’s dividend payments are directly applicable to the Corporation.

Table of Contents

Transfer Agent:

American Stock Transfer & Trust Company, LLC (800) 937-5449
(AST)
6201 15th Avenue
Brooklyn, NY 11219

The following brokerage firms make a market in First Keystone Corporation common stock:

RBC Wealth Management	(800) 223-4207
Janney Montgomery Scott LLC	(800) 526-6397
Stifel Nicolaus & Co. Inc.	(800) 679-5446
Boenning & Scattergood, Inc.	(800) 883-1212

Dividend Restrictions on the Bank

Generally, as a Pennsylvania state chartered bank, under Pennsylvania banking law, the Bank may only pay dividends out of accumulated net earnings.

Dividend Restrictions on the Corporation

Under the Pennsylvania Business Corporation Law of 1988, as amended, the Corporation may not pay a dividend if, after giving effect thereto, either:

- The Corporation would be unable to pay its debts as they become due in the usual course of business; or
- The Corporation's total assets would be less than its total liabilities.

The determination of total assets and liabilities may be based upon:

- Financial statements prepared on the basis of generally accepted accounting principles;
- Financial statements that are prepared on the basis of other accounting practices and principles that are reasonable under the circumstances; or
- A fair valuation or other method that is reasonable under the circumstances.

ITEM 6. [RESERVED]

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

The purpose of Management's Discussion and Analysis of First Keystone Corporation, a bank holding company (the "Corporation"), and its wholly owned subsidiary, First Keystone Community Bank (the "Bank"), is to assist the reader in reviewing the financial information presented and should be read in conjunction with the consolidated financial statements and other financial data contained herein. Refer to Forward-Looking Statements on page 1 for detailed information.

RESULTS OF OPERATIONS

Year Ended December 31, 2022 Versus Year Ended December 31, 2021

Net income decreased to $14,024,000 for the year ended December 31, 2022, as compared to $14,688,000 for the prior year, a decrease of 4.5%. Earnings per share, both basic and diluted, for 2022 was $2.35 as compared to $2.49 in 2021, a decrease of 5.6%. Dividends per share for 2022 and 2021 were $1.12. The Corporation's return on average assets was 1.07% in 2022 and 1.15% in 2021. Return on average equity increased to 10.75% in 2022 from 9.93% in 2021. Total interest income in 2022 amounted to $46,413,000, an increase of $4,365,000 or 10.4% from 2021. The increase in interest income is due to increased interest rates, growth in commercial real estate loans, and increased interest and dividend income earned on securities, offset by a $1,224,000 decrease in PPP loan fees due to the discontinuation of the SBA program. Total interest expense of $8,913,000 increased $3,765,000 or 73.1% from 2021. The majority of this increase is related to an increase in interest paid to depositors resulting from increased interest rates and an increase in interest paid on short-term borrowings.

Selected financial data and performance ratios of the Corporation for the past five years are presented below in Table 1.

Table 1 — Selected Financial Data

(Dollars in thousands, except per share data)	For the Year Ended December 31,				
	2022	2021	2020	2019	2018
SELECTED FINANCIAL DATA AT YEAR END:					
Total assets	**$ 1,329,194**	$ 1,320,350	$ 1,179,047	$ 1,007,226	$ 1,012,000
Total securities	**375,143**	439,878	368,357	279,861	317,614
Net loans	**850,195**	744,161	712,677	640,727	599,647
Total deposits	**993,499**	1,077,969	937,488	761,628	671,553
Total long-term borrowings	**25,000**	35,000	45,000	55,000	45,000
Total stockholders' equity	**120,386**	148,555	144,242	128,752	116,756
SELECTED OPERATING DATA:					
Interest income	**$ 46,413**	$ 42,048	$ 39,567	$ 38,527	$ 35,573
Interest expense	**8,913**	5,148	6,360	10,243	8,620
Net interest income	**37,500**	36,900	33,207	28,284	26,953
(Credit) provision for loan losses	**(264)**	860	1,200	450	200
Net interest income after (credit) provision for loan losses	**37,764**	36,040	32,007	27,834	26,753
Non-interest income	**5,331**	7,323	6,012	6,929	5,562
Non-interest expense	**26,777**	26,354	24,605	23,422	22,645
Income before income tax expense	**16,318**	17,009	13,414	11,341	9,670
Income tax expense	**2,294**	2,321	1,577	1,114	459
Net income	**$ 14,024**	$ 14,688	$ 11,837	$ 10,227	$ 9,211
PER SHARE DATA:					
Net income	**$ 2.35**	$ 2.49	$ 2.03	$ 1.77	$ 1.60
Dividends	**1.12**	1.12	1.08	1.08	1.08
PERFORMANCE RATIOS:					
Return on average assets	**1.07 %**	1.15 %	1.09 %	1.02 %	0.92 %
Return on average equity	**10.75 %**	9.93 %	8.61 %	8.17 %	8.05 %
Dividend payout	**47.70 %**	45.05 %	53.29 %	61.08 %	67.26 %
Average equity to average assets	**9.92 %**	11.57 %	12.72 %	12.42 %	11.39 %

Net interest income, as indicated below in Table 2, increased by $600,000 or 1.6% to $37,500,000 for the year ended December 31, 2022. The Corporation's net interest income on a fully tax equivalent basis increased by $569,000, or 1.5% to $39,369,000 in 2022 as compared to $38,800,000 in 2021.

Table 2 — Reconciliation of Taxable Equivalent Net Interest Income

(Dollars in thousands)

		2022/2021 Increase/(Decrease)		
	2022	Amount	%	2021
Interest Income	**$ 46,413**	**$ 4,365**	**10.4**	$ 42,048
Interest Expense	**8,913**	**3,765**	**73.1**	5,148
Net Interest Income	**37,500**	**600**	**1.6**	36,900
Tax Equivalent Adjustment	**1,869**	**(31)**	**(1.6)**	1,900
Net Interest Income (fully tax equivalent)	**$ 39,369**	**$ 569**	**1.5**	$ 38,800

Table 3 — Average Balances, Rates and Interest Income and Expense

(Dollars in thousands)

	2022			2021		
	Average Balance	**Interest**	**Yield/ Rate**	Average Balance	Interest	Yield/ Rate
Interest Earning Assets:						
Loans:						
Commercial, net[1,2,4]	**$ 85,022**	**$ 3,047**	**3.58 %**	$ 94,377	$ 2,681	2.84 %
Real Estate[1,2]	**716,896**	**30,868**	**4.31 %**	637,461	27,427	4.30 %
Consumer, net[1,4]	**5,251**	**416**	**7.93 %**	5,001	395	7.91 %
Fees on Loans	**—**	**1,269**	**— %**	—	2,545	— %
Total Loans[5]	**807,169**	**35,600**	**4.41 %**	736,839	33,048	4.49 %
Securities:						
Taxable	**297,471**	**7,449**	**2.50 %**	281,742	5,640	2.00 %
Tax-Exempt[1,3]	**117,414**	**4,953**	**4.22 %**	129,870	5,084	3.91 %
Total Investment Securities	**414,885**	**12,402**	**2.99 %**	411,612	10,724	2.61 %
Restricted Investment in Bank Stocks	**4,279**	**264**	**6.17 %**	2,193	96	4.38 %
Interest-Bearing Deposits in Other Banks	**8,476**	**16**	**0.19 %**	53,622	80	0.15 %
Total Other Interest Earning Assets	**12,755**	**280**	**2.19 %**	55,815	176	0.32 %
Total Interest Earning Assets	**1,234,809**	**48,282**	**3.91 %**	1,204,266	43,948	3.65 %
Non-Interest Earning Assets:						
Cash and Due From Banks	**9,528**			9,218		
Allowance for Loan Losses	**(9,077)**			(8,144)		
Premises and Equipment	**19,296**			19,448		
Other Assets	**61,294**			53,569		
Total Non-Interest Earning Assets	**81,041**			74,091		
Total Assets	**$ 1,315,850**			$ 1,278,357		
Interest Bearing Liabilities:						
Savings, NOW, Money Markets and Interest Checking	**$ 631,217**	**$ 4,040**	**0.64 %**	$ 626,511	$ 1,454	0.23 %
Time Deposits	**163,525**	**1,219**	**0.75 %**	181,459	1,689	0.93 %
Securities Sold U/A to Repurchase	**26,825**	**225**	**0.84 %**	26,352	92	0.35 %
Short-Term Borrowings	**60,735**	**1,710**	**2.82 %**	553	2	0.34 %
Long-Term Borrowings	**28,890**	**628**	**2.17 %**	38,013	817	2.15 %
Subordinated Debentures	**25,000**	**1,091**	**4.36 %**	25,000	1,094	4.38 %
Total Interest Bearing Liabilities	**936,192**	**8,913**	**0.95 %**	897,888	5,148	0.57 %
Non-Interest Bearing Liabilities:						
Demand Deposits	**242,010**			220,615		
Other Liabilities	**7,162**			11,888		
Stockholders' Equity	**130,486**			147,966		
Total Liabilities/Stockholders' Equity	**$ 1,315,850**			$ 1,278,357		
Net Interest Income Tax Equivalent		**$ 39,369**			$ 38,800	
Net Interest Spread			**2.96 %**			3.08 %
Net Interest Margin			**3.19 %**			3.22 %

[1]Tax-exempt income has been adjusted to a tax equivalent basis using an incremental rate of 21% and statutory interest expense disallowance.
[2]Includes tax equivalent adjustments on tax-free municipal loans of $228,000 and $188,000 for years 2022 and 2021, respectively.
[3]Includes tax equivalent adjustments on tax-free municipal securities of $1,641,000 and $1,712,000 for years 2022 and 2021, respectively.
[4]Installment loans are stated net of unearned interest.
[5]Average loan balances include non-accrual loans. Interest income on non-accrual loans is not included.

NET INTEREST INCOME

The major source of operating income for the Corporation is net interest income. Net interest income is the difference between interest income on earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, including deposits and other borrowings. The amount of interest income is dependent upon both the volume of earning assets and the level of interest rates. In addition, the volume of non-performing loans affects interest income. The amount of interest expense varies with the amount of funds needed to support earning assets, interest rates paid on deposits and borrowed funds, and finally, the level of interest free deposits.

Table 3 on the preceding page provides a summary of average outstanding balances of earning assets and interest bearing liabilities with the associated interest income and interest expense as well as average tax equivalent rates earned and paid as of year-end 2022 and 2021.

The yield on earning assets was 3.91% in 2022 and 3.65% in 2021. The rate paid on interest bearing liabilities was 0.95% in 2022 and 0.57% in 2021. This resulted in a decrease in our net interest spread to 2.96% in 2022, as compared to 3.08% in 2021.

As Table 3 illustrates, net interest margin, which is interest income less interest expense divided by average earning assets, was 3.19% in 2022 as compared to 3.22% in 2021. Net interest margins are presented on a tax-equivalent basis. In 2022, the yield on earning assets increased by 0.26% and the rate paid on interest bearing liabilities increased by 0.38%. Yields increased for a majority of interest earning assets and interest bearing liabilities during 2022, mainly as a result of the current high interest rate environment. The yield on loans decreased from 4.49% in 2021 to 4.41% in 2022 mainly due to fewer loan fees earned due to the discontinuation of the SBA PPP program. The securities portfolio yield increased to 2.99% in 2022 as compared to 2.61% in 2021. The increase was mainly the result of the elevated rate environment impacting variable rate securities. The average rate paid on short-term borrowings increased 2.48% from 0.34% in 2021 to 2.82% in 2022 due to higher interest rates paid on a significantly higher overnight borrowing balance. The rate paid on savings, NOW, money market, and interest checking accounts increased 0.41% from 0.23% to 0.64% and the average rate paid on time deposits decreased 0.18% from 0.93% to 0.75%. Interest income exempt from federal tax was $3,771,000 in 2022 and $3,743,000 in 2021. Interest income exempt from federal tax increased due to the origination of tax-exempt loans. Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental rate of 21%.

The decrease in net interest margin at December 31, 2022 compared to December 31, 2021 was primarily due to decreased SBA PPP loan fees and the effect on the yields on total loans and increased yields on deposits and borrowings in 2022, as compared to 2021. Fully tax equivalent net interest income increased by $569,000 or 1.5% to $39,369,000 at December 31, 2022 compared to $38,800,000 at December 31, 2021. During 2022, the Federal Reserve increased the federal-funds rate by 4.25%, resulting in a target range of 4.25% - 4.50%. The Corporation could experience a decrease in net interest income if market rates remain static or continue to increase, as the Corporation's net interest income continues to be liability sensitive. To negate the potential impact of a decreasing net interest margin, the Corporation will continue to focus on attracting organic loan growth and lower cost core deposits such as checking, savings, and money market accounts, thereby further reducing its dependence on higher priced certificates of deposit and short-term borrowings. The Corporation is actively monitoring and restructuring its portfolios to become more asset sensitive, which will allow for better performance in a static or rates-up environment. The Corporation will continue to evaluate the potential impact of short-term rate fluctuations in 2023, as well as the slope and position of the yield curve.

Table 4 sets forth changes in interest income and interest expense for the periods indicated for each category of interest earning assets and interest bearing liabilities. Information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by prior rate); (ii) changes in rate (changes in average rate multiplied by prior average volume); and, (iii) changes in rate and volume (changes in average volume multiplied by changes in average rate).

In 2022, the increase in net interest income on a fully tax equivalent basis of $569,000 resulted from an increase in volume of $3,137,000 and a decrease of $2,568,000 due to changes in rate.

Table 4 — Rate/Volume Analysis

(Dollars in thousands)

	2022 COMPARED TO 2021		
	VOLUME	RATE	NET
Interest Income:			
Loans, Net	$ 3,154	$ (602)	$ 2,552
Taxable Securities	315	1,494	1,809
Tax-Exempt Securities	(488)	357	(131)
Restricted Investment in Bank Stocks	91	77	168
Other	(67)	3	(64)
Total Interest Income	$ 3,005	$ 1,329	$ 4,334
Interest Expense			
Savings, NOW and Money Markets	$ 11	$ 2,575	$ 2,586
Time Deposits	(167)	(303)	(470)
Securities Sold U/A to Repurchase	2	131	133
Short-Term Borrowings	218	1,490	1,708
Long-Term Borrowings	(196)	7	(189)
Subordinated Debentures	—	(3)	(3)
Total Interest Expense	(132)	3,897	3,765
Net Interest Income	$ 3,137	$ (2,568)	$ 569

The change in interest due to both volume and rate has been allocated to change due to volume and change due to rate in proportion to the absolute value of the change in each. Balances on non-accrual loans are included for computational purposes. Interest income on non-accrual loans is not included.

PROVISION FOR LOAN LOSSES

For the year ended December 31, 2022, the provision for loan losses resulted in a credit balance of $264,000 as compared to $860,000 expense for the year ended December 31, 2021. The decrease in the provision for loan losses in 2022 as compared to 2021 resulted from excess balances exceeding the required allowance for loan losses that were returned to the provision, along with the Corporation's analysis of the current loan portfolio, including historic losses, past-due trends, current economic conditions, loan portfolio growth, and other relevant factors. The provision for loan losses for the year ended December 31, 2022 is also reflective of management's assessment of the continued risk associated with the uncertainty surrounding geopolitical and economic concerns. Charge-off and recovery activity in the allowance for loan losses resulted in net charge-offs of $142,000 and $113,000 for the years ended December 31, 2022 and 2021, respectively. See Allowance for Loan Losses on page 35 for further discussion.

Gross charge-offs amounted to $206,000 at December 31, 2022, as compared to $158,000 at December 31, 2021. The increased level of charge-offs for the year ended December 31, 2022 was mainly due to a charge-off in the amount of $148,000 that was completed during the third quarter of 2022 on a commercial and industrial loan to a residential home builder. The business has ceased operations as a result of financial difficulties; however, this is not suggestive of a regional industry issue. This charge-off contributed to the increased balance of net charge-offs in 2022 over 2021 but was not indicative of a significant change in asset quality in the overall loan portfolio. See Table 11 – Analysis of Allowance for Loan Losses for further details.

The allowance for loan losses as a percentage of average loans outstanding was 1.03% as of December 31, 2022 and 1.18% as of December 31, 2021.

On a quarterly basis, management performs, and the Corporation's Audit Committee and the Board of Directors review a detailed analysis of the adequacy of the allowance for loan losses. This analysis includes an evaluation of credit risk concentration, delinquency trends, past loss experience, current economic conditions, composition of the loan portfolio, classified loans and other relevant factors.

The Corporation will continue to monitor its allowance for loan losses and make future adjustments to the allowance through the provision for loan losses as conditions warrant. Although the Corporation believes that the allowance for loan losses is adequate to provide for losses inherent in the loan portfolio, there can be no assurance that future losses will not exceed the estimated amounts or that additional provisions will not be required in the future.

The Corporation is subject to periodic regulatory examination by the Pennsylvania Department of Banking and Securities and the FDIC. As part of the examination, the regulators will assess the adequacy of the Corporation's allowance for loan losses and may include factors not considered by the Corporation. In the event that a regulatory examination results in a conclusion that the Corporation's allowance for loan losses is not adequate, the Corporation may be required to increase its provision for loan losses.

NON-INTEREST INCOME

Non-interest income is derived primarily from service charges and fees, ATM fees and debit card income, trust department revenue, increases in the cash surrender value of bank owned life insurance, gains on sales of mortgage loans and other miscellaneous income. In addition, net securities gains and losses also impact total non-interest income. Table 5 provides the yearly non-interest income by category, along with the amount, dollar changes, and percentage of change comparing the last two years.

Non-interest income through December 31, 2022 was $5,331,000, a decrease of 27.2%, or $1,992,000, from 2021. The decrease was due to decreases in net securities (losses) gains and decreases in net (losses) gains on sales of mortgage loans in 2022.

During 2022, net securities (losses) gains decreased $1,169,000 to a net loss of $846,000. The decrease was due to the Corporation recognizing $726,000 in net losses on the sales of debt and equity securities in 2022. The Corporation also recognized $120,000 in net losses on held equity securities in 2022 due to market valuation fluctuations, as compared to recognizing $319,000 in net gains on held equity securities in 2021.

Gains on sales of mortgage loans amounted to a net loss of $7,000 in 2022 as compared to providing income of $980,000 in 2021. The decrease in net (losses) gains on sales of mortgage loans in 2022 was due to a low number of individual loans sold in 2022 along with many of the loans sold in 2022 being sold at a loss. These factors were due to the current rate environment and fewer loans being originated with the intent to sell in 2022. The Corporation continues to service the majority of mortgages which are sold. This servicing income provides an additional source of non-interest income on an ongoing basis.

Service charges and fees increased by $279,000 or 14.6% in 2022 as compared to 2021. The increase was due to increased overdraft fees on DDA accounts in 2022 as a result of more accounts in overdraft status. ATM fees and debit card income decreased by $37,000 or 1.7% in 2022 as compared to 2021 due to decreased ATM surcharge fees as the result of decreased transaction volume in 2022.

Other income, consisting primarily of safe deposit box rentals, income from the sale of retail non-deposit investment products, and miscellaneous fees, decreased $44,000, or 13.9% in 2022 as compared to 2021 as the Corporation recognized less annuity income from the sale of retail non-deposit investments in 2022.

Table 5 — Non-Interest Income

(Dollars in thousands)		2022/2021 Increase/(Decrease)		
	2022	Amount	%	2021
Trust department	$ 975	$ (33)	(3.3)	$ 1,008
Service charges and fees	2,193	279	14.6	1,914
Increase in cash surrender value of life insurance	597	(1)	(0.2)	598
ATM fees and debit card income	2,146	(37)	(1.7)	2,183
Net (losses) gains on sales of mortgage loans	(7)	(987)	(100.7)	980
Other	273	(44)	(13.9)	317
Subtotal	6,177	(823)	(11.8)	7,000
Net securities (losses) gains	(846)	(1,169)	(361.9)	323
Total	$ 5,331	$ (1,992)	(27.2)	$ 7,323

NON-INTEREST EXPENSE

Total non-interest expense amounted to $26,777,000, an increase of $423,000, or 1.6% in 2022. Expenses associated with employees (salaries and employee benefits) continue to be the largest non-interest expenditure. Salaries and employee benefits amounted to $14,554,000 or 54.4% of total non-interest expense in 2022 and $14,148,000 or 53.7% in 2021. Salaries and employee benefits increased $406,000, or 2.9% in 2022. The increase in 2022 was due to normal merit increases and new hires, along with an increase in medical insurance costs in 2022. The number of full-time equivalent employees was 201 as of December 31, 2022 and 198 as of December 31, 2021.

Net occupancy expense increased $51,000, or 2.7% in 2022 as compared to 2021. Net furniture and equipment and computer expense increased $297,000, or 16.6% in 2022 compared to 2021. The increase in 2022 was due to the implementation of several new software programs in 2022 to increase data security and efficiency.

Professional services increased $220,000, or 21.0% in 2022 as compared to 2021. The higher expense in 2022 was mainly due to an increase in consulting expense as the result of strategic planning and consulting services associated with implementing new internal software systems contracts along with normal increases in annual audit expenses.

Pennsylvania shares tax expense increased $36,000, or 3.0% in 2022 as compared to 2021. FDIC insurance expense increased $67,000, or 15.8% in 2022 as compared to 2021. FDIC insurance expense varies with changes in net asset size, risk ratings, and FDIC derived assessment rates.

ATM and debit card fees expense decreased $192,000, or 17.6% in 2022 as compared to 2021 due to negotiations of new internal systems contracts resulting in some lower fees and vendor relationship credits that were applied to the expenses related to those systems. Data processing fees decreased $285,000, or 23.8% in 2022 as compared to 2021. This decrease was also the result of the negotiations of new systems contracts.

Advertising expense decreased $18,000, or 4.4% in 2022 as compared to 2021. Other non-interest expense decreased $156,000, or 4.9% in 2022 as compared to 2021. This decrease was due to a reduction in the provision for unfunded loan commitments along with less amortization expense related to a limited partnership that was fully amortized at the beginning of 2022.

The overall level of non-interest expense remains low, relative to the Corporation’s peers (community banks from $1 billion to $3 billion in assets). The Corporation’s total non-interest expense was 2.04% of average assets in 2022 and 2.06% in 2021, which places the Corporation among the leaders in its peer financial institution categories in controlling non-interest expense.

Table 6 — Non-Interest Expense

(Dollars in thousands)		2022/2021 Increase/(Decrease)		
	2022	Amount	%	2021
Salaries and employee benefits	$ 14,554	$ 406	2.9	$ 14,148
Occupancy, net	1,936	51	2.7	1,885
Furniture and equipment	594	24	4.2	570
Computer expense	1,493	273	22.4	1,220
Professional services	1,270	220	21.0	1,050
Pennsylvania shares tax	1,238	36	3.0	1,202
FDIC Insurance	490	67	15.8	423
ATM and debit card fees	899	(192)	(17.6)	1,091
Data processing fees	915	(285)	(23.8)	1,200
Foreclosed assets held for resale	—	(3)	(100.0)	3
Advertising	389	(18)	(4.4)	407
Other	2,999	(156)	(4.9)	3,155
Total	$ 26,777	$ 423	1.6	$ 26,354

INCOME TAX EXPENSE

Income tax expense for the year ended December 31, 2022, was $2,294,000 as compared to $2,321,000 for the year ended December 31, 2021. The effective income tax rate was 14.1% in 2022 and 13.6% in 2021. The increase in the effective tax rate for 2022 was due to slightly lower tax-exempt income and fewer tax credits recognized. The Corporation recognized $249,000 and $405,000 of tax credits from low-income housing partnerships for the years ended December 31, 2022 and 2021, respectively.

FINANCIAL CONDITION

GENERAL

Total assets increased to $1,329,194,000 at year-end 2022, an increase of 0.7% from year-end 2021.

Total debt securities available-for-sale decreased $64,472,000 or 14.7% to $373,444,000 as of December 31, 2022.

Net loans increased in 2022 from $744,161,000 to $850,195,000, a 14.2% increase. Loan demand grew in 2022 as the Bank has realized an increase in loan originations, primarily in the commercial real estate portfolio.

The cash surrender value of bank owned life insurance totaled $25,389,000 at December 31, 2022, an increase of $597,000 or 2.4% from 2021. This increase represents tax-free income included in non-interest income on the consolidated statements of income.

Investments in low-income housing partnerships were $3,763,000 at year-end 2022, an increase of 145.9% from year-end 2021. The Corporation became a limited partner in a new real estate venture during 2021 with an initial investment of $435,000. In 2022, capital contributions in the combined amount of $2,458,000 were made in relation to the new real estate venture. Investing in low-income housing real estate ventures enables the Corporation to recognize tax credits and satisfy Community Reinvestment Act initiatives.

As of December 31, 2022, total deposits amounted to $993,499,000, a decrease of 7.8% from 2021. The decrease is due to decreases in both non-interest and interest bearing deposits, primarily due to a $70,297,000 decrease in municipal deposits. Core deposits, which include demand deposits and interest bearing demand deposits (NOWs), money market accounts, savings accounts, and time deposits of individuals, continue to be the Corporation's most significant source of funds.

The Corporation continues to maintain and manage its asset growth. The Corporation's strong equity capital position provides an opportunity to further leverage its asset growth. Short and long-term borrowings increased in 2022 by $116,041,000, mainly due to an increase in net loans and a decrease in total deposits causing an increase in short-term borrowings.

Total stockholders' equity decreased to $120,386,000 at December 31, 2022, a decrease of $28,169,000, primarily due to a decrease in the market value of the securities portfolio resulting in an accumulated other comprehensive loss position.

SEGMENT REPORTING

Currently, management measures the performance and allocates the resources of the Corporation as a single segment.

EARNING ASSETS

Earning assets are defined as those assets that produce interest income. By maintaining a healthy asset utilization rate, i.e., the volume of earning assets as a percentage of total assets, the Corporation maximizes income. The earning asset ratio (average interest earning assets divided by average total assets) equaled 93.8% for 2022 compared to 94.2% for 2021. This indicates that the management of earning assets is a priority and non-earning assets, primarily cash and due from banks, fixed assets and other assets, are maintained at minimal levels. The primary earning assets are loans and securities.

SECURITIES

The Corporation uses securities to not only generate interest and dividend revenue, but also to help manage interest rate risk and to provide liquidity to meet operating cash needs.

The securities portfolio consists of debt securities available-for-sale. No securities were established in a trading account. Debt securities available-for-sale decreased $64,472,000 or 14.7% to $373,444,000 in 2022. At December 31, 2022, the net unrealized loss, net of the tax effect, on these securities was $29,558,000 and was included in stockholders' equity as accumulated other comprehensive (loss) income. Table 7 provides data on the fair value of the Corporation's securities portfolio on the dates indicated. The vast majority of security purchases are allocated as available-for-sale. This provides the Corporation with increased flexibility should there be a need or desire to liquidate a security.

The securities portfolio includes, U.S. treasuries, U.S. government corporations and agencies, corporate debt obligations, mortgage-backed securities, asset-backed securities, and obligations of state and political subdivisions, both tax-exempt and taxable.

Debt securities available-for-sale may be sold as part of the overall asset and liability management process. Realized gains and losses are reflected in the results of operations on the Corporation's Consolidated Statements of Income. As of December 31, 2022, the securities portfolio does not contain any off-balance sheet derivatives or trust preferred investments.

Table 7 — Securities

(Dollars in thousands)	Available-For-Sale	
	December 31, 2022	**December 31, 2021**
U.S. Treasury securities	**$ 6,801**	$ 7,729
U. S. Government corporations and agencies	**142,855**	122,487
Other mortgage-backed debt securities	**33,688**	39,550
Obligations of state and political subdivisions	**110,689**	186,176
Asset-backed securities	**36,418**	36,542
Corporate debt securities	**42,993**	45,432
Total	**$ 373,444**	$ 437,916

The amortized cost and fair value of securities, by contractual maturity, are shown below at December 31, 2022. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Table 8 — Securities Maturity Table

(Dollars in thousands)	**December 31, 2022** Debt Securities Available-For-Sale					
	U.S. Treasury Securities	U.S. Government Corporations & Agencies Obligations[1]	Other Mortgage Backed Debt Securities[1]	Obligations of State & Political Subdivisions	Asset Backed Securities	Corporate Debt Securities
Within 1 Year:						
Amortized cost	$ —	$ —	$ 2,006	$ 1,939	$ —	$ 5,032
Fair value	—	—	1,935	1,928	—	5,066
1 - 5 Years:						
Amortized cost	2,886	678	6,471	18,634	—	7,593
Fair value	2,542	670	6,194	17,820	—	7,563
5 - 10 Years:						
Amortized cost	4,967	16,994	1,097	26,479	—	33,213
Fair value	4,259	17,098	1,064	23,605	—	30,364
After 10 Years:						
Amortized cost	—	140,027	27,193	78,124	37,526	—
Fair value	—	125,087	24,495	67,336	36,418	—
Total:						
Amortized cost	$ 7,853	$ 157,699	$ 36,767	$ 125,176	$ 37,526	$ 45,838
Fair value	6,801	142,855	33,688	110,689	36,418	42,993

[1]Mortgage-backed and asset-backed securities are allocated for maturity reporting at their original maturity date.

Marketable equity securities consist of common stock investments in other commercial banks and bank holding companies. At December 31, 2022 and 2021, the Corporation had $1,699,000 and $1,962,000, respectively, in equity securities recorded at fair value, a decrease of $263,000 or 13.4%.

LOANS

Total loans increased to $858,469,000 as of December 31, 2022, compared to a balance of $752,841,000 as of December 31, 2021. Table 9 provides data relating to the composition of the Corporation's loan portfolio on the dates indicated. Total loans increased $105,628,000, or 14.0% in 2022 compared to an increase of $32,231,000, or 4.5% in 2021.

Steady demand for borrowing by businesses accounted for the 14.0% increase in the loan portfolio from December 31, 2021 to December 31, 2022. Overall, the Commercial and Industrial portfolio (which includes tax-free Commercial and Industrial loans) increased $4,473,000 or 5.4% from $82,526,000 at December 31, 2021 to $86,999,000 at December 31, 2022. The increase in the Commercial and Industrial portfolio during the year ended December 31, 2022 was attributable to the portion of the Commercial and Industrial portfolio excluding SBA PPP loans which increased $9,254,000 during the year ended December 31, 2022, mainly resulting from $17,072,000 in new loan originations for the year ended December 31, 2022 and an increase in utilization of existing Commercial and Industrial lines of credit of $5,067,000, offset by loan payoffs of $6,238,000 and regular principal payments and other typical fluctuations in the Commercial and Industrial portfolio during the year ended December 31, 2022. This was offset by a reduction of $4,781,000 in the portion of the Commercial and Industrial portfolio attributable to SBA PPP loans, the balance of which decreased from $4,894,000 at December 31, 2021 to $113,000 at December 31, 2022, as a result of loan forgiveness. The Commercial Real Estate portfolio (which includes tax-free Commercial Real Estate loans) increased $89,895,000 or 17.2% from $521,654,000 at December 31, 2021 to $611,549,000 at December 31, 2022. The increase is mainly attributable to new loan originations of $162,459,000 for the year ended December 31, 2022, offset by loan payoffs of $58,616,000 and a decrease in utilization of existing Commercial Real Estate lines of credit of $11,778,000, along with regular principal payments and other typical amortization in the Commercial Real Estate portfolio during the year ended December 31, 2022. Residential Real Estate loans increased $11,123,000 or 7.8% from $143,383,000 at December 31, 2021 to $154,506,000 at December 31, 2022. The increase was mainly the result of $34,329,000 in new loan originations and an increase in utilization of existing Residential Real Estate (Home Equity) lines of credit of $2,644,000, offset by net loans sold of $3,410,000, loan payoffs of $16,121,000 (of which $4,734,000 was refinanced with the Bank during the year ended December 31, 2022 with new refinanced loan balances included in the new loan origination total), and regular principal payments and other typical amortization in the Residential Real Estate portfolio during the year ended December 31, 2022. Net loans sold for the year ended December 31, 2022 consisted of total loans sold during the year ended December 31, 2022 of $5,685,000, offset with loans opened and sold in the same quarter during each quarter of 2022 which amounted to $2,275,000. The Corporation continues to originate and sell certain long-term fixed rate residential mortgage loans, which conform to secondary market requirements, when the market pricing is favorable. The Corporation derives ongoing income from the servicing of mortgages sold in the secondary market. The Corporation continues its efforts to lend to creditworthy borrowers.

Management believes that the loan portfolio is well diversified. The total commercial portfolio was $698,548,000 at December 31, 2022. Of total loans, $611,549,000 or 71.3% were secured by commercial real estate, primarily lessors of residential buildings and dwellings and lessors of non-residential buildings. The Corporation continues to monitor these portfolios.

All loan relationships in excess of $1,500,000 are reviewed internally and/or externally through a loan review process on an annual basis. Such review is based upon analysis of current financial statements of the borrower, co-borrowers/guarantors, payment history, and economic conditions.

Overall, the portfolio risk profile as measured by loan grade is considered low risk, as $836,405,000 or 97.5% of gross loans are graded Pass; $634,000 or 0.1% are graded Special Mention; $20,301,000 or 2.4% are graded Substandard; and $0 are graded Doubtful. The rating is intended to represent the best assessment of risk available at a given point in time, based upon a review of the borrower's financial statements, credit analysis, payment history with the Bank, credit history and lender knowledge of the borrower. See Note 3 — Loans and Allowance for Loan Losses for risk grading tables.

Overall, non-pass grades decreased to $20,935,000 at December 31, 2022, as compared to $24,737,000 at December 31, 2021. Commercial and Industrial non-pass grades decreased to $725,000 as of December 31, 2022, compared to $796,000 as of December 31, 2021. Commercial Real Estate non-pass grades decreased to $19,415,000 as of December 31, 2022 as compared to $22,346,000 as of December 31, 2021. Residential Real Estate and Consumer non-pass grades decreased to $795,000 as of December 31, 2022, as compared to $1,595,000 as of December 31, 2021.

The decrease in Commercial Real Estate non-pass grades from December 31, 2021 to December 31, 2022 is attributable to various fluctuations that transpired in the Commercial Real Estate non-pass grade portfolio throughout 2022. A payoff was completed during the second quarter of 2022 on a Substandard non-accrual loan to a contractor specializing in modular construction that carried a balance of $1,000,000 at December 31, 2021. Additionally, four loans to the owners/operators of an indoor family entertainment complex that were classified as Substandard and carried an aggregate balance of $753,000 at December 31, 2021 and one loan to the owner/operator of a multi-unit apartment building that was classified as Special Mention and carried a balance of $729,000 as of December 31, 2021 were upgraded to pass-grade status during the year ended December 31, 2022. There were also $750,000 in principal payments/paydowns made during the fourth quarter of 2022 on a non-performing loan to a student housing holding company that was classified as Substandard at both December 31, 2021 and December 31, 2022.

The Corporation continues to internally underwrite each of its loans to comply with prescribed policies and approval levels established by its Board of Directors.

The classes of the Corporation's loan portfolio net of unearned discount and net deferred loan fees and costs are summarized in Table 9.

Table 9 — Loans

(Dollars in thousands)	December 31,				
	2022	2021	2020	2019	2018
Commercial and Industrial	**$ 86,999**	$ 82,526	$ 91,875	$ 86,712	$ 92,220
Commercial Real Estate	**611,549**	521,654	466,728	395,801	348,476
Residential Real Estate	**154,506**	143,383	156,983	159,350	159,741
Consumer	**5,415**	5,278	5,024	5,869	5,955
Total Loans	**$ 858,469**	$ 752,841	$ 720,610	$ 647,732	$ 606,392

The Corporation's maturity and interest rate sensitivity information related to the loan portfolio is summarized in Table 10.

Table 10 — Loan Maturity and Interest Sensitivity

Loans by Maturity

(Dollars in thousands)	**December 31, 2022**			
	One Year and Less	After One Year Through Five Years	After Five Years	Total
Commercial and Industrial	$ 11,262	$ 33,338	$ 42,399	$ 86,999
Commercial Real Estate	37,651	137,547	436,351	611,549
Residential Real Estate	8,703	33,942	111,861	154,506
Consumer	1,682	3,113	620	5,415
Total	$ 59,298	$ 207,940	$ 591,231	$ 858,469

The above data represents the amount of loans receivable at December 31, 2022 which, based on remaining scheduled repayments of principal, are due in the periods indicated.

Loans by Repricing

(Dollars in thousands)	December 31, 2022 One Year and Less	After One Year Through Five Years	After Five Years	Total
Commercial and Industrial	$ 30,808	$ 43,861	$ 12,330	$ 86,999
Commercial Real Estate	83,905	517,849	9,795	611,549
Residential Real Estate	17,624	31,161	105,721	154,506
Consumer	2,533	2,856	26	5,415
Total	$ 134,870	$ 595,727	$ 127,872	$ 858,469
Loans with a fixed interest rate	$ 24,727	$ 72,265	$ 112,155	$ 209,147
Loans with a variable interest rate	110,143	523,462	15,717	649,322
Total	$ 134,870	$ 595,727	$ 127,872	$ 858,469

The above data represents the amount of loans receivable at December 31, 2022 which are due or have the opportunity to reprice in the periods indicated, based on remaining scheduled repayments of principal for fixed rate loans or date of next repricing opportunity for variable rate loans. The fixed and variable portions of the amounts of loans receivable due or repricing in the periods indicated are also summarized above.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses constitutes the amount available to absorb losses within the loan portfolio. As of December 31, 2022, the allowance for loan losses was $8,274,000 as compared to $8,680,000 as of December 31, 2021. The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for possible loan losses when management believes that the collectability of the principal is unlikely. The risk characteristics of the loan portfolio are managed through various control processes, including credit evaluations of individual borrowers, periodic reviews, and diversification by industry. Risk is further mitigated through the application of lending procedures such as the holding of adequate collateral and the establishment of contractual guarantees.

Management performs a quarterly analysis to determine the adequacy of the allowance for loan losses. The methodology in determining adequacy incorporates specific and general allocations together with a risk/loss analysis on various segments of the portfolio according to an internal loan review process. This assessment results in an allocated allowance. Management maintains its loan review and loan classification standards consistent with those of its regulatory supervisory authority.

Management considers, based upon its methodology, that the allowance for loan losses is adequate to cover foreseeable future losses. However, there can be no assurance that the allowance for loan losses will be adequate to cover significant losses, if any, that might be incurred in the future. On a quarterly basis, management evaluates the qualitative factors utilized in the calculation of the Corporation's allowance for loan losses and various adjustments are made to these factors as deemed necessary at the time of evaluation. The uncertain economic climate has played a large role in the qualitative factor adjustments that have been implemented throughout 2021 and 2022. Qualitative factors remained unchanged during the first quarter of 2021, as the economy and unemployment levels showed marked improvement over the prior quarter. During the second quarter of 2021, the qualitative factors related to the local/regional economy were decreased by one basis point across all loan segments, as the economy and job growth in the Company's market areas demonstrated marked improvement over the prior quarter, and the qualitative factor related to collateral values was increased by one basis point for both the Commercial Real Estate and Residential Real Estate portfolio segments due to an artificial increase in market values in the real estate sector as individuals' willingness to pay above-average market prices has sparked uncertainty surrounding collateral values in the real estate market. Qualitative factors remained unchanged during the third quarter of 2021. During the fourth quarter of 2021, the qualitative factors related to external factors/conditions were increased by one basis point across all loan segments due to increased inflation rates, as well as elevated unemployment levels (although improved from 2020 and early 2021) and the uncertainty of how broad the changes implemented by the Federal Reserve would be. The qualitative factors related to collateral values were also increased by one basis point across all loan segments during the fourth quarter of 2021, as collateral values continued to artificially increase as individuals were willing to pay above-average market prices in all sectors. During the first quarter of 2022, the qualitative factors related to the local/regional economy were increased by one basis point across all loan segments due to ongoing economic uncertainty resulting from supply chain disruptions caused by the COVID-19 pandemic, conflicts in foreign countries causing inflationary pressures due to reductions/disruptions in the production of the commodities controlled by these countries, increased interest rates, and the overall inflation rate continuing to rise. During the second quarter of 2022, the qualitative factors remained unchanged. During the third quarter of 2022, the qualitative factors related to the management and review systems components were each decreased by two basis points across all loan segments due to consistency and experience within the Company's management and satisfactory exam results related to the Company's loan review process. During the fourth quarter of 2022, the qualitative factor related to collateral values was decreased by one basis point in the Commercial and Industrial, Tax Free, and Consumer portfolio segments and decreased by two basis points in the Commercial Real Estate and Residential Real Estate portfolio segments, as the artificial increase in market rates related to equipment, commodities, and real estate have begun to subside. The qualitative factor related to delinquency trends was also decreased by one basis point in the Commercial and Industrial, Commercial Real Estate, and Residential Real Estate portfolio segments, as the Corporation's levels of past due loans, non-accrual loans, and charge-offs have been lower in these portfolios in the last two years than in previous years. Modifications granted in compliance with Section 4013 of the CARES Act were highest in the Commercial Real Estate portfolio segment, the long-term effects of which are still very unclear, as there is still uncertainty related to the lagging economic effects of the COVID-19 pandemic, especially in relation to this segment of the Corporation's loan portfolio.

Table 11 contains an analysis of the allowance for loan losses indicating charge-offs and recoveries by year. In 2022 and 2021, net charge-offs as a percentage of average loans was 0.02%, respectively. Net charge-offs amounted to $142,000 in 2022 and $113,000 in 2021. Net charge-offs were higher in 2022 than in 2021, mainly due to a charge-off in the amount of $148,000 that was completed during the third quarter of 2022 on a commercial and industrial loan to a residential construction company. The business has ceased operations as a result of financial difficulties.

For the year ended December 31, 2022, the provision for loan losses resulted in a credit balance of $264,000, as compared to $860,000 expense for the year ended December 31, 2021. The net effect of the credit balance of the provision and net charge-offs resulted in the year-end allowance for loan losses of $8,274,000 of which 8.5% was attributed to the Commercial and Industrial component, 71.7% attributed to the Commercial Real Estate component, 18.8% attributed to the Residential Real Estate component, 1.0% attributed to the Consumer component, and 0% being the unallocated component (refer to the activity in Note 3 — Loans and Allowance for Loan Losses on page 74.) The Corporation determined that the provision for loan losses made during 2022 was sufficient to maintain the allowance for loan losses at a level necessary for the probable losses inherent in the loan portfolio as of December 31, 2022.

Table 11 — Analysis of Allowance for Loan Losses

(Dollars in thousands)	Years Ended December 31,				
As of and for the nine months ended:	**2022**	2021	2020	2019	2018
Beginning balance	**$ 8,680**	$ 7,933	$ 7,005	$ 6,745	$ 7,487
Charge-offs:					
Commercial and Industrial	**158**	13	90	—	18
Commercial Real Estate	**3**	29	141	64	783
Residential Real Estate	**12**	80	33	69	181
Consumer	**33**	36	37	71	57
	206	158	301	204	1,039
Recoveries:					
Commercial and Industrial	**3**	—	14	6	31
Commercial Real Estate	**40**	30	—	—	60
Residential Real Estate	**16**	4	8	2	—
Consumer	**5**	11	7	6	6
	64	45	29	14	97
Net charge-offs	**142**	113	272	190	942
Additions (credited) charged to operations	**(264)**	860	1,200	450	200
Balance at end of period	**$ 8,274**	$ 8,680	$ 7,933	$ 7,005	$ 6,745
Ratio of net charge-offs during the period to average loans outstanding during the period	**0.02 %**	0.02 %	0.04 %	0.03 %	0.16 %
Allowance for loan losses to average loans outstanding during the period	**1.03 %**	1.18 %	1.16 %	1.13 %	1.15 %

It is the policy of management and the Corporation's Board of Directors to make a provision for both identified and unidentified losses inherent in its loan portfolio. A provision for loan losses is charged to operations based upon an evaluation of the potential losses in the loan portfolio. This evaluation takes into account such factors as portfolio concentrations, delinquency trends, trends of non-accrual and classified loans, economic conditions, and other relevant factors.

The loan review process, which is conducted quarterly, is an integral part of the Bank's evaluation of the loan portfolio. A detailed quarterly analysis to determine the adequacy of the Corporation's allowance for loan losses is reviewed by the Board of Directors.

With the Bank's manageable level of net charge-offs and the additions to the reserve from the credit balance of the provision, the allowance for loan losses as a percentage of average loans amounted to 1.03% in 2022 and 1.18% in 2021.

Table 12 sets forth the allocation of the Bank's allowance for loan losses by loan category and the percentage of loans in each category to the total allowance for loan losses at the dates indicated. The portion of the allowance for loan losses allocated to each loan category does not represent the total available for future losses that may occur within the loan category, since the total loan loss allowance is a valuation reserve applicable to the entire loan portfolio.

Table 12 — Allocation of Allowance for Loan Losses

(Dollars in thousands)

	December 31,									
	2022	**%***	2021	%*	2020	%*	2019	%*	2018	%*
Commercial and Industrial	**$ 704**	**8.5**	$ 681	8.8	$ 787	10.8	$ 634	9.7	$ 724	11.7
Commercial Real Estate	**5,932**	**71.7**	5,408	70.1	4,762	65.4	4,116	63.0	3,700	59.8
Residential Real Estate	**1,557**	**18.8**	1,539	20.0	1,643	22.5	1,665	25.5	1,650	26.6
Consumer	**81**	**1.0**	84	1.1	94	1.3	114	1.8	117	1.9
Unallocated	**—**	**N/A**	968	N/A	647	N/A	476	N/A	554	N/A
	$ 8,274	**100.0**	$ 8,680	100.0	$ 7,933	100.0	$ 7,005	100.0	$ 6,745	100.0

*Percentage of allocation in each category to total allocations in the Allowance for Loan Loss Analysis, excluding unallocated.

NON-PERFORMING ASSETS

Table 13 details the Corporation's non-performing assets and impaired loans as of the dates indicated. Generally, a loan is classified as non-accrual and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against current period income. A modification of a loan constitutes a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession that the Corporation would not otherwise consider. Modifications to loans classified as TDRs generally include reductions in contractual interest rates, principal deferments and extensions of maturity dates at a stated interest rate lower than the current market for a new loan with similar risk characteristics. While unusual, there may be instances of loan principal forgiveness. Any loan modifications made in response to the COVID-19 pandemic are not considered TDRs as long as the criteria set forth in Section 4013 of the CARES Act are met. Foreclosed assets held for resale represent property acquired through foreclosure, or considered to be an in-substance foreclosure.

Total non-performing assets amounted to $5,359,000 as of December 31, 2022, as compared to $7,066,000 as of December 31, 2021. The economy continues to be unstable. Inflation has receded but remains at a very high level. The war between Ukraine and Russia is continuing to cause worldwide turmoil. The unemployment rate remains at a low level, but the labor force participation rate also remains at a low level. The need for workers has driven wages up in most sectors. Inflation is causing extreme concerns in all areas of the economy. The war abroad and its effects on various commodities continues to have a negative impact on inflation. Values of new and used homes and automobiles have leveled off. The Federal Reserve has raised interest rates to not recently seen levels with a commitment for additional increases throughout the coming year until inflation falls back in line with its established guidelines. These forces have had a direct effect on the Corporation's non-performing assets. The Corporation is closely monitoring its Commercial Real Estate portfolio because of the current uncertain economic environment. Non-accrual loans totaled $5,051,000 as of December 31, 2022 as compared to $7,066,000 as of December 31, 2021. There were no foreclosed assets held for resale as of December 31, 2022 or December 31, 2021. There were three loans past-due 90 days or more and still accruing interest as of December 31, 2022 which carried an aggregate balance of $308,000, compared to December 31, 2021 when there were no loans past-due 90 days or more and still accruing interest. The loans past-due 90 days or more and still accruing interest as of December 31, 2022 consisted of one commercial real estate loan and two residential real estate loans, all of which were well-secured and in the process of collection.

Non-performing assets to total loans was 0.62% as of December 31, 2022 compared to 0.94% at December 31, 2021. Non-performing assets to total assets was 0.40% as of December 31, 2022 compared to 0.54% at December 31, 2021. The allowance for loan losses to total non-performing assets was 154.39% as of December 31, 2022 as compared to 122.84% as of December 31, 2021. Additional detail can be found in Table 13 – Non-Performing Assets and Impaired

Loans and the Loans Receivable on Non-Accrual Status table in Note 3 — Loans and Allowance for Loan Losses. Asset quality is a priority and the Corporation retains a full-time loan review officer to closely track and monitor overall loan quality, along with a full-time loan workout department to manage collection and liquidation efforts.

Performing substandard loans which are not deemed to be impaired have characteristics that cause management to have doubts regarding the ability of the borrower to perform under present loan repayment terms and which may result in reporting these loans as non-performing loans in the future. Performing substandard loans not deemed to be impaired amounted to $10,776,000 at December 31, 2022 and $10,463,000 at December 31, 2021.

Impaired loans were $11,207,000 at December 31, 2022 and $13,673,000 at December 31, 2021. The largest impaired loan relationship at December 31, 2022 consisted of a performing loan to a student housing holding company, which was classified as a TDR. The loan is secured by commercial real estate and carried a balance of $2,797,000 at December 31, 2022, net of $943,000 that had been charged-off to date, compared to December 31, 2021 when the loan carried a balance of $2,864,000, net of $943,000 that had been charged-off to date. The second largest impaired loan relationship at December 31, 2022 consisted of a non-performing loan to a student housing holding company which is secured by commercial real estate. At December 31, 2022, the loan carried a balance of $2,340,000, net of $1,989,000 that had been charged off to date, compared to December 31, 2021 when the loan carried a balance of $3,090,000, net of $1,989,000 that had been charged-off to date. The third largest impaired loan relationship at December 31, 2022 consisted of five non-performing loans to a plastic processing company focused on non-post-consumer recycling. Three loans are classified in the Commercial and Industrial portfolio and modified as TDRs and two loans are secured by commercial real estate. The loans carried an aggregate balance of $1,084,000 as of December 31, 2022, compared to December 31, 2021 when the loans carried an aggregate balance of $1,176,000.

The Corporation estimates impairment based on its analysis of the cash flows or collateral estimated at fair value less cost to sell. For collateral dependent loans, the estimated appraisal or other qualitative adjustments and cost to sell percentages are determined based on the market area in which the real estate securing the loan is located, among other factors, and therefore, can differ from one loan to another. Of the $11,207,000 in impaired loans at December 31, 2022, none were located outside the Corporation's primary market area.

The outstanding recorded investment of loans categorized as TDRs as of December 31, 2022 and December 31, 2021 was $7,480,000 and $8,020,000, respectively. The decrease in TDRs at December 31, 2022 as compared to December 31, 2021 is mainly attributable to regular principal payments and paydowns on existing TDRs that were completed during the year ended December 31, 2022. Of the thirty restructured loans at December 31, 2022, four loans were classified in the Commercial and Industrial portfolio, twenty-five loans were classified in the Commercial Real Estate portfolio, and one loan was classified in the Residential Real Estate portfolio. TDRs at December 31, 2022 consisted of ten term modifications beyond the original stated term, three interest rate modifications, and sixteen payment modifications. At December 31, 2022, there was also one troubled debt restructuring that experienced all three types of modification—payment, rate, and term. TDRs are separately evaluated for impairment disclosures, and if necessary, a specific allocation is established. As of December 31, 2022 and 2021, there were no specific allocations attributable to the TDRs. There were no unfunded commitments on TDRs at December 31, 2022 and 2021.

At December 31, 2022, three commercial and industrial loans classified as TDRs with a combined recorded investment of $664,000, and five commercial real estate loans classified as TDRs with a combined recorded investment of $684,000 were not in compliance with the terms of their restructure, compared to December 31, 2021 when three commercial and industrial loans classified as TDRs with a combined recorded investment of $708,000, ten commercial real estate loans classified as TDRs with a combined recorded investment of $590,000, and one residential real estate loan classified as a TDR with a recorded investment of $14,000 were not in compliance with the terms of their restructure.

Of the loans that were modified as TDRs within the twelve months preceding December 31, 2022, no loans experienced payment defaults during the year ended December 31, 2022. Three commercial real estate loans totaling $285,000 that were modified as TDRs within the twelve months preceding December 31, 2021 experienced payment defaults during the year ended December 31, 2021.

The Corporation's non-accrual loan valuation procedure for any loans greater than $250,000 requires an appraisal to be obtained and reviewed annually at year end, unless the Board of Directors waives such requirement for a specific loan, in favor of obtaining a Certificate of Inspection instead, defined as an internal evaluation completed by the Corporation. A quarterly collateral evaluation is performed which may include a site visit, property pictures and discussions with realtors and other similar business professionals to ascertain current values.

For non-accrual loans less than $250,000 upon classification and typically at year end, the Corporation completes a Certificate of Inspection, which includes the results of an onsite inspection, and may consider value indicators such as insured values, tax assessed values, recent sales comparisons and a review of the previous evaluations.

Improving loan quality is a priority. The Corporation actively works with borrowers to resolve credit problems and will continue its close monitoring efforts in 2023. Excluding the assets disclosed in Table 13 – Non-Performing Assets and Impaired Loans and the Troubled Debt Restructurings section in Note 3 — Loans and Allowance for Loan Losses, management is not aware of any information about borrowers' possible credit problems which cause serious doubt as to their ability to comply with present loan repayment terms.

In addition, regulatory authorities, as an integral part of their examinations, periodically review the allowance for possible loan losses. They may require additions to allowances based upon their judgments about information available to them at the time of examination.

The economic climate remains in a very frail state. The war between Ukraine and Russia has exacerbated the difficulties in the national and state economy and experts at all levels are attempting to calculate the intermediate or long term affects. The Corporation may experience difficulties collecting payments on time from its borrowers, and certain types of loans may need to be modified, which could cause a rise in the level of impaired loans, non-performing assets, charge-offs, and delinquencies. Should such metrics increase, additions to the balance of the Corporation's allowance for loan losses could be required. The extent of the impact of these stressors on the Corporation's operational and financial performance will depend on certain developments including inflationary controls enacted, the labor force, supply bottlenecks, the longevity of the war, and the effectiveness in controlling the lingering effects of the COVID-19 outbreak, etc. and the after-effects of these factors. These factors may not immediately impact the Corporation's operational and financial performance, as the effects of these factors may lag into the future. The Corporation is also susceptible to the impact of economic and fiscal policy factors that may evolve in the post-pandemic environment.

A concentration of credit exists when the total amount of loans to borrowers, who are engaged in similar activities that are similarly impacted by economic or other conditions, exceed 10% of total loans. As of December 31, 2022 and 2021 management is of the opinion that there were no loan concentrations exceeding 10% of total loans.

Table 13 — Non-Performing Assets and Impaired Loans

(Dollars in thousands)	December 31, 2022	December 31, 2021
Non-performing assets		
Non-accrual loans	**$ 5,051**	$ 7,066
Foreclosed assets held for resale	**—**	—
Loans past-due 90 days or more and still accruing interest	**308**	—
Total non-performing assets	**$ 5,359**	$ 7,066
Impaired loans		
Non-accrual loans	**$ 5,051**	$ 7,066
Accruing TDRs	**6,156**	6,607
Total impaired loans	**11,207**	13,673
Allocated allowance for loan losses	**—**	—
Net investment in impaired loans	**$ 11,207**	$ 13,673
Impaired loans with a valuation allowance	**$ —**	$ —
Impaired loans without a valuation allowance	**11,207**	13,673
Total impaired loans	**$ 11,207**	$ 13,673
Allocated valuation allowance as a percent of impaired loans	**— %**	— %
Impaired loans to total loans	**1.31 %**	1.81 %
Non-performing assets to total loans	**0.62 %**	0.94 %
Non-performing assets to total assets	**0.40 %**	0.54 %
Allowance for loan losses to impaired loans	**73.83 %**	63.48 %
Allowance for loan losses to total non-performing assets	**154.39 %**	122.84 %

Real estate mortgages comprise 89.2% of the loan portfolio as of December 31, 2022, as compared to 88.3% as of December 31, 2021. Real estate mortgages consist of both residential and commercial real estate loans. The real estate loan portfolio is well diversified in terms of borrowers, collateral, interest rates, and maturities. Also, the residential real estate loan portfolio is largely comprised of fixed rate mortgages. The real estate loans are concentrated primarily in the Corporation's market area and are subject to risks associated with the local economy. The commercial real estate loans typically reprice approximately every three to five years and are also concentrated in the Corporation's market area. The Corporation's loss exposure on its impaired loans continues to be mitigated by collateral positions on these loans. The allocated allowance for loan losses associated with impaired loans is generally computed based upon the related collateral value of the loans. The collateral values are determined by recent appraisals or Certificates of Inspection, but are generally discounted by management based on historical dispositions, changes in market conditions since the last valuation and management's expertise and knowledge of the borrower and the borrower's business.

DEPOSITS, OTHER BORROWED FUNDS AND SUBORDINATED DEBT

Consumer and commercial retail deposits are attracted primarily by the Corporation's eighteen full service office locations, one loan production office, and through its internet banking presence. The Corporation offers a broad selection of deposit products and continually evaluates its interest rates and fees on deposit products. The Corporation regularly reviews competing financial institutions' interest rates, especially when establishing interest rates on certificates of deposit.

Deposits decreased by $84,470,000, or 7.8% for the year ending December 31, 2022 as compared to December 31, 2021. The decrease in deposits in 2022 can be attributed to decreases in non-interest bearing, interest bearing, savings and time deposits. The decrease in deposits was mainly the result of a $70,297,000 decrease in municipal deposits and other normal fluctuations in deposits during 2022.

The following schedule reflects the remaining maturities of time deposits and other time open deposits of $100,000 or more at December 31, 2022.

(Dollars in thousands)	Time Deposits ≥$100,000	Other Time Open Deposits ≥$100,000
Less than or equal to 3 months	$ 6,487	$ 855
Over 3 months through 6 months	8,558	—
Over 6 months through 12 months	21,976	—
Over 12 months	19,831	—
	$ 56,852	$ 855

Total borrowings were $178,418,000 as of December 31, 2022, compared to $62,377,000 at December 31, 2021. During 2022, long-term borrowings decreased from $35,000,000 to $25,000,000. The decrease in long-term borrowings in 2022 was the result of the maturity of one individual term note with FHLB.

Short-term debt increased from $27,377,000 in 2022 to $153,418,000 as of December 31, 2022 as a result of decreased deposit balances and growth in the loan portfolio. Short-term borrowings are comprised of federal funds purchased, securities sold under agreements to repurchase, Federal Discount Window and short-term borrowings from FHLB. Short-term borrowings from FHLB are commonly used to offset seasonal fluctuations in deposits.

In connection with FHLB borrowings, Federal Discount Window, and securities sold under agreements to repurchase, the Corporation maintains certain eligible assets as collateral.

The following table shows information about the Corporation's short-term borrowings as of December 31, 2022 and 2021.

Table 14 — Short-Term Borrowings

(Dollars in thousands)

	2022			
	Period End Balance	**Average Balance**	**Maximum Month End Balance**	**Average Rate**
Federal funds purchased	**$ —**	**$ 13**	**$ —**	**— %**
Securities sold under agreements to repurchase	**20,368**	**26,825**	**30,868**	**0.84 %**
Federal Discount Window	**—**	**3**	**—**	**2.78 %**
Federal Home Loan Bank	**133,050**	**60,719**	**133,050**	**2.82 %**
	$ 153,418	**$ 87,560**	**$ 163,918**	**2.21 %**

(Dollars in thousands)

	2021			
	Period End Balance	Average Balance	Maximum Month End Balance	Average Rate
Federal funds purchased	$ —	$ —	$ —	0.36 %
Securities sold under agreements to repurchase	27,377	26,352	29,853	0.35 %
Federal Discount Window	—	—	—	0.36 %
Federal Home Loan Bank	—	553	770	0.34 %
	$ 27,377	$ 26,905	$ 30,623	0.35 %

On December 10, 2020, the Corporation issued $25,000,000 aggregate principal amount of Subordinated Notes due December 31, 2030 (the "2020 Notes"). The 2020 Notes are intended to be treated as Tier 2 capital for regulatory capital purposes. The 2020 Notes bear a fixed interest rate of 4.375% per year for the first five years and then float based on a benchmark rate (as defined).

CAPITAL STRENGTH

Normal increases in capital are generated by net income, less cash dividends paid out. Also, the net unrealized gains or losses on debt securities available-for-sale, net of taxes, referred to as accumulated other comprehensive (loss) income, may increase or decrease total equity capital. The total net decrease in capital was $28,169,000 in 2022 after an increase of $4,313,000 in 2021. The decrease in equity capital in 2022 was due to a decrease in accumulated other comprehensive (loss) income of $37,146,000 in 2022 as a result of market fluctuations in the securities portfolio offset by the retention of $7,334,000 in earnings and the issuance of new shares through the Corporation's Dividend Reinvestment Program ("DRIP") amounting to $1,643,000.

The Corporation had 231,611 and 231,612 shares of common stock as of December 31, 2022 and December 31, 2021, respectively, at a cost of $5,709,000, as treasury stock, authorized and issued but not outstanding.

Return on average equity ("ROE") is computed by dividing net income by average stockholders' equity. This ratio was 10.75% for 2022 and 9.93% for 2021.

Adequate capitalization of banks and bank holding companies is required and monitored by regulatory authorities. Table 15 reflects risk-based capital ratios and the leverage ratio for the Bank. The Bank's leverage ratio was 10.38% at December 31, 2022 and 10.14% at December 31, 2021.

The Bank has consistently maintained regulatory capital ratios at or above the "well capitalized" standards. To be categorized as "well capitalized", the Bank must maintain minimum tier 1 risk-based capital, common equity tier 1 risk based capital, total risk-based capital and tier 1 leverage ratios of 8.0%, 6.5%, 10.0% and 5.0%, respectively. For additional information on capital ratios, see Note 13 — Regulatory Matters. The risk-based capital calculation assigns various levels of risk to different categories of bank assets, requiring higher levels of capital for assets with more risk. Also measured in the risk-based capital ratio is credit risk exposure associated with off-balance sheet contracts and commitments.

Table 15 — Capital Ratios

At December 31, 2022, the Bank met the definition of a "well-capitalized" institution under the regulatory framework for prompt corrective action and the minimum capital requirements under Basel III. The following table presents the Bank's capital ratios as of December 31, 2022 and December 31, 2021:

	December 31, 2022	December 31, 2021	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 leverage ratio (to average assets)	**10.38 %**	10.14 %	5.00 %
Common Equity Tier 1 capital ratio (to risk-weighted assets)	**15.24 %**	15.52 %	6.50 %
Tier 1 risk-based capital ratio (to risk-weighted assets)	**15.24 %**	15.52 %	8.00 %
Total risk-based capital ratio	**16.15 %**	16.57 %	10.00 %

Under the final capital rules that became effective on January 1, 2015, there was a requirement for a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets which is in addition to the other minimum risk-based capital standards in the rule. Institutions that do not maintain this required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement was phased in over three years beginning in 2016. The capital buffer requirement effectively raises the minimum required common equity tier 1 capital ratio to 7.0%, the tier 1 capital ratio to 8.5%, and the total capital ratio to 10.5% on a fully phased-in basis on January 1, 2019. As of December 31, 2022, the Bank meets all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis.

The Corporation's capital ratios are not materially different than those of the Bank.

LIQUIDITY MANAGEMENT

The Corporation's objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity is needed to provide the funding requirements of depositors' withdrawals, loan growth, and other operational needs.

Sources of liquidity are as follows:

- Growth in the core deposit base;
- Proceeds from sales or maturities of securities;
- Payments received on loans and mortgage-backed and asset-backed securities;
- Overnight correspondent bank borrowings on various credit lines, notes, etc., with various levels of capacity;
- Securities sold under agreements to repurchase; and
- Brokered CDs.

At December 31, 2022, the Corporation had $495,974,000 in available borrowing capacity at FHLB (inclusive of the outstanding balances of FHLB long-term notes, FHLB short-term borrowings and irrevocable standby letters of credit issued by FHLB); the maximum borrowing capacity at ACBB was $15,000,000 and the maximum borrowing capacity of the Federal Discount Window was $2,235,000.

The Corporation enters into "Repurchase Agreements" in which it agrees to sell securities subject to an obligation to repurchase the same or similar securities. Because the agreement both entitles and obligates the Corporation to repurchase the assets, the Corporation may transfer legal control of the securities while still retaining effective control. As a result, the repurchase agreements are accounted for as collateralized financing agreements (secured borrowings) and act as an additional source of liquidity. Securities sold under agreements to repurchase were $20,368,000 at December 31, 2022.

Asset liquidity is provided by securities maturing in one year or less, other short-term investments, federal funds sold, and cash and due from banks. The liquidity is augmented by repayment of loans and cash flows from mortgage-backed and asset-backed securities. Liability liquidity is accomplished primarily by maintaining a core deposit base, acquired by attracting new deposits and retaining maturing deposits. Also, short-term borrowings provide funds to meet liquidity needs.

Net cash flows provided by operating activities were $16,528,000 and $15,255,000 as of December 31, 2022 and December 31, 2021, respectively. Net income amounted to $14,024,000 for the year ended December 31, 2022 and $14,688,000 for the year ended December 31, 2021. The (credit) provision for loan losses resulted in a credit balance of $264,000 for the year ended December 31, 2022 and a provision balance of $860,000 for the year ended December 31, 2021. During the years ended December 31, 2022 and 2021, net premium amortization on securities amounted to $3,008,000 and $2,930,000, respectively. Net losses on sales of mortgage loans were $7,000 as of December 31, 2022, compared to net gains on sales of mortgage loans of $980,000 as of December 31, 2021. Originations of mortgage loans originated for resale exceeded proceeds (including gains) from sales of mortgage loans originated for resale by $2,168,000 and $1,404,000 for the years ended December 31, 2022 and 2021, respectively. Net securities losses were $846,000 for the year ended December 31, 2022, compared to net securities gains of $323,000 for the year ended December 31, 2021. Accrued interest payable increased by $312,000 during the year ended December 31, 2022 and decreased by $154,000 during the year ended December 31, 2021. Other assets increased by $342,000 and $1,554,000 during the years ended December 31, 2022 and 2021, respectively. Other liabilities increased by $321,000 during the year ended December 31, 2022, compared to an increase of $305,000 during the year ended December 31, 2021.

Investing activities used cash of $93,634,000 and $111,345,000 during the years ended December 31, 2022 and 2021, respectively. Net activity in the available-for-sale securities portfolio (including proceeds from sale, maturities, and redemptions, net against purchases) provided cash of $19,295,000 during the year ended December 31, 2022 and used cash of $80,814,000 during the year ended December 31, 2021. Net change in restricted investment in bank stocks used cash of $5,217,000 during the year ended December 31, 2022 and provided cash of $328,000 during the year ended December 31, 2021. Net cash used to originate loans amounted to $103,609,000 and $29,960,000 during the years ended December 31, 2022 and 2021, respectively. Purchase of premises and equipment used cash of $1,892,000 and $492,000 during the years ended December 31, 2022 and 2021, respectively. Purchase of investment in real estate ventures used cash of $2,458,000 and $435,000 during the years ended December 31, 2022 and 2021, respectively.

Financing activities provided cash of $26,506,000 and $133,248,000 during the years ended December 31, 2022 and 2021, respectively. Deposits decreased by $87,470,000 during the year ended December 31, 2022 and increased by $140,481,000 during the year ended December 31, 2021. Short-term borrowings increased by $126,041,000 during the year ended December 31, 2022 and increased by $7,883,000 during the year ended December 31, 2021. Repayment of long-term borrowings amounted to $10,000,000 for both the years ended December 31, 2022 and 2021, respectively. Dividends paid amounted to $6,690,000 for the year ended December 31, 2022, compared to $6,617,000 for the year ended December 31, 2021.

Managing liquidity remains an important segment of asset/liability management. The overall liquidity position of the Corporation is maintained by an active asset/liability management committee. The Corporation believes that its core deposit base is stable even in periods of changing interest rates. Liquidity and funds management are governed by policies and measured on a monthly basis. These measurements indicate that liquidity generally remains stable and exceeds the Corporation's minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way. Given our financial strength, we expect to be able to maintain adequate liquidity as we manage through the current environment, utilizing current funding options and possibly utilizing new options.

Table 16 represents scheduled maturities of the Corporation's contractual obligations by time remaining until maturity as of December 31, 2022.

Table 16 — Contractual Obligations

(Dollars in thousands)

December 31, 2022	Less than 1 Year	1 - 3 Years	4 -5 Years	Over 5 Years	Total
Time deposits	$ 99,132	$ 55,511	$ 11,457	$ —	$ 166,100
Securities sold under agreement to repurchase	20,368	—	—	—	20,368
Short-term borrowings	133,050	—	—	—	133,050
Long-term borrowings	3,000	20,000	—	2,000	25,000
Subordinated debentures	—	—	—	25,000	25,000
Operating lease obligations	175	280	294	2,474	3,223
Financing lease obligations	7	—	—	—	7
	$ 255,732	$ 75,791	$ 11,751	$ 29,474	$ 372,748

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At December 31, 2022, the Corporation had outstanding unfunded commitments to extend credit of $121,938,000 and outstanding standby letters of credit of $5,596,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. Please refer to Note 14 — Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk for a discussion of the nature, business purpose, and importance of the Corporation's off-balance sheet arrangements.

MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. The Corporation's market risk is composed primarily of interest rate risk. The Corporation's interest rate risk results from timing differences in the repricing of assets, liabilities, off-balance sheet instruments, and changes in relationships between rate indices and the potential exercise of explicit or embedded options.

Increases in the level of interest rates also may adversely affect the fair value of the Corporation's securities and other earning assets. Generally, the fair value of fixed-rate instruments fluctuates inversely with changes in interest rates. As a result, increases in interest rates could result in decreases in the fair value of the Corporation's interest-earning assets, which could adversely affect the Corporation's results of operations if sold, or, in the case of interest-earning assets classified as available-for-sale, the Corporation's stockholders' equity, if retained. Under FASB Accounting Standards Codification ("ASC") 320-10, *Investments – Debt Securities*, changes in the unrealized gains and losses, net of taxes, on debt securities classified as available-for-sale are reflected in the Corporation's stockholders' equity. The Corporation does not own any trading assets.

Asset/Liability Management

The principal objective of asset/liability management is to manage the sensitivity of the net interest margin to potential movements in interest rates and to enhance profitability through returns from managed levels of interest rate risk. The Corporation actively manages the interest rate sensitivity of its assets and liabilities. Table 17 presents an interest sensitivity analysis of assets and liabilities as of December 31, 2022. Several techniques are used for measuring interest rate sensitivity. Interest rate risk arises from the mismatches in the repricing of assets and liabilities within a given time period, referred to as a rate sensitivity gap. If more assets than liabilities mature or reprice within the time frame, the Corporation is asset sensitive. This position would contribute positively to net interest income in a rising rate environment. Conversely, if more liabilities mature or reprice, the Corporation is liability sensitive. This position would contribute positively to net interest income in a falling rate environment.

Limitations of interest rate sensitivity gap analysis as illustrated in Table 17 include: a) assets and liabilities which contractually reprice within the same period may not, in fact, reprice at the same time or to the same extent; b) changes in market interest rates do not affect all assets and liabilities to the same extent or at the same time, and c) interest rate sensitivity gaps reflect the Corporation's position on a single day (December 31, 2022 in the case of the following schedule) while the Corporation continually adjusts its interest sensitivity throughout the year. The Corporation's cumulative gap at one year indicates the Corporation is liability sensitive at December 31, 2022.

Table 17 — Interest Rate Sensitivity Analysis

(Dollars in thousands)

	December 31, 2022				
	One Year	1 - 5 Years	Beyond 5 Years	Not Rate Sensitive	Total
Assets	$ 143,737	$ 480,432	$ 645,263	$ 59,762	$ 1,329,194
Liabilities/Stockholders' Equity	527,544	181,078	472,780	147,792	1,329,194
Interest Rate Sensitivity Gap	$ (383,807)	$ 299,354	$ 172,483	$ (88,030)	
Cumulative Gap	$ (383,807)	$ (84,453)	$ 88,030	—	

Earnings at Risk

The Bank's Asset/Liability Committee ("ALCO") is responsible for reviewing the interest rate sensitivity position and establishing policies to monitor and limit exposure to interest rate risk. The guidelines established by ALCO are reviewed by the Corporation's Board of Directors. The Corporation recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet beyond interest rate sensitivity gap. Although the Corporation continues to measure its interest rate sensitivity gap, the Corporation utilizes additional modeling for interest rate risk in the overall balance sheet. Earnings at risk and economic values at risk are analyzed.

Earnings simulation modeling addresses earnings at risk and net present value estimation addresses economic value at risk. While each of these interest rate risk measurements has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk to the Corporation.

Earnings Simulation Modeling

The Corporation's net income is affected by changes in the level of interest rates. Net income is also subject to changes in the shape of the yield curve. For example, a flattening of the yield curve would result in a decline in earnings due to the compression of earning asset yields and increased liability rates, while a steepening would result in increased earnings as earning asset and liability yields widen.

Earnings simulation modeling is the primary mechanism used in assessing the impact of changes in interest rates on net interest income. The model reflects management's assumptions related to asset yields and rates paid on liabilities, deposit sensitivity, size and composition of the balance sheet. The assumptions are based on what management believes at that time to be the most likely interest rate environment. Earnings at risk is the change in net interest income from a base case scenario under various scenarios of rate shock increases and decreases in the interest rate earnings simulation model.

Table 18 presents an analysis of the changes in net interest income and net present value of the balance sheet resulting from various immediate shock increases or decreases in the level of interest rates, such as two percentage points (200 basis points) in the level of interest rates. The calculated estimates of change in net interest income and net present value of the balance sheet are compared to current limits approved by ALCO and the Board of Directors. The earnings simulation model projects net interest income would decrease 13.12%, 25.38% and 36.53% in the 100, 200 and 300 basis point increasing rate scenarios presented. In addition, the earnings simulation model projects net interest income would increase 10.96% and 19.00% in the 100 and 200 basis point decreasing rate scenarios presented, respectively. All of these forecasts are within the Corporation's one year policy guidelines, aside from the 200 basis point immediate increase scenario at (25.38)% vs. the policy limit of (20.00)% and the 300 basis point immediate increase scenario at (36.53)% vs. the policy limit of (25.00)%.

The analysis and model used to quantify the sensitivity of net interest income becomes less reliable in a decreasing rate scenario given the current interest rate environment with federal funds trading in the 425 - 450 basis point range and many deposit accounts still lagging at markedly lower rates. Results of the decreasing basis point declining scenarios are affected by the fact that many of the Corporation's interest-bearing liabilities are at rates below 1% and therefore likely may not decline 100 or more basis points. However, the Corporation's interest-sensitive assets are able to decline by these amounts. For the years ended December 31, 2022 and 2021, the cost of interest-bearing liabilities averaged 0.95% and 0.57%, respectively, and the yield on average interest-earning assets, on a fully taxable equivalent basis, averaged 3.91% and 3.65%, respectively.

Net Present Value Estimation

The net present value measures economic value at risk and is used for helping to determine levels of risk at a point in time present in the balance sheet that might not be taken into account in the earnings simulation model. The net present value of the balance sheet is defined as the discounted present value of asset cash flows minus the discounted present value of liability cash flows. At December 31, 2022, net present value is projected to decrease 3.99%, 10.65%, and 19.17% in the 100, 200 and 300 basis point immediate increase scenarios, respectively. Additionally, the 100 and

200 basis point immediate decreases in rates are estimated to affect net present value with a decrease of 1.60% and 13.45%, respectively. All scenarios presented are within the Corporation's policy limits.

The computation of the effects of hypothetical interest rate changes are based on many assumptions. They should not be relied upon solely as being indicative of actual results, since the computations do not account for actions management could undertake in response to changes in interest rates.

Table 18 — Effect of Change in Interest Rates

	Projected Change
Effect on Net Interest Income	
1-Year Net Income Simulation Projection	
+300 bp Shock vs. Stable Rate	(36.53)%
+200 bp Shock vs. Stable Rate	(25.38)%
+100 bp Shock vs. Stable Rate	(13.12)%
Flat rate	
–100 bp Shock vs. Stable Rate	10.96 %
–200 bp Shock vs. Stable Rate	19.00 %
Effect on Net Present Value of Balance Sheet	
Static Net Present Value Change	
+300 bp Shock vs. Stable Rate	(19.17)%
+200 bp Shock vs. Stable Rate	(10.65)%
+100 bp Shock vs. Stable Rate	(3.99)%
Flat rate	
–100 bp Shock vs. Stable Rate	(1.60)%
–200 bp Shock vs. Stable Rate	(13.45)%

Table 19 shows the quarterly results of operations for the Corporation for the years ended December 31, 2022 and 2021:

Table 19 — Quarterly Results of Operations (Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended			
2022	**March 31**	**June 30**	**September 30**	**December 31**
Interest income	**$ 10,629**	**$ 11,111**	**$ 11,897**	**$ 12,776**
Interest expense	**1,173**	**1,330**	**2,378**	**4,032**
Net interest income	**9,456**	**9,781**	**9,519**	**8,744**
Provision (credit) for loan losses	**219**	**218**	**219**	**(920)**
Non-interest income	**1,389**	**1,514**	**1,493**	**935**
Non-interest expense	**6,516**	**6,595**	**6,711**	**6,955**
Income before income tax expense	**4,110**	**4,482**	**4,082**	**3,644**
Income tax expense	**567**	**660**	**578**	**489**
Net income	**$ 3,543**	**$ 3,822**	**$ 3,504**	**$ 3,155**
Basic and diluted earnings per share	**$ 0.60**	**$ 0.64**	**$ 0.58**	**$ 0.53**

(Dollars in thousands, except per share data)

2021	Three Months Ended March 31	June 30	September 30	December 31
Interest income	$ 10,275	$ 10,259	$ 10,716	$ 10,798
Interest expense	1,305	1,288	1,283	1,272
Net interest income	8,970	8,971	9,433	9,526
Provision for loan losses	135	135	185	405
Non-interest income	1,875	1,865	1,697	1,886
Non-interest expense	6,197	6,547	6,267	7,343
Income before income tax expense	4,513	4,154	4,678	3,664
Income tax expense	635	549	655	482
Net income	$ 3,878	$ 3,605	$ 4,023	$ 3,182
Basic and diluted earnings per share	$ 0.66	$ 0.61	$ 0.68	$ 0.54

Critical Accounting Estimates

The Corporation has chosen accounting policies that it believes are appropriate to accurately and fairly report its operating results and financial position, and the Corporation has applied those policies in a consistent manner.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America require that the Corporation make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical or other factors believed to be reasonable under the circumstances. The Corporation evaluates these estimates and assumptions on an ongoing basis and may retain outside consultants, lawyers and actuaries to assist in its evaluation. These estimates, assumptions and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions and judgments.

The Corporation considers three accounting policies to be critical because they involve the most significant judgments and estimates used in preparation of its consolidated financial statements. The three policies are the determination of other-than-temporary impairment of securities, the determination of the allowance for loan losses, and the assessment of goodwill for possible impairment.

Other-Than-Temporary Impairment of Securities. Valuations for the securities portfolio are determined using quoted market prices, where available. If quoted market prices are not available, securities valuation is based on pricing models, quotes for similar securities, and observable yield curves and spreads. In addition to valuation, management must assess whether there are any declines in value below the carrying value of the securities that should be considered other than temporary or otherwise require an adjustment in carrying value and recognition of the loss in the Corporation's Consolidated Statements of Income.

Allowance for Loan Losses. The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the Corporation's Consolidated Balance Sheets.

Goodwill. Goodwill represents the excess purchase consideration over the fair value of net assets acquired in connection with acquisitions. Goodwill is not amortized but is periodically evaluated for impairment. Impairment testing is performed using either a qualitative or quantitative approach. The Corporation has selected December 31 as the date to perform the annual goodwill impairment test. Additionally, a goodwill impairment evaluation is performed on an interim basis when events or circumstances indicate impairment potentially exists.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of
First Keystone Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of First Keystone Corporation and Subsidiary (Company) as of December 31, 2022 and 2021, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

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

Critical Audit Matter

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

Allowance for Loan Losses – Qualitative Factor Adjustments – Refer to Notes 1 and 3 to the consolidated financial statements

Critical Audit Matter Description

As disclosed in Note 3 to the Company's consolidated financial statements, the Company's loan portfolio totaled $858M as of December 31, 2022, and the related allowance for loan losses was $8.3M. As described in Note 1, the allowance for loan losses consists of specific and general reserve components in order to estimate losses that have been incurred as of the consolidated balance sheet date. In calculating the general reserve component, management considers historical loss experience based on loan type and qualitative factor adjustments for changes not reflected in the historical loss experience.

The determination of the qualitative factor adjustments involves significant estimates based on subjective assumptions that require a high degree of management judgment about the following internal or external factors: changes in lending policies and procedures; changes in macroeconomic conditions; changes in the nature and volume of the loan portfolio; changes in the experience and ability of lending management; changes in the volume of past due, nonaccrual, and adversely-classified loans; changes in the loan review system; changes in the value of underlying collateral; existence of any concentrations of credit; and effect of other external factors, such as competition or the regulatory environment. Changes in these assumptions could have a material effect on the allowance for loan losses.

The allowance for loan losses is an accounting estimate with significant measurement uncertainty and involves the application of significant judgment by management. Therefore, a high degree of auditor judgment and significant auditor effort was required in evaluating the audit evidence obtained related to the qualitative factor adjustments used by management in the calculation.

How the Critical Audit Matter was Addressed in the Audit

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

- Testing the design and operating effectiveness of internal controls relating to the evaluation of the assumptions and inputs used to evaluate the qualitative factors, including controls addressing:
  - Management's review of the underlying data inputs used in the determination of qualitative factor adjustments for completeness and accuracy.
  - Management's review of the conclusions reached related to the qualitative and quantitative loss factors and the resulting allocation to the allowance for loan losses.
- Substantively testing the appropriateness of the judgments and assumptions used in management's estimation process for developing the qualitative factor adjustments, including:
  - Assessing whether all relevant factors have been considered that affect the collectability of the loan portfolio.
  - Testing the risk grade factor based on the risk rating assigned to each
  - Evaluating the completeness, accuracy, and relevance of underlying internal and external data inputs used as a basis for the qualitative factor adjustments and corroborating these inputs by comparing to the Company's lending practices, historical loan portfolio performance, and third-party macroeconomic data.
  - Testing the mathematical accuracy of the calculation and allocation of qualitative factors to the appropriate loan categories.

/s/ Baker Tilly US, LLP

We have served as the Company's auditor since 2018.
Iselin, New Jersey
March 15, 2023

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per share data)	December 31,	
	2022	2021
ASSETS		
Cash and due from banks	**$ 9,441**	$ 9,600
Interest-bearing deposits in other banks	**1,297**	51,738
Total cash and cash equivalents	**10,738**	61,338
Time deposits with other banks	**—**	247
Debt securities available-for-sale, at fair value	**373,444**	437,916
Marketable equity securities, at fair value	**1,699**	1,962
Restricted investment in bank stocks, at cost	**7,136**	1,919
Loans	**858,398**	746,835
Loans held for sale	**71**	6,006
Allowance for loan losses	**(8,274)**	(8,680)
Net loans	**850,195**	744,161
Premises and equipment, net	**19,024**	18,158
Operating lease right-of-use assets	**1,541**	1,025
Accrued interest receivable	**4,391**	4,361
Cash surrender value of bank owned life insurance	**25,389**	24,792
Investments in low-income housing partnerships	**3,763**	1,530
Goodwill	**19,133**	19,133
Deferred income taxes	**9,129**	—
Other assets	**3,612**	3,808
TOTAL ASSETS	**$ 1,329,194**	$ 1,320,350
LIABILITIES		
Deposits:		
Non-interest bearing	**$ 231,754**	$ 249,040
Interest bearing	**761,745**	828,929
Total deposits	**993,499**	1,077,969
Short-term borrowings	**153,418**	27,377
Long-term borrowings	**25,000**	35,000
Subordinated debentures	**25,000**	25,000
Operating lease liabilities	**2,029**	1,499
Accrued interest payable	**563**	251
Deferred income taxes	**—**	631
Other liabilities	**9,299**	4,068
TOTAL LIABILITIES	**1,208,808**	1,171,795
STOCKHOLDERS' EQUITY		
Preferred stock, par value $2.00 per share; authorized 1,000,000 shares as of December 31, 2022 and December 31, 2021; issued 0 as of December 31, 2022 and December 31, 2021	**—**	—
Common stock, par value $2.00 per share; authorized 20,000,000 shares as of December 31, 2022 and December 31, 2021; issued 6,250,763 as of December 31, 2022 and 6,178,835 as of December 31, 2021; outstanding 6,019,152 as of December 31, 2022 and 5,947,223 as of December 31, 2021	**12,502**	12,358
Surplus	**42,439**	40,940
Retained earnings	**100,712**	93,378
Accumulated other comprehensive (loss) income	**(29,558)**	7,588
Treasury stock, at cost, 231,611 shares as of December 31, 2022 and 231,612 shares as of December 31, 2021	**(5,709)**	(5,709)
TOTAL STOCKHOLDERS' EQUITY	**120,386**	148,555
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 1,329,194**	$ 1,320,350

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

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

	Years Ended December 31, 2022	2021
INTEREST INCOME		
Interest and fees on loans	**$ 35,372**	$ 32,860
Interest and dividend income on securities:		
Taxable	**7,394**	5,578
Tax-exempt	**3,312**	3,372
Dividends	**55**	62
Dividend income on restricted investment in bank stocks	**264**	96
Interest on interest-bearing deposits in other banks	**16**	80
Total interest income	**46,413**	42,048
INTEREST EXPENSE		
Interest on deposits	**5,259**	3,144
Interest on short-term borrowings	**1,935**	93
Interest on long-term borrowings	**628**	817
Interest on subordinated debt	**1,091**	1,094
Total interest expense	**8,913**	5,148
Net interest income	**37,500**	36,900
(Credit) provision for loan losses	**(264)**	860
Net interest income after (credit) provision for loan losses	**37,764**	36,040
NON-INTEREST INCOME		
Trust department	**975**	1,008
Service charges and fees	**2,193**	1,914
Increase in cash surrender value of life insurance	**597**	598
ATM fees and debit card income	**2,146**	2,183
Net (losses) gains on sales of mortgage loans	**(7)**	980
Net securities (losses) gains	**(846)**	323
Other	**273**	317
Total non-interest income	**5,331**	7,323
NON-INTEREST EXPENSE		
Salaries and employee benefits	**14,554**	14,148
Occupancy, net	**1,936**	1,885
Furniture and equipment expense	**594**	570
Computer expense	**1,493**	1,220
Professional services	**1,270**	1,050
Pennsylvania shares tax	**1,238**	1,202
FDIC insurance, net	**490**	423
ATM and debit card fees	**899**	1,091
Data processing fees	**915**	1,200
Foreclosed assets held for resale expense, net	**—**	3
Advertising	**389**	407
Other	**2,999**	3,155
Total non-interest expense	**26,777**	26,354
Income before income tax expense	**16,318**	17,009
Income tax expense	**2,294**	2,321
NET INCOME	**$ 14,024**	$ 14,688
PER SHARE DATA		
Net income per share:		
Basic	**$ 2.35**	$ 2.49
Diluted	**2.35**	2.49
Dividends per share	**1.12**	1.12

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

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Dollars in thousands)

	Years Ended December 31, 2022	2021
Net Income	**$ 14,024**	$ 14,688
Other comprehensive loss:		
Unrealized net holding losses on debt securities available-for-sale arising during the period, net of income taxes of $(10,027) and $(1,404), respectively	**(37,720)**	(5,279)
Less reclassification adjustment for net losses (gains) included in net income, net of income taxes of $153 and $(1), respectively (a) (b)	**574**	(3)
Total other comprehensive loss	**(37,146)**	(5,282)
Total Comprehensive (Loss) Income	**$ (23,122)**	$ 9,406

(a) Gross amounts are included in net securities (losses) gains on the consolidated statements of income in non-interest income.

(b) Income tax amounts are included in income tax expense on the consolidated statements of income.

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

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except share and per share data)

	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at January 1, 2021	6,115,281	$ 12,231	$ 39,543	$ 85,307	$ 12,870	$ (5,709)	$ 144,242
Net Income				14,688			14,688
Other comprehensive loss, net of taxes					(5,282)		(5,282)
Issuance of common stock under dividend reinvestment plan	63,554	127	1,397				1,524
Dividends - $1.12 per share				(6,617)			(6,617)
Balance at December 31, 2021	6,178,835	12,358	40,940	93,378	7,588	(5,709)	148,555
Net Income				**14,024**			**14,024**
Other comprehensive loss, net of taxes					**(37,146)**		**(37,146)**
Issuance of common stock under dividend reinvestment plan	**71,928**	**144**	**1,499**				**1,643**
Dividends - $1.12 per share				**(6,690)**			**(6,690)**
Balance at December 31, 2022	**6,250,763**	**$ 12,502**	**$ 42,439**	**$ 100,712**	**$ (29,558)**	**$ (5,709)**	**$ 120,386**

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

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	**2022**	2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 14,024**	$ 14,688
Adjustments to reconcile net income to net cash provided by operating activities:		
(Credit) provision for loan losses	**(264)**	860
Depreciation and amortization	**1,056**	1,038
Net premium amortization on securities	**3,008**	2,930
Deferred income tax expense (benefit)	**114**	(111)
Net losses (gains) on sales of mortgage loans	**7**	(980)
Proceeds from sales of mortgage loans originated for sale	**5,678**	30,721
Originations of mortgage loans originated for sale	**(7,846)**	(32,125)
Net securities losses (gains)	**846**	(323)
(Increase) decrease in accrued interest receivable	**(30)**	183
Increase in cash surrender value of bank owned life insurance	**(597)**	(598)
Net losses on disposals of premises and equipment	**16**	4
Increase in other assets	**(342)**	(1,554)
Amortization of investment in low-income housing partnerships	**225**	371
Increase (decrease) in accrued interest payable	**312**	(154)
Increase in other liabilities	**321**	305
NET CASH PROVIDED BY OPERATING ACTIVITIES	**16,528**	15,255
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of equity securities and debt securities available-for-sale	**58,845**	6
Proceeds from maturities and redemptions of debt securities available-for-sale	**51,943**	55,318
Purchases of debt securities available-for-sale	**(91,493)**	(136,138)
Net decrease in time deposits with other banks	**247**	—
Net change in restricted investment in bank stocks	**(5,217)**	328
Net increase in loans	**(103,609)**	(29,960)
Purchase of premises and equipment	**(1,892)**	(492)
Purchase of investment in real estate venture	**(2,458)**	(435)
Proceeds from sales of foreclosed assets held for resale	**—**	28
NET CASH USED IN INVESTING ACTIVITIES	**(93,634)**	(111,345)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	**(84,470)**	140,481
Net increase in short-term borrowings	**126,041**	7,883
Repayment of finance lease obligations	**(10)**	(10)
Repayment of long-term borrowings	**(10,000)**	(10,000)
Common stock issued	**1,635**	1,511
Dividends paid	**(6,690)**	(6,617)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**26,506**	133,248
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(50,600)**	37,158
CASH AND CASH EQUIVALENTS, BEGINNING	**61,338**	24,180
CASH AND CASH EQUIVALENTS, ENDING	**$ 10,738**	$ 61,338
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	**$ 8,601**	$ 5,302
Income taxes paid	**2,289**	2,489
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES		
Purchased securities settling after year-end	**5,434**	—
Loans transferred from held for sale to held for investment portfolio	**(7,900)**	(12,044)
Common stock subscription receivable	**8**	13
Right-of-use assets obtained in exchange for lease liabilities	**598**	33

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

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of First Keystone Corporation and Subsidiary (the "Corporation") are in accordance with accounting principles generally accepted in the United States of America ("GAAP") and conform to common practices within the banking industry. The more significant accounting policies follow:

Principles of Consolidation

The consolidated financial statements include the accounts of First Keystone Corporation and its wholly-owned subsidiary, First Keystone Community Bank (the "Bank"). All significant inter-company balances and transactions have been eliminated in consolidation.

Nature of Operations

The Corporation, headquartered in Berwick, Pennsylvania, provides a full range of banking, trust and related services through its wholly-owned Bank subsidiary and is subject to competition from other financial institutions in connection with these services. The Bank serves a customer base which includes individuals, businesses, governments, and public and institutional customers primarily located in the Northeast Region of Pennsylvania. The Bank has 18 full service offices, one loan production office, and 19 Automated Teller Machines ("ATM") located in Columbia, Luzerne, Montour, Monroe, and Northampton counties. The Corporation must also adhere to certain federal and state banking laws and regulations and are subject to periodic examinations made by various state and federal agencies.

Segment Reporting

The Bank acts as an independent community financial services provider, and offers traditional banking and related financial services to individual, business, government, and public and institutional customers. Through its branch and ATM network, as well as online banking, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and mortgage loans; and the providing of other financial services. The Bank also performs personal, corporate, pension and fiduciary services through its trust department.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail, trust and mortgage banking operations of the Corporation. As such, discrete financial information is not available and segment reporting would not be meaningful.

Significant Concentrations of Credit Risk

The majority of the Corporation's activities involve customers located primarily in Columbia, Luzerne, Montour, Monroe, Northampton, and Lehigh counties in Pennsylvania. The types of securities in which the Corporation invests are presented in Note 2 – Securities. Credit risk as it relates to investment activities is moderated through the monitoring of ratings, geographic concentrations, etc. residing in the portfolio and the observance of minimum rating levels in the investment policy. Note 3 – Loans and Allowance for Loan Losses summarizes the types of lending in which the Corporation engages. The inherent risks associated with lending activities are mitigated by adhering to established underwriting practices and policies, as well as portfolio diversification and thorough monitoring of the loan portfolio. It is management's opinion that the investment and loan portfolios were well balanced at December 31, 2022, to the extent necessary to avoid any significant concentrations of credit risk.

Use of Estimates

The preparation of these consolidated financial statements, in conformity with GAAP, 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 these consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant changes include the determination of other-than-temporary impairment ("OTTI") on securities, the determination of the allowance for loan losses, and the assessment of goodwill for possible impairment.

Subsequent Events

The Corporation has evaluated events and transactions occurring subsequent to the consolidated balance sheet date of December 31, 2022, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued. On February 28, 2023, the Board of Directors declared a dividend of $0.28 per share for the first quarter of 2023. The dividend is payable on March 31, 2023 to shareholders of record as of March 16, 2023.

Cash and Cash Equivalents

For purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand and due from banks, interest-bearing deposits in other banks, and federal funds sold. The Corporation considers cash classified as interest-bearing deposits with other banks as a cash equivalent since they are represented by cash accounts essentially on a demand basis and mature within one year. Federal funds are also included as a cash equivalent because they are generally purchased and sold for one-day periods.

Time Deposits with Other Banks

Time deposits with other banks consist of fully insured certificates of deposit in other banks with maturity dates between one and five years.

Securities

The Corporation classifies its securities as either "Held-to-Maturity" or "Available-for-Sale" at the time of purchase. Securities are accounted for on a trade date basis. Debt securities are classified as Held-to-Maturity when the Corporation has the ability and positive intent to hold the securities to maturity. Securities classified as Held-to-Maturity are carried at cost adjusted for amortization of premium and accretion of discount to maturity.

Debt securities not classified as Held-to-Maturity are included in the Available-for-Sale category and are carried at fair value. The amount of any unrealized gain or loss, net of the effect of deferred income taxes, is reported as accumulated other comprehensive (loss) income (AOCI) in the consolidated balance sheets and consolidated statements of changes in stockholders' equity. Management's decision to sell Available-for-Sale securities is based on changes in economic conditions controlling the sources and applications of funds, terms, availability of and yield of alternative investments, interest rate risk and the need for liquidity.

The cost of debt securities classified as Held-to-Maturity or Available-for-Sale is adjusted for amortization of premiums to the earliest call date and accretion of discounts to expected maturity. Such amortization and accretion, as well as interest and dividends, are included in interest and dividend income on securities. Realized gains and losses are included in net securities gains and losses in the consolidated statements of income. The cost of securities sold, redeemed or matured is based on the specific identification method.

In accordance with ASC 825-10, equity securities with readily determinable fair values are stated at fair value with realized and unrealized gains and losses reported in income. Equity securities without readily determinable fair values are recorded at cost less impairment, if any.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Securities classified as Available-for-Sale or Held-to-Maturity are generally evaluated for OTTI under Financial Accounting Standards Board ("FASB") ASC 320, *Investments - Debt and Equity Securities*. In determining OTTI under the FASB ASC 320 model, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs on debt securities, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected, and the realized loss is recognized as impairment charges on securities on the consolidated statements of income. The amount of the total OTTI related to the other factors shall be recognized in other comprehensive (loss) income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the security.

The fair market value of the equity securities tends to fluctuate with the overall equity markets as well as the trends specific to each institution. The equity securities portfolio is reviewed in a similar manner as that of the debt securities with greater emphasis placed on the length of time the market value has been less than the carrying value and the financial sector outlook. The Corporation also reviews dividend payment activities, levels of non-performing assets and loan loss reserves. The starting point for the equity analysis is the length and severity of market value decline. The realized loss is recognized as impairment charges on securities on the consolidated statements of income. The previous cost basis less the OTTI recognized in earnings becomes the new cost basis of the investment.

Restricted Investment in Bank Stocks

The Corporation owns restricted stock investments in the Federal Home Loan Bank of Pittsburgh ("FHLB-Pittsburgh") and Atlantic Community Bankers Bank ("ACBB"). These investments do not have a readily determinable fair value because their ownership is restricted and they can be sold back only to the FHLB-Pittsburgh, ACBB or to another member institution. Therefore, these investments are carried at cost. At December 31, 2022, the Corporation held $7,101,000 in stock of FHLB-Pittsburgh and $35,000 in stock of ACBB. At December 31, 2021, the Corporation held $1,884,000 in stock of FHLB-Pittsburgh and $35,000 in stock of ACBB.

Management evaluates the restricted investment in bank stocks for impairment on a quarterly basis. Management's determination of whether these investments are impaired is based on management's assessment of the ultimate recoverability of the cost of these investments rather than by recognizing temporary declines in value. The following factors were evaluated to determine the ultimate recoverability of the cost of the Corporation's restricted investment in bank stocks; (i) the significance of the decline in net assets of the correspondent bank as compared to the capital stock amount for the correspondent bank and the length of time this situation has persisted; (ii) commitments by the correspondent bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of the correspondent bank; (iii) the impact of legislative and regulatory changes on the institutions and, accordingly, on the customer base of the correspondent bank; and (iv) the liquidity position of the correspondent bank. Based on the analysis of these factors, management determined that no impairment charge was necessary related to the restricted investment in bank stocks during 2022 or 2021.

Loans

Net loans are stated at their outstanding recorded investment, net of deferred fees and costs, unearned income and the allowance for loan losses. Interest on loans is recognized as income over the term of each loan, generally, by the accrual method. Loan origination fees and certain direct loan origination costs have been deferred with the net amount amortized using the straight line method or the interest method over the contractual life of the related loans as an interest yield adjustment.

The loans receivable portfolio is segmented into commercial, residential and consumer loans. Commercial loans consist of the following classes: Commercial and Industrial and Commercial Real Estate.

Commercial and Industrial Lending

The Corporation originates commercial and industrial loans principally to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes, which include short-term loans and lines of credit to finance machinery and equipment, inventory and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Most business lines of credit are written on demand and are reviewed annually.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum thresholds have been established by the Corporation and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, business financial statements, collateral appraisals or internal evaluations, etc. Commercial and industrial loans are typically supported by personal guarantees of the borrower.

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower's character and capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as the conditions affecting the borrower. Evaluation of the borrower's past, present and future cash flows is also an important aspect of the Corporation's analysis of the borrower's ability to repay. SBA PPP loans that have been issued by the Corporation as a result of the enactment of the CARES Act in response to the economic impact of the COVID-19 pandemic are included in the Corporation's Commercial and Industrial portfolio and are underwritten pursuant to the PPP as administered by the SBA under the CARES Act. See the Coronavirus Pandemic Impact on the Loan Portfolio section on page 62 for more information regarding the Corporation's underwriting of these loans.

Commercial and industrial loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions. Commercial and industrial loans are typically made on the basis of the borrower's ability to make repayment from cash flows from the borrower's primary business activities. As a result, the availability of funds for the repayment of commercial and industrial loans is dependent on the success of the business itself, which in turn, is likely to be dependent upon the general economic environment.

As an addition to the commercial loans receivable portfolio, the Corporation may purchase the guaranteed portion of loans secured by the U.S. Government. The originating bank retains the unguaranteed portion of the loan. The loans are sponsored by one of the various government agencies including the SBA, United States Department of Agriculture (“USDA”), and the Farm Service Agency (“FSA”). Government Guaranteed Loans ("GGLs") carry no credit risk due to an unconditional and irrevocable guarantee (which is supported by the full faith and credit of the U.S. Government) on all principal and the balance of interest accruing through ninety days beyond the date that demand is made to the originating bank for repurchase of the loan. As of December 31, 2022, the Corporation's balance of GGLs was $4,631,000, compared to $3,829,000 at December 31, 2021.

Commercial Real Estate Lending

The Corporation engages in commercial real estate lending in its primary market area and surrounding areas. The Corporation’s commercial real estate portfolio is secured primarily by commercial retail space, commercial office buildings, residential housing and hotels. Generally, commercial real estate loans have terms that do not exceed twenty years, have loan-to-value ratios of up to eighty percent of the value of the collateral property, and are typically supported by personal guarantees of the borrowers.

In underwriting these loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower’s credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. The value of the property is determined by either independent appraisers or internal evaluations performed by Bank officers.

Commercial real estate loans generally present a higher level of risk than residential real estate secured loans. Repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project and/or the effect of the general economic conditions on income producing properties.

Residential Real Estate Lending (Including Home Equity)

The Corporation’s residential real estate portfolio is comprised of one-to-four family residential mortgage loan originations, home equity term loans and home equity lines of credit. These loans are generated by the Corporation’s marketing efforts, its present customers, walk-in customers and referrals. These loans originate primarily within or with customers from the Corporation’s market area.

The Corporation’s one-to-four family residential mortgage originations are secured principally by properties located in its primary market area and surrounding areas. The Corporation offers fixed-rate mortgage loans with terms up to a maximum of thirty years for both permanent structures and those under construction. Loans with terms of thirty years are normally held for sale and sold without recourse; most of the residential mortgages held in the Corporation’s residential real estate portfolio have maximum terms of twenty years. Generally, the majority of the Corporation’s residential mortgage loans originate with a loan-to-value of eighty percent or less, or those with primary mortgage insurance at ninety-five percent or less. Home equity term loans are secured by the borrower’s primary residence and typically have a maximum loan-to-value of eighty percent and a maximum term of fifteen years. In general, home equity lines of credit are secured by the borrower’s primary residence with a maximum loan-to-value of eighty percent and a maximum term of twenty years.

In underwriting one-to-four family residential mortgage loans, the Corporation evaluates the borrower’s ability to make monthly payments, the borrower’s prior loan repayment history and the value of the property securing the loan. The ability and willingness to repay is assessed based upon the borrower’s employment history, current financial conditions and credit background. A majority of the properties securing residential real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires mortgage loan borrowers to obtain an attorney’s title opinion or title insurance and fire and property insurance, including flood insurance, if applicable.

Residential mortgage loans, home equity term loans and home equity lines of credit generally present a lower level of risk than consumer loans because they are secured by the borrower's primary residence. Risk is increased when the Corporation is in a subordinate position, especially to another lender, for the loan collateral.

Residential mortgage loans held for sale are carried at the lower of cost or market on an aggregate basis determined by independent pricing from appropriate federal or state agency investors. These loans are sold without recourse. Loans held for sale amounted to $71,000 at December 31, 2022 and $6,006,000 at December 31, 2021.

Consumer Lending

The Corporation offers a variety of secured and unsecured consumer loans, including vehicle loans, stock loans and loans secured by financial institution deposits. These loans originate primarily within or with customers from the Corporation's market area.

Consumer loan terms vary according to the type and value of collateral and creditworthiness of the borrower. In underwriting personal loans, a thorough analysis is performed regarding the borrower's willingness and financial ability to repay the loan as agreed. The ability and willingness to repay is assessed based upon the borrower's employment history, current financial condition and credit background.

Consumer loans may entail greater credit risk than residential real estate loans, particularly in the case of personal loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles or recreational equipment. In such cases, repossessed collateral for a defaulted personal loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, personal loan collections are dependent on the borrower's continuing financial stability and therefore, are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Coronavirus Pandemic Impact on the Loan Portfolio

As a result of the economic impact of the COVID-19 coronavirus pandemic, the CARES Act was enacted in the United States on March 27, 2020. The Corporation is approved by the SBA to fund loans under the SBA's Paycheck Protection Program created as part of the CARES Act. The PPP loans have 1.00% interest rates, lender fees, two or five-year terms (depending on date of origination), and may qualify for forgiveness. These loans funded by the Corporation are subject to the terms and conditions applicable to all loans made pursuant to the PPP, as administered by the SBA under the CARES Act. The PPP calls for these loans to be fully guaranteed by the SBA. PPP loan origination fees and certain loan origination costs have been deferred with the net amount accreted using the straight line method over the contractual life of the related loans as an interest yield adjustment. If a loan is forgiven pursuant to the terms and conditions applicable to the PPP, the remaining origination fees and costs are recognized at the time of forgiveness. All PPP loans are carried in the Corporation's Commercial and Industrial loan portfolio. As of December 31, 2022, the Corporation held 2 PPP loans in its Commercial and Industrial portfolio, which carried an aggregate balance of $113,000 which were granted during the first round of PPP issuance and did not qualify for forgiveness. At December 31, 2021, the Corporation held 122 PPP loans in its Commercial and Industrial portfolio, carrying an aggregate balance of $4,894,000, of which 2 loans carrying an aggregate balance of $160,000 were granted during the first round of PPP issuance and 120 loans carrying an aggregate balance of $4,734,000 were granted during the second round of PPP issuance.

An additional provision of the CARES Act, Section 4013 provides financial institutions the option to suspend requirements to categorize certain loan modifications as Troubled Debt Restructurings ("TDRs"), as long as specific criteria are met. To qualify, the loan modifications must be made on a good-faith basis in response to the COVID-19 pandemic, must occur between March 1, 2020 and the earlier of September 30, 2021 or the termination date of the national emergency related to the COVID-19 pandemic as declared by the President of the United States, and the loans must have been paid current (less than 30 days past due prior to any relief) as of December 31, 2019. In compliance with Section 4013 of the CARES Act, the Corporation has granted modification requests to defer principal and/or interest payments or modify interest rates on various loans across all portfolio segments. Of the loan modifications that have been granted in compliance with Section 4013 of the CARES Act, there were no loan modifications still actively on deferral as of December 31, 2022, compared to December 31, 2021 when there was 1 loan modification still actively on deferral carrying a balance of $9,423,000. See page 77 for additional information regarding the Section 4013 CARES Act modifications.

Delinquent Loans

Generally, a loan is considered to be past-due when scheduled loan payments are in arrears 10 days or more. Delinquent notices are generated automatically when a loan is 10 or 15 days past-due, depending on loan type. Collection efforts continue on past-due loans that have not been brought current, when it is believed that some chance exists for improvement in the status of the loan. Past-due loans are continually evaluated with the determination for charge-off being made when no reasonable chance remains that the status of the loan can be improved.

Commercial and industrial and commercial real estate loans are charged off in whole or in part when they become sufficiently delinquent based upon the terms of the underlying loan contract and when a collateral deficiency exists. Because all or part of the contractual cash flows are not expected to be collected, the loan is considered to be impaired, and the Corporation estimates the impairment based on its analysis of the cash flows or collateral estimated at fair value less cost to sell. Should a GGL default, demand is made to the originating bank for repurchase of the loan. If the originating bank does not repurchase the loan, demand for repurchase is then made to the appropriate government agency which has provided the guarantee for the loan.

Residential real estate and consumer loans are charged off when they become sufficiently delinquent based upon the terms of the underlying loan contract and when the value of the underlying collateral is not sufficient to support the loan balance and a loss is expected. At that time, the amount of estimated collateral deficiency, if any, is charged off for loans secured by collateral, and all other loans are charged off in full. Loans with collateral are written down to the estimated fair value of the collateral less cost to sell.

Existing loans in which the borrower has declared bankruptcy are considered on a case by case basis to determine whether repayment is likely to occur (eg. reaffirmation by the borrower with demonstrated repayment ability). Otherwise, loans are charged off in full or written down to the estimated fair value of collateral less cost to sell.

Generally, a loan is classified as non-accrual and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest. A loan may remain on accrual status if it is well secured (or supported by a strong guarantee) and in the process of collection. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against interest income. Certain non-accrual loans may continue to perform; that is, payments are still being received. Generally, the payments are applied to principal. These loans remain under constant scrutiny, and if performance continues, interest income may be recorded on a cash basis based on management’s judgment regarding the collectability of principal.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level estimated by management to be adequate to absorb potential loan losses. Management’s periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are individually classified as impaired. Select loans are not aggregated for collective impairment evaluation, as such; all loans are subject to individual impairment evaluation should the facts and circumstances pertinent to a particular loan suggest that such evaluation is necessary. Factors considered by management in determining impairment include payment status 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. If a loan is impaired, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from collateral. TDRs are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's contractual rate at inception. If a TDR is considered to be a collateral dependent loan, the loan may be reported at the net realizable value of the collateral. For TDRs that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers all other loans not identified as impaired (aside from GGLs, which do not require an allowance) and is based on historical losses and qualitative factors. The historical loss component of the allowance is determined by losses recognized by portfolio segment over an eight quarter lookback period that management has determined best represents the current credit cycle. Qualitative factors impacting each portfolio segment may include: delinquency trends, loan volume trends, Bank policy changes, management processes and oversight, economic trends (including change in consumer and business disposable incomes, unemployment and under-employment levels, and other conditions), concentrations by industry or product, internal and external loan review processes, collateral value and market conditions, and external factors including regulatory issues and competition.

GGLs do not require an associated allowance for loan losses due to the underlying irrevocable and unconditional guarantee, which is supported by the full faith and credit of the U.S. Government. Should a GGL default, the loan will be repurchased by the originating bank or the appropriate government agency that has provided the guarantee for the loan.

Although PPP loans do not require an associated allowance for loan losses due to the program's call for a full guarantee by the SBA, the Corporation has taken the conservative approach and has calculated a qualitative allocation for the PPP loans under the general component of the allowance for the Commercial and Industrial portfolio.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A reserve for unfunded lending commitments is provided for possible credit losses on off-balance sheet credit exposures. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and, if necessary, is recorded in other liabilities on the consolidated balance sheets. As of December 31, 2022 and 2021 the amount of the reserve for unfunded lending commitments was $68,000 and $177,000, respectively.

The Corporation is subject to periodic examination by its federal and state examiners, and may be required by such regulators to recognize additions to the allowance for loan losses based on their assessment of credit information available to them at the time of their examinations.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the existing loan agreement. Under current accounting standards, the allowance for loan losses related to impaired loans is based on discounted cash flows using the loan’s contractual interest rate at inception or the net realizable value of the collateral for certain collateral dependent loans.

From time to time, the Corporation may agree to modify/restructure the contractual terms of a borrower's loan. The restructuring of a loan is considered a TDR if both the following conditions are met: (i) the borrower is experiencing financial difficulties, and (ii) the Corporation has granted a concession. The most common concessions granted include one or more modifications to the terms of the debt, such as (a) a reduction in the interest rate for the remaining life of the debt, (b) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (c) a temporary period of interest-only payments, and (d) a reduction in the contractual payment amount for either a short period or remaining term of the loan. A less common concession is the forgiveness of a portion of the principal.

The determination of whether a borrower is experiencing financial difficulties takes into account not only the current financial condition of the borrower, but also the potential financial condition of the borrower were a concession not granted. Similarly, the determination of whether a concession has been granted is subjective in nature. For example, simply extending the term of a loan at its original interest rate or even at a higher interest rate could be interpreted as a concession unless the borrower could readily obtain similar credit terms from a different lender.

Loans modified in a TDR considered impaired and may or may not be placed on non-accrual status until the Corporation determines the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrates a period of performance according to the restructured terms of six months. Any loan modifications made in response to the COVID-19 pandemic are not considered TDRs as long as the criteria set forth in Section 4013 of the CARES Act are met. See page 77 for further discussion of the Section 4013 CARES Act modifications.

The Corporation utilizes a risk grading matrix as a tool for managing credit risk in the loan portfolio and assigns an asset quality rating (risk grade) to all Commercial and Industrial, Commercial Real Estate, Residential Real Estate and Consumer loans. An asset quality rating is assigned using the guidance provided in the Corporation’s loan policy. Primary responsibility for assigning the asset quality rating rests with the credit department. The asset quality rating is validated periodically by both an internal and external loan review process.

The commercial loan grading system focuses on a borrower’s financial strength and performance, experience and depth of management, primary and secondary sources of repayment, the nature of the business and the outlook for the particular industry. Primary emphasis is placed on financial condition and trends. The grade also reflects current economic and industry conditions; as well as other variables such as liquidity, cash flow, revenue/earnings trends, management strengths or weaknesses, quality of financial information, and credit history.

The loan grading system for Residential Real Estate and Consumer loans focuses on the borrower’s credit score and credit history, debt-to-income ratio and income sources, collateral position and loan-to-value ratio.

Risk grade characteristics are as follows:

Risk Grade 1 – MINIMAL RISK through Risk Grade 6 – MANAGEMENT ATTENTION (Pass Grade Categories)

Risk is evaluated via examination of several attributes including but not limited to financial trends, strengths and weaknesses, likelihood of repayment when considering both cash flow and collateral, sources of repayment, leverage position, management expertise, and repayment history.

At the low-risk end of the rating scale, a risk grade of 1 - Minimal Risk is the grade reserved for loans with exceptional credit fundamentals and virtually no risk of default or loss. Loan grades then progress through escalating ratings of 2 through 6 based upon risk. Risk Grade 2 - Modest Risk are loans with sufficient cash flows; Risk Grade 3 - Average Risk are loans with key balance sheet ratios slightly above the borrower’s peers; Risk Grade 4 - Acceptable Risk are loans with key balance sheet ratios usually near the borrower’s peers, but one or more ratios may be higher; and Risk Grade 5 – Marginally Acceptable are loans with strained cash flow, increasing leverage and/or weakening markets. Risk Grade 6 - Management Attention are loans with weaknesses resulting from declining performance trends and the borrower's cash flows may be temporarily strained. Loans in this category are performing according to terms, but present some type of potential concern.

Risk Grade 7 − SPECIAL MENTION (Non-Pass Category)

Assets in this category are adequately collateralized but have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Corporation's credit position at some future date. The loans may constitute increased credit risk, but not to the point of justifying a classification of substandard. No loss of principal or interest is envisioned, but risk is increasing beyond that at which the loan originally would have been granted. Historically, cash flows are inconsistent; financial trends show some deterioration. Liquidity and leverage ratios are above industry averages. Financial information could be incomplete or inadequate. A Special Mention asset has potential weaknesses that deserve management's close attention.

Risk Grade 8 − SUBSTANDARD (Non-Pass Category)

Generally, these assets are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have "well-defined" weaknesses that jeopardize the full liquidation of the debt.

These loans are characterized by the distinct possibility that the Corporation will sustain some loss if the aggregate amount of substandard assets is not fully covered by the liquidation of the collateral used as security. Substandard loans have a high probability of payment default and require more intensive supervision by Corporation management.

Risk Grade 9 − DOUBTFUL (Non-Pass Category)

Generally, loans graded doubtful have all the weaknesses inherent in a substandard loan with the added factor that the weaknesses are pronounced to a point whereby the basis of current information, conditions, and values, collection or liquidation in full is deemed to be highly improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors that may work to strengthen the asset, its classification is deferred until, for example, a proposed merger, acquisition, liquidation procedure, capital injection, perfection of liens on additional collateral and/or refinancing plan is completed. Loans are graded doubtful if they contain weaknesses so serious that collection or liquidation in full is questionable.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation computed principally utilizing the straight-line method over the estimated useful lives of the assets. Long-lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying value may not be recovered. Maintenance and minor repairs are charged to operations as incurred. The cost and accumulated depreciation of the premises and equipment retired or sold are eliminated from the property accounts at the time of retirement or sale, and the resulting gain or loss is reflected in current operations.

Mortgage Servicing Rights

The Corporation originates and sells real estate loans to investors in the secondary mortgage market. After the sale, the Corporation may retain the right to service these loans. The mortgage loans sold and serviced for others are not included in the consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $87,671,000 and $93,906,000 at December 31, 2022 and 2021, respectively. When originated mortgage loans are sold and servicing is retained, a servicing asset is capitalized based on relative fair value at the date of the sale. Servicing assets are amortized as an offset to other fees in proportion to, and over the period of, estimated net servicing income. The servicing asset is included in other assets in the consolidated balance sheets and amounted to $319,000 at December 31, 2022 and $367,000 at December 31, 2021. The amount of servicing income earned was $230,000 and $228,000 at December 31, 2022 and 2021, respectively. Amortization recognized in relation to mortgage servicing rights was $88,000 and $120,000 at December 31, 2022 and 2021, respectively. Both income and amortization are included in service charges and fees on the consolidated statements of income. Gains or losses on sales of mortgage loans are recognized based on the differences between the selling price and the carrying value of the related mortgage loans sold.

Bank Owned Life Insurance

The cash surrender value of bank owned life insurance is carried as an asset, and changes in cash surrender value are recorded as non-interest income in the consolidated statements of income.

The Corporation entered into agreements to provide post-retirement benefits to two retired employees in the form of life insurance payable to the employee's beneficiaries upon their death through endorsement split dollar life insurance arrangements. The Corporation's accrued liabilities for this benefit agreement as of December 31, 2022 and 2021 which are included in other liabilities in the Corporation's consolidated balance sheets were $53,000 and $56,000, respectively. The related income (expense) for this benefit agreement amounted to $3,000 in 2022 and $(20,000) in 2021. The expense recognized in 2021 was the result of service costs associated with the benefit agreement.

Investments in Low-Income Housing Partnerships

The Corporation is a limited partner in real estate ventures that own and operate affordable residential low-income housing apartment buildings for elderly and mentally challenged adult residents. The investments are accounted for under the cost method. Under the cost method, the Corporation recognizes tax credits as they are allocated and amortizes the initial cost of the investment over the period that the tax credits are allocated to the Corporation. The amount of tax credits allocated to the Corporation were $249,000 and $405,000 in 2022 and 2021, respectively, and the amortization of the investments in the limited partnerships were $225,000 and $371,000 in 2022 and 2021, respectively. During 2021, the Corporation became a limited partner in a real estate venture with an initial investment of $435,000. In 2022, capital contributions in the combined amount of $2,458,000 were made in relation to the new real estate venture. The new limited partnership has not begun amortizing and future contributions will be required.

Goodwill

Goodwill resulted from the acquisition of the Pocono Community Bank in November 2007 and of certain fixed and operating assets acquired and deposit liabilities assumed of the branch of another financial institution in Danville, Pennsylvania, in January 2004. Such goodwill represents the excess cost of the acquired assets relative to the assets fair value at the dates of acquisition. During the first quarter of 2008, $152,000 of liabilities related to the Pocono acquisition were recorded as a purchase accounting adjustment resulting in an increase in the excess purchase price. The amount was comprised of the finalization of severance agreements and contract terminations related to the acquisition. In accordance with current accounting standards, goodwill is not amortized. Management performs an annual evaluation for impairment. Any impairment of goodwill results in a charge to income. The Corporation periodically assesses whether events or changes in circumstances indicate that the carrying amounts of goodwill and other intangible assets may be impaired. Goodwill is evaluated for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Management notes that the emergence of COVID-19 as a global pandemic during 2020 and throughout 2021 has resulted in significant deterioration in general economic conditions and has caused a deterioration in the environment in which the Corporation operates. The full impact to earnings in the banking industry and to the Corporation specifically, remains uncertain. The Corporation has evaluated the goodwill included in its consolidated balance sheet at December 31, 2022, and has determined there was no impairment as of that date. In addition, the Corporation did not identify any impairment in 2021. No assurance can be given that future impairment tests will not result in a charge to earnings.

Foreclosed Assets Held for Resale

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell on the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed and if fair value less cost to sell declines subsequent to foreclosure, a valuation allowance is recorded through expense. Revenues derived from and costs to maintain the assets and subsequent gains and losses on sales are included in non-interest expense on the consolidated statements of income.

Income Taxes

The Corporation accounts for income taxes in accordance with income tax accounting guidance FASB ASC Topic 740, *Income Taxes*.

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

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Corporation accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more-likely-than-not means a likelihood of more than 50%; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

The Corporation recognizes interest and penalties on income taxes, if any, as a component of income tax expense in the consolidated statements of income.

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Corporation. At December 31, 2022 and 2021, there were no potential common shares outstanding. The following table sets forth the computation of basic and diluted earnings per share.

(In thousands, except earnings per share)	Year Ended December 31,	
	2022	2021
Net income	**$ 14,024**	$ 14,688
Weighted-average common shares outstanding	**5,974**	5,908
Basic and diluted earnings per share	**$ 2.35**	$ 2.49

Treasury Stock

The purchase of the Corporation's common stock is recorded at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a first-in-first-out basis.

Trust Assets and Revenues

Property held by the Corporation in a fiduciary or agency capacity for its customers is not included in the accompanying consolidated financial statements since such items are not assets of the Corporation. Assets held in trust were $111,172,000 and $108,339,000 at December 31, 2022 and 2021, respectively. Trust Department income is generally recognized on a cash basis and is not materially different than if it were reported on an accrual basis (see Table 5 – Non-Interest Income for details).

Comprehensive (Loss) Income

The Corporation is required to present accumulated other comprehensive (loss) income in a full set of general-purpose financial statements for all periods presented. Accumulated other comprehensive (loss) income is comprised of net unrealized holding (losses) gains on the debt securities available-for-sale portfolio. The Corporation has elected to report these effects on the consolidated statements of comprehensive (loss) income.

Advertising Costs

It is the Corporation's policy to expense advertising costs in the period in which they are incurred.

Recent Accounting Standards Updates ("ASU"):

There were no new accounting pronouncements affecting the Corporation during the year ended December 31, 2022 that were not already adopted by the Corporation in previous periods.

Pending ASUs:

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU No. 2016-13 requires financial assets measured at amortized cost to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. ASU No. 2016-13 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2019. In November 2019, the FASB issued ASU 2019-10, Financial Instruments-Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842), to delay the effective date for smaller reporting companies to fiscal years, and interim periods within those fiscal years, beginning after December 15, 2022. The Corporation has taken steps to prepare for the implementation, such as: forming an internal committee, gathering pertinent data, consulting with outside professionals, subscribing to a new software system, and running existing and new methodologies concurrently through the period of implementation. The Corporation has elected to adopt this pronouncement as of January 1, 2023. The Corporation continues to evaluate the impact the CECL model will have on the accounting for credit losses, and expects to recognize a one-time, cumulative effect adjustment to the allowance for loan losses at the beginning of the first reporting period in which the new standard is effective. The Corporation is completing its data and model validation analysis and working to finalize policies and control framework related to the adoption process.

In March 2022, the FASB issued ASU 2022-02, *Financial Instruments-Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, which eliminates the accounting guidance on troubled debt restructurings ("TDRs") by creditors that have adopted the current expected credit losses ("CECL") model and enhances disclosure requirements for certain loan refinancing and restructurings by creditors made to borrowers experiencing financial difficulty. The ASU also amends the guidance on "vintage disclosures" to require disclosure of current-period gross charge-offs by year of origination. For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2022- 02 are effective upon adoption of ASU 2016-13. Entities may elect to apply the guidance on TDR recognition and measurement by using a modified retrospective transition method, which would result in a cumulative-effect adjustment to retained earnings, or to adopt the amendments prospectively. If an entity elects to adopt the updated guidance on TDR recognition and measurement prospectively, the guidance should be applied to modifications occurring after the date of adoption. The amendments on TDR disclosures and vintage disclosures should be adopted prospectively. The Company adopted ASU 2022-02 upon the adoption of ASU 2016-13, and does not anticipate a material impact on the Company's consolidated financial statements.

Transfer of Financial Assets

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

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the consolidated balance sheets when they are funded.

Reclassifications

Certain amounts previously reported have been reclassified, when necessary, to conform with presentations used in the 2022 consolidated financial statements. Such reclassifications have no effect on the Corporation's net income.

NOTE 2 — SECURITIES

The amortized cost, related estimated fair value, and unrealized gains and losses for debt securities classified as "available-for-sale" were as follows at December 31, 2022 and 2021:

(Dollars in thousands)	**Debt Securities Available-for-Sale**			
December 31, 2022:	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Treasury securities	**$ 7,853**	**$ —**	**$ (1,052)**	**$ 6,801**
Obligations of U.S. Government Agencies and Sponsored Agencies:				
Mortgage-backed	**146,707**	**—**	**(15,032)**	**131,675**
Other	**10,992**	**233**	**(45)**	**11,180**
Other mortgage backed securities	**36,767**	**—**	**(3,079)**	**33,688**
Obligations of state and political subdivisions	**125,176**	**266**	**(14,753)**	**110,689**
Asset-backed securities	**37,526**	**—**	**(1,108)**	**36,418**
Corporate debt securities	**45,838**	**183**	**(3,028)**	**42,993**
Total	**$ 410,859**	**$ 682**	**$ (38,097)**	**$ 373,444**

(Dollars in thousands)	Debt Securities Available-for-Sale			
December 31, 2021:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 7,825	$ —	$ (96)	$ 7,729
Obligations of U.S. Government Agencies and Sponsored Agencies:				
Mortgage-backed	116,039	560	(1,688)	114,911
Other	7,636	5	(65)	7,576
Other mortgage backed securities	39,881	99	(430)	39,550
Obligations of state and political subdivisions	175,021	11,709	(554)	186,176
Asset-backed securities	36,555	143	(156)	36,542
Corporate debt securities	45,354	448	(370)	45,432
Total	$ 428,311	$ 12,964	$ (3,359)	$ 437,916

Debt securities available-for-sale with an aggregate fair value of $315,836,000 at December 31, 2022 and $401,861,000 at December 31, 2021, were pledged to secure public funds, trust funds, securities sold under agreements to repurchase and the Federal Discount Window aggregating $241,385,000 at December 31, 2022 and $318,074,000 at December 31, 2021.

The amortized cost and fair value of securities, by contractual maturity, are shown below at December 31, 2022. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Available-for-Sale	
	Amortized Cost	Fair Value
1 year or less	$ 6,971	$ 6,994
Over 1 year through 5 years	29,664	28,469
Over 5 years through 10 years	74,848	68,609
Over 10 years	115,902	104,009
Mortgage-backed securities	183,474	165,363
Total	$ 410,859	$ 373,444

At December 31, 2022, the Corporation had holdings of securities from one issuer in excess of ten percent of consolidated stockholders' equity, other than the U.S. Government and U.S. Government Agencies and Corporations. Holdings in Sallie Mae Bank securities had a fair value of $17,362,000 as of December 31, 2022. There were no aggregate holdings of securities with a single issuer (excluding the U.S. Government and U.S. Government Agencies and Corporations) which exceeded ten percent of consolidated stockholders' equity at December 31, 2021. The quality rating of the obligations of state and political subdivisions are generally investment grade, as rated by Moody's, Standard and Poor's or Fitch. The typical exceptions are local issues which are not rated, but are secured by the full faith and credit obligations of the communities that issued these securities.

Proceeds from sales of investments in debt securities available-for-sale during 2022 and 2021 were $58,675,000 and $0, respectively. Gross gains realized on these sales were $221,000 and $0, respectively. Gross losses on these sales were $974,000 and $0, respectively. There were no impairment losses realized on debt securities available-for-sale during 2022 or 2021.

At December 31, 2022 and 2021, the Corporation had $1,699,000 and $1,962,000, respectively, in equity securities recorded at fair value. The following is a summary of unrealized and realized gains and losses recognized in net income on equity securities during 2022 and 2021:

(Dollars in thousands)

	December 31, 2022	December 31, 2021
Net (losses) and gains from market value fluctuations recognized during the period on equity securities	**$ (93)**	$ 323
Less: Net gains recognized during the period on equity securities sold during the period	**27**	4
Net (losses) and gains recognized during the reporting period on equity securities still held at the reporting date	**$ (120)**	$ 319

The Corporation and its investment advisors monitor the entire portfolio at least quarterly with particular attention given to securities in a continuous loss position of at least ten percent for over twelve months. Based on the factors described above, management did not consider any securities to be other-than-temporarily impaired at December 31, 2022 and 2021.

The summary below shows the gross unrealized losses and fair value of the Corporation's debt securities, aggregated by investment category, of which individual securities have been in a continuous unrealized loss position for less than 12 months or 12 months or more as of December 31, 2022 and 2021:

December 31, 2022

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
Available-for-Sale:	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. Treasury securities	**$ —**	**$ —**	**$ 6,801**	**$ (1,052)**	**$ 6,801**	**$ (1,052)**
Obligations of U.S. Government Agencies and Sponsored Agencies:						
Mortgage-backed	**61,067**	**(2,184)**	**65,174**	**(12,848)**	**126,241**	**(15,032)**
Other	**1,589**	**(2)**	**3,168**	**(43)**	**4,757**	**(45)**
Other mortgage-backed debt securities	**16,167**	**(962)**	**17,521**	**(2,117)**	**33,688**	**(3,079)**
Obligations of state and political subdivisions	**56,565**	**(5,881)**	**35,704**	**(8,872)**	**92,269**	**(14,753)**
Asset-backed securities	**24,136**	**(405)**	**12,282**	**(703)**	**36,418**	**(1,108)**
Corporate debt securities	**15,827**	**(1,073)**	**18,345**	**(1,955)**	**34,172**	**(3,028)**
Total	**$ 175,351**	**$ (10,507)**	**$ 158,995**	**$ (27,590)**	**$ 334,346**	**$ (38,097)**

December 31, 2021

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
Available-for-Sale:	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury securities	$ 7,729	$ (96)	$ —	$ —	$ 7,729	$ (96)
Obligations of U.S. Government Agencies and Sponsored Agencies:						
Mortgage-backed	66,195	(1,271)	11,697	(417)	77,892	(1,688)
Other	—	—	6,687	(65)	6,687	(65)
Other mortgage-backed debt securities	11,036	(225)	7,362	(205)	18,398	(430)
Obligations of state and political subdivisions	25,867	(362)	3,931	(192)	29,798	(554)
Asset-backed securities	11,232	(49)	6,315	(107)	17,547	(156)
Corporate debt securities	19,485	(315)	3,445	(55)	22,930	(370)
Total	$ 141,544	$ (2,318)	$ 39,437	$ (1,041)	$ 180,981	$ (3,359)

The Corporation invests in various forms of agency debt including residential and commercial mortgage-backed securities and callable debt. The mortgage-backed agency securities are issued by Federal Home Loan Mortgage Corporation ("FHLMC"), Federal National Mortgage Association ("FNMA"), Government National Mortgage Association ("GNMA") or SBA. The other mortgage-backed securities consist of private (non-agency) residential and commercial mortgage-backed securities. The municipal securities consist of general obligations and revenue bonds. Asset-backed securities consist of private (non-agency) student loan pools backed by the Federal Family Education Loan Program ("FFELP") which carry a 97% federal government guarantee. Corporate debt securities consist of senior debt and subordinated debt holdings.

The fair market value of the above securities is influenced by market interest rates, prepayment speeds on mortgage securities, bid-offer spreads in the marketplace and credit premiums for various types of agency debt. These factors change continuously and therefore the market value of these securities may be higher or lower than the Corporation's carrying value at any measurement date. Management does not believe any of their 95 debt securities with a less than one year unrealized loss position, or any of their 88 debt securities with a one year or greater unrealized loss position, as of December 31, 2022, represent an other-than-temporary impairment, as these unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities. The Corporation expects to collect principal and interest payments as defined under the original terms as all contracted payments on securities in the portfolio are current as of December 31, 2022.

NOTE 3 — LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table presents the classes of the loan portfolio summarized by risk rating as of December 31, 2022 and 2021:

(Dollars in thousands)	Commercial and Industrial		Commercial Real Estate	
	December 31, 2022	December 31, 2021	**December 31, 2022**	December 31, 2021
Grade:				
1-6 Pass	**$ 85,845**	$ 81,561	**$ 591,309**	$ 498,565
7 Special Mention	**—**	—	**634**	1,098
8 Substandard	**725**	796	**18,781**	21,248
9 Doubtful	**—**	—	**—**	—
Add (deduct): Unearned discount	**—**	—	**—**	—
Net deferred loan fees and costs	**429**	169	**825**	743
Total loans	**$ 86,999**	$ 82,526	**$ 611,549**	$ 521,654

	Residential Real Estate Including Home Equity		Consumer	
	December 31, 2022	December 31, 2021	**December 31, 2022**	December 31, 2021
Grade:				
1-6 Pass	**$ 153,902**	$ 141,983	**$ 5,349**	$ 5,210
7 Special Mention	**—**	570	**—**	—
8 Substandard	**795**	1,020	—	5
9 Doubtful	**—**	—	**—**	—
Add (deduct): Unearned discount	**—**	—	**—**	—
Net deferred loan fees and costs	**(191)**	(190)	**66**	63
Total loans	**$ 154,506**	$ 143,383	**$ 5,415**	$ 5,278

	Total Loans	
	December 31, 2022	December 31, 2021
Grade:		
1-6 Pass	**$ 836,405**	$ 727,319
7 Special Mention	**634**	1,668
8 Substandard	**20,301**	23,069
9 Doubtful	**—**	—
Add (deduct): Unearned discount	—	—
Net deferred loan fees and costs	**1,129**	785
Total loans	**$ 858,469**	$ 752,841

Commercial and Industrial and Commercial Real Estate include loans categorized as tax-free in the amounts of $28,079,000 and $1,492,000 at December 31, 2022 and $24,647,000 and $1,671,000 at December 31, 2021. Commercial and Industrial loans also included $4,631,000 and $3,829,000 of GGLs and $113,000 and $4,894,000 of PPP loans as of December 31, 2022 and 2021, respectively. Loans held for sale amounted to $71,000 at December 31, 2022 and $6,006,000 at December 31, 2021. During the year ended December 31, 2022, $7,900,000 in loans that had been previously held for sale were transferred to held for investment status, as the Corporation no longer had the intent to sell these loans.

The activity in the allowance for loan losses, by loan class, is summarized below for the years indicated.

(Dollars in thousands)	Commercial and Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
As of and for the year ended December 31, 2022:						
Allowance for Loan Losses:						
Beginning balance	**$ 681**	**$ 5,408**	**$ 1,539**	**$ 84**	**$ 968**	**$ 8,680**
Charge-offs	**(158)**	**(3)**	**(12)**	**(33)**	**—**	**(206)**
Recoveries	**3**	**40**	**16**	**5**	**—**	**64**
Provision (credit)	**178**	**487**	**14**	**25**	**(968)**	**(264)**
Ending Balance	**$ 704**	**$ 5,932**	**$ 1,557**	**$ 81**	**$ —**	**$ 8,274**
Ending balance: individually evaluated for impairment	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
Ending balance: collectively evaluated for impairment	**$ 704**	**$ 5,932**	**$ 1,557**	**$ 81**	**$ —**	**$ 8,274**
Loans Receivable:						
Ending Balance	**$ 86,999**	**$ 611,549**	**$ 154,506**	**$ 5,415**	**$ —**	**$ 858,469**
Ending balance: individually evaluated for impairment	**$ 973**	**$ 9,495**	**$ 739**	**$ —**	**$ —**	**$ 11,207**
Ending balance: collectively evaluated for impairment	**$ 86,026**	**$ 602,054**	**$ 153,767**	**$ 5,415**	**$ —**	**$ 847,262**

(Dollars in thousands)	Commercial and Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
As of and for the year ended December 31, 2021:						
Allowance for Loan Losses:						
Beginning balance	$ 787	$ 4,762	$ 1,643	$ 94	$ 647	$ 7,933
Charge-offs	(13)	(29)	(80)	(36)	—	(158)
Recoveries	—	30	4	11	—	45
(Credit) provision	(93)	645	(28)	15	321	860
Ending Balance	$ 681	$ 5,408	$ 1,539	$ 84	$ 968	$ 8,680
Ending balance: individually evaluated for impairment	$ —	$ —	$ —	$ —	$ —	$ —
Ending balance: collectively evaluated for impairment	$ 681	$ 5,408	$ 1,539	$ 84	$ 968	$ 8,680
Loans Receivable:						
Ending Balance	$ 82,526	$ 521,654	$ 143,383	$ 5,278	$ —	$ 752,841
Ending balance: individually evaluated for impairment	$ 1,017	$ 11,803	$ 853	$ —	$ —	$ 13,673
Ending balance: collectively evaluated for impairment	$ 81,509	$ 509,851	$ 142,530	$ 5,278	$ —	$ 739,168

The outstanding recorded investment of loans categorized as TDRs as of December 31, 2022 and December 31, 2021 was $7,480,000 and $8,020,000, respectively. The decrease in TDRs at December 31, 2022 as compared to December 31, 2021 is mainly attributable to regular principal payments and paydowns on existing TDRs that were completed during the year ended December 31, 2022. There were no unfunded commitments on TDRs at December 31, 2022 and 2021.

During the year ended December 31, 2022, two loans with a combined post modification balance of $515,000 were modified as TDRs, compared to the year ended December 31, 2021 when four loans with a combined post modification balance of $360,000 were modified as TDRs. The loan modifications for the year ended December 31, 2022 consisted of two payment modifications, compared to December 31, 2021 when the loan modifications consisted of two term modifications beyond the original stated term and two payment modifications.

The following table presents the outstanding recorded investment of TDRs at the dates indicated:

(Dollars in thousands)	**December 31, 2022**	December 31, 2021
Non-accrual TDRs	**$ 1,324**	$ 1,413
Accruing TDRs	**6,156**	6,607
Total	**$ 7,480**	$ 8,020

At December 31, 2022, three commercial and industrial loans classified as TDRs with a combined recorded investment of $664,000 and five commercial real estate loans classified as TDRs with a combined recorded investment of $684,000 were not in compliance with the terms of their restructure, compared to December 31, 2021 when three commercial and industrial loans classified as TDRs with a combined recorded investment of $708,000, ten commercial real estate loans classified as TDRs with a combined recorded investment of $590,000, and one residential real estate loan classified as a TDR with a recorded investment of $14,000 were not in compliance with the terms of their restructure.

Of the loans that were modified as TDRs within the twelve months preceding December 31, 2022, no loans experienced payment defaults during the year ended December 31, 2022. Three commercial real estate loans totaling $285,000 that were modified as TDRs within the twelve months preceding December 31, 2021 experienced payment defaults during the year ended December 31, 2021.

The following table presents information regarding the loan modifications categorized as TDRs during the year ended December 31, 2022 and 2021.

(Dollars in thousands)	**Year Ended December 31, 2022**			
	Number of Contracts	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Recorded Investment**
Commercial Real Estate	**2**	**$ 481**	**$ 515**	**$ 501**
Total	**2**	**$ 481**	**$ 515**	**$ 501**

(Dollars in thousands)	Year Ended December 31, 2021			
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment
Commercial Real Estate	4	$ 360	$ 360	$ 342
Total	4	$ 360	$ 360	$ 342

The following table provides detail regarding the types of loan modifications made for loans categorized as TDRs during the year ended December 31, 2022 and 2021 with the total number of each type of modification performed.

	Year Ended December 31, 2022			
	Rate Modification	**Term Modification**	**Payment Modification**	**Number Modified**
Commercial Real Estate	—	—	**2**	**2**
Total	—	—	**2**	**2**

	Year Ended December 31, 2021			
	Rate Modification	Term Modification	Payment Modification	Number Modified
Commercial Real Estate	—	2	2	4
Total	—	2	2	4

In the wake of the COVID-19 pandemic, during the second quarter of 2020, the Corporation began granting loan modification requests to defer principal and/or interest payments or modify interest rates. These loans are not classified as TDRs according to Section 4013 of the CARES Act, as long as the specific criteria set forth in the Act are met. As of December 31, 2022, there were no loan modifications in compliance with Section 4013 of the CARES Act that were still actively on deferral, compared to December 31, 2021 when there was one loan in the amount of $9,423,000 that was still actively on deferral, which was returned to normal payment status during the first quarter of 2022.

The recorded investment, unpaid principal balance, and the related allowance of the Corporation's impaired loans are summarized below at December 31, 2022 and 2021.

(Dollars in thousands)	December 31, 2022			December 31, 2021		
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and Industrial	**$ 973**	**$ 973**	**$ —**	$ 1,017	$ 1,017	$ —
Commercial Real Estate	**9,495**	**12,430**	**—**	11,803	14,735	—
Residential Real Estate	**739**	**771**	**—**	853	885	—
With an allowance recorded:						
Commercial and Industrial	**—**	**—**	**—**	—	—	—
Commercial Real Estate	**—**	**—**	**—**	—	—	—
Residential Real Estate	**—**	**—**	**—**	—	—	—
Total	**$ 11,207**	**$ 14,174**	**$ —**	$ 13,673	$ 16,637	$ —
Total consists of:						
Commercial and Industrial	**$ 973**	**$ 973**	**$ —**	$ 1,017	$ 1,017	$ —
Commercial Real Estate	**$ 9,495**	**$ 12,430**	**$ —**	$ 11,803	$ 14,735	$ —
Residential Real Estate	**$ 739**	**$ 771**	**$ —**	$ 853	$ 885	$ —

At December 31, 2022 and 2021, $7,480,000 and $8,020,000 of loans classified as TDRs were included in impaired loans with a total allocated allowance of $0 at both December 31, 2022 and December 31, 2021. The recorded investment represents the loan balance reflected on the consolidated balance sheets net of any charge-offs. The unpaid balance is equal to the gross amount due on the loan.

The average recorded investment and interest income recognized for the Corporation's impaired loans are summarized below for the years ended December 31, 2022 and 2021.

(Dollars in thousands)	**For the Year Ended December 31, 2022**		For the Year Ended December 31, 2021	
	Average Recorded Investment	**Interest Income Recognized**	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial and Industrial	**$ 992**	**$ 14**	$ 1,052	$ 9
Commercial Real Estate	**10,741**	**294**	12,571	346
Residential Real Estate	**841**	**1**	1,107	2
With an allowance recorded:				
Commercial and Industrial	—	—	—	—
Commercial Real Estate	—	—	198	—
Residential Real Estate	—	—	—	—
Total	**$ 12,574**	**$ 309**	$ 14,928	$ 357
Total consists of:				
Commercial and Industrial	**$ 992**	**$ 14**	$ 1,052	$ 9
Commercial Real Estate	**$ 10,741**	**$ 294**	$ 12,769	$ 346
Residential Real Estate	**$ 841**	**$ 1**	$ 1,107	$ 2

Of the $309,000 and $357,000 in interest income recognized on impaired loans for the years ended December 31, 2022 and 2021, respectively, $0 and $3,000 in interest income was recognized with respect to non-accrual loans for each respective period.

Total non-performing assets (which includes loans receivable on non-accrual status, foreclosed assets held for resale and loans past-due 90 days or more and still accruing interest) as of December 31, 2022 and 2021 were as follows:

(Dollars in thousands)	**December 31, 2022**	December 31, 2021
Commercial and Industrial	**$ 664**	$ 708
Commercial Real Estate	**3,658**	5,519
Residential Real Estate	**729**	839
Total non-accrual loans	**5,051**	7,066
Foreclosed assets held for resale	—	—
Loans past-due 90 days or more and still accruing interest	**308**	—
Total non-performing assets	**$ 5,359**	$ 7,066

If interest on non-accrual loans had been accrued at original contract rates, interest income would have increased by $2,174,000 in 2022 and $1,858,000 in 2021.

There were no foreclosed assets held for resale at December 31, 2022 or December 31, 2021. Consumer mortgage loans secured by residential real estate for which the Corporation has entered into formal foreclosure proceedings but for which physical possession of the property has yet to be obtained amounted to $41,000 at both December 31, 2022 and December 31, 2021. These balances were not included in foreclosed assets held for resale at December 31, 2022 or December 31, 2021.

The following tables present the classes of the loan portfolio summarized by the past-due status at December 31, 2022 and 2021:

(Dollars in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current-29 Days Past Due	Total Loans	90 Days Or Greater Past Due and Still Accruing Interest
December 31, 2022:							
Commercial and Industrial	**$ 61**	**$ 63**	**$ 640**	**$ 764**	**$ 86,235**	**$ 86,999**	**$ —**
Commercial Real Estate	**2,074**	**34**	**3,797**	**5,905**	**605,644**	**611,549**	**140**
Residential Real Estate	**608**	**25**	**897**	**1,530**	**152,976**	**154,506**	**168**
Consumer	**11**	**2**	**—**	**13**	**5,402**	**5,415**	**—**
Total	**$ 2,754**	**$ 124**	**$ 5,334**	**$ 8,212**	**$ 850,257**	**$ 858,469**	**$ 308**

(Dollars in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current-29 Days Past Due	Total Loans	90 Days Or Greater Past Due and Still Accruing Interest
December 31, 2021:							
Commercial and Industrial	$ 47	$ —	$ 678	$ 725	$ 81,801	$ 82,526	$ —
Commercial Real Estate	116	189	4,891	5,196	516,458	521,654	—
Residential Real Estate	553	191	839	1,583	141,800	143,383	—
Consumer	14	—	—	14	5,264	5,278	—
Total	$ 730	$ 380	$ 6,408	$ 7,518	$ 745,323	$ 752,841	$ —

At December 31, 2022 and 2021 commitments to lend additional funds with respect to impaired loans consisted of one irrevocable letter of credit in the amount of $1,249,000 that was associated with a loan to a developer of a residential sub-division.

NOTE 4 — PREMISES AND EQUIPMENT

Premises and equipment at December 31, 2022 and 2021 is as follows:

(Dollars in thousands)

	Estimated Useful Life (in years)	2022	2021
Land	N/A	**$ 3,744**	$ 3,744
Buildings	5-40	**22,114**	20,929
Leasehold improvements	1-20	**335**	193
Equipment	3-25	**7,937**	8,031
		34,130	32,897
Less: Accumulated depreciation		**15,106**	14,739
Total		**$ 19,024**	$ 18,158

Depreciation amounted to $1,026,000 for 2022 and $1,008,000 for 2021 in the consolidated statements of income.

NOTE 5 — DEPOSITS

Major classifications of deposits at December 31, 2022 and 2021 consisted of:

(Dollars in thousands)	**December 31, 2022**	December 31, 2021
Non-interest bearing demand	**$ 231,754**	$ 249,040
Interest bearing demand	**335,559**	395,033
Savings	**260,086**	260,804
Time certificates of deposits less than $250,000	**151,575**	158,914
Time certificates of deposits $250,000 or greater	**13,400**	13,030
Other time	**1,125**	1,148
Total deposits	**$ 993,499**	$ 1,077,969

Total deposits decreased $84,470,000 to $993,499,000 as of December 31, 2022 due to decreases in non-interest bearing, interest bearing, savings and time deposits. The decrease in deposits was mainly the result of a $70,297,000 decrease in municipal deposits and other normal fluctuations in deposits during 2022. As of December 31, 2022 and 2021 the Corporation had $20,000,000 in brokered deposits (CDs).

The following is a schedule reflecting classification and remaining maturities of time deposits at December 31, 2022:

(Dollars in thousands) Year Ending	
2023	$ 99,132
2024	24,523
2025	30,988
2026	7,390
2027	4,067
Total time deposits	$ 166,100

NOTE 6 — SHORT-TERM BORROWINGS

Short-term borrowings include federal funds purchased, securities sold under agreements to repurchase, Federal Discount Window, and FHLB advances, which generally represent overnight or less than 30 -day borrowings.

Short-term borrowings and weighted-average interest rates at and for the years ended December 31, 2022 and 2021 are as follows:

(Dollars in thousands)	**2022**		2021	
	Amount	**Average Rate**	Amount	Average Rate
Federal funds purchased	**$ —**	**— %**	$ —	0.36 %
Securities sold under agreements to repurchase	**20,368**	**0.84 %**	27,377	0.35 %
Federal Discount Window	**—**	**2.78 %**	—	0.36 %
Federal Home Loan Bank of Pittsburgh	**133,050**	**2.82 %**	—	0.34 %
Total	**$ 153,418**	**2.21 %**	$ 27,377	0.35 %

At December 31, 2022, the maximum borrowing capacity of federal funds purchased and the Federal Discount Window was $15,000,000 and $2,235,000, respectively. Please refer to Note 7 — Long-Term Borrowings for the Corporation's maximum borrowing capacity at FHLB.

Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”)

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets.

As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability on the Corporation’s consolidated balance sheets, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is not offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). The collateral is held by a correspondent bank in the counterparty’s custodial account. The counterparty has the right to sell or repledge the investment securities.

The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreements as of December 31, 2022 and 2021.

(Dollars in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Liabilities Presented in the Consolidated Balance Sheet	Financial Instruments	Cash Collateral Pledge	Net Amount
December 31, 2022						
Repurchase agreements (a)	**$ 20,368**	**$ —**	**$ 20,368**	**$ (20,368)**	**$ —**	**$ —**
December 31, 2021						
Repurchase agreements (a)	$ 27,377	$ —	$ 27,377	$ (27,377)	$ —	$ —

(a) As of December 31, 2022 and 2021, the fair value of securities pledged in connection with repurchase agreements was $34,160,000 and $37,735,000, respectively.

The following table presents the remaining contractual maturity of the master netting arrangement or repurchase agreements as of December 31, 2022.

(Dollars in thousands)	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 days	Greater 30 -90 Days	Greater than 90 Days	Total
December 31, 2022:					
Repurchase agreements and repurchase-to-maturity transactions:					
U.S. Treasury and/or agency securities	**$ 20,368**	**$ —**	**$ —**	**$ —**	**$ 20,368**
Total	**$ 20,368**	**$ —**	**$ —**	**$ —**	**$ 20,368**

NOTE 7 — LONG-TERM BORROWINGS

Long-term borrowings are comprised of advances from FHLB. Under terms of a blanket agreement, collateral for the FHLB loans is certain qualifying assets of the Bank. The qualifying assets are real estate mortgages and certain investment securities.

A schedule of long-term borrowings by maturity as of December 31, 2022 and 2021 follows:

(Dollars in thousands)

	2022	2021
Due 2022, 2.34%	$ —	$ 10,000
Due 2023, 2.96%	3,000	3,000
Due 2024, 1.68%	20,000	20,000
Due 2028, 5.14%	2,000	2,000
Total long-term borrowings	$ 25,000	$ 35,000

The Corporation's long-term borrowings consist of notes at fixed interest rates. Upon any default, under the terms of a master agreement, FHLB may declare all indebtedness of the Corporation immediately due. In addition, FHLB shall not be required to fund advances under any outstanding commitments.

Irrevocable standby letters of credit may be issued to a customer/beneficiary by the FHLB on the Corporation's behalf in order to secure public/municipal unit deposits, provide credit enhancement to certain transaction types, or to support payment obligations to third parties. These irrevocable standby letters of credit are supported by an irrevocable and independent guarantee by the FHLB for the Corporation's pledging obligation to secure public/municipal unit deposits which eliminates the need for the Corporation to pledge collateral in the amount necessary to secure these funds. The Corporation began utilizing this service offered by the FHLB during the second quarter of 2021. There were no irrevocable standby letters of credit which could be drawn on through FHLB's close of business on December 31, 2022 or 2021. Any irrevocable standby letters of credit are issued as necessary in an amount appropriate to secure specific public/municipal unit deposits.

Under terms of a blanket agreement, collateral for the FHLB loans and letters of credit consists of certain qualifying assets of the Bank. Principal qualifying assets are certain real estate mortgages and investment securities. As of December 31, 2022, loans of $702,548,000 were pledged to FHLB which resulted in a FHLB maximum borrowing capacity of $495,974,000. As of December 31, 2022, no securities were pledged as collateral to FHLB to secure FHLB loans and letters of credit.

NOTE 8 — SUBORDINATED DEBENTURES

On December 10, 2020, the Corporation issued $25,000,000 aggregate principal amount of Subordinated Notes due 2030 (the "2020 Notes") to accredited investors. The 2020 Notes are intended to be treated as Tier 2 capital for regulatory capital purposes. The Corporation utilized the net proceeds it received from the sale of the 2020 Notes to support organic growth and for general corporate purposes.

The 2020 Notes bear a fixed interest rate of 4.375% per year for the first five years and then float based on a benchmark rate (as defined). Interest is payable semi-annually in arrears on June 30 and December 31 of each year, which began on June 30, 2021, for the first five years after issuance and will be payable quarterly in arrears thereafter on March 31, June 30, September 30 and December 31. The 2020 Notes will mature on December 31, 2030 and are redeemable in whole or in part, without premium or penalty, at any time on or after December 31, 2025 and prior to December 31, 2030. Additionally, if all or any portion of the 2020 Notes cease to be deemed Tier 2 capital, the Corporation may redeem, in whole and not in part, at any time upon giving not less than ten days' notice, an amount equal to one hundred percent (100%) of the principal amount outstanding plus accrued but unpaid interest to but excluding the date fixed for redemption.

Holders of the 2020 Notes may not accelerate the maturity of the 2020 Notes, except upon the bankruptcy, insolvency, liquidation, receivership or similar law of the Corporation or the Bank.

NOTE 9 — INCOME TAXES

The current and deferred components of the income tax expense consisted of the following:

(Dollars in thousands)

	2022	2021
Federal		
Current	**$ 2,180**	$ 2,432
Deferred	**114**	(111)
Income tax expense	**$ 2,294**	$ 2,321

The following is a reconciliation between the income tax expense and the amount of income taxes which would have been provided at the statutory rate of 21%:

(Dollars in thousands)

	2022		2021	
	Amount	**Rate**	Amount	Rate
Federal income tax at statutory rate	**$ 3,427**	**21.0 %**	$ 3,572	21.0 %
Tax-exempt income	**(749)**	**(4.6)**	(761)	(4.5)
Low-income housing credits	**(249)**	**(1.5)**	(405)	(2.4)
Bank owned life insurance income	**(125)**	**(0.7)**	(126)	(0.7)
Other	**(10)**	**(0.1)**	41	0.2
Income tax expense and rate	**$ 2,294**	**14.1 %**	$ 2,321	13.6 %

The components of the net deferred tax asset and liability at December 31, 2022 and 2021 are as follows:

(Dollars in thousands)

	2022	2021
Deferred Tax Assets:		
Net unrealized losses on debt securities available-for-sale	**$ 7,857**	$ —
Allowance for loan losses	**1,738**	1,823
Provision for unfunded commitments	**14**	37
Deferred compensation	**238**	260
Contributions	**6**	8
Accrued rent expense	**103**	100
Operating lease liabilities	**426**	315
Finance lease liabilities	**1**	3
Limited partnership investments	**313**	283
Impairment loss on securities	**4**	4
Deferred health insurance	**48**	37
Capital and net operating loss carry forwards	**258**	438
Valuation allowance related to state net operating losses	**(258)**	(438)
Total	**10,748**	2,870
Deferred Tax Liabilities:		
Net unrealized gains on debt securities available-for-sale	**—**	2,017
Loan fees and costs	**237**	164
Net unrealized gains on marketable equity securities	**319**	354
Operating lease right-of-use assets	**426**	315
Accumulated depreciation	**287**	300
Accretion	**36**	41
Mortgage servicing rights	**57**	53
Intangibles	**257**	257
Total	**1,619**	3,501
Net Deferred Tax Asset (Liability)	**$ 9,129**	$ (631)

A valuation allowance for deferred tax assets was recorded in the amount of $258,000 and $438,000 at December 31, 2022 and 2021, respectively. The valuation allowance relates to state net operating loss carryforwards for which realizability is uncertain. At December 31, 2022 and 2021, the Corporation had state net operating loss carryforwards, net of a valuation allowance, of $0, which are available to offset future state taxable income, and expire at various dates through 2042.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible and tax planning strategies, management believes it is more likely than not that the Corporation will realize the benefits of these deferred tax assets, net of any valuation allowance at December 31, 2022.

The Corporation did not have any uncertain tax positions at December 31, 2022 and 2021.

The Corporation and its subsidiary file a consolidated federal income tax return. The Corporation is no longer subject to examination by Federal or State taxing authorities for the years before 2019.

NOTE 10 — EMPLOYEE BENEFIT PLANS AND DEFERRED COMPENSATION AGREEMENTS

The Corporation maintains a 401k Plan which has a combined tax qualified savings feature and profit sharing feature for the benefit of its employees. Effective January 1, 2014, the Plan became a Safe Harbor Plan. Under the savings feature, the Corporation makes safe harbor matching contributions of 100% of the first 3% of compensation an employee contributes to the Plan and 50% of the next 2% of compensation an employee contributes to the Plan. The safe harbor matching contributions amounted to $352,000 and $343,000 in 2022 and 2021, respectively. Under the profit sharing feature, contributions, at the discretion of the Board of Directors, are funded currently and amounted to $442,000 and $518,000 in 2022 and 2021, respectively.

The Corporation also has non-qualified deferred compensation agreements with one of its current officers and five retired officers. These agreements are essentially unsecured promises by the Corporation to make monthly payments to the officers over fifteen or twenty year periods. Payments begin based upon specific criteria — generally, when the officer retires. To account for the cost of payments yet to be made in the future, the Corporation recognizes an accrued liability in years prior to when payments begin based on the present value of those future payments. The Corporation's accrued liability for these deferred compensation agreements, reported in other liabilities on the consolidated balance sheets, as of December 31, 2022 and 2021, was $848,000 and $934,000, respectively. The related expense for these agreements, reported in salaries and employee benefits on the consolidated statements of income, amounted to $36,000 and $65,000 in 2022 and 2021, respectively.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

In the normal course of business, there are various pending legal actions and proceedings that are not reflected in the consolidated financial statements. Management does not believe the outcome of these actions and proceedings will have a material effect on the consolidated financial position of the Corporation.

The Corporation currently leases three branch banking facilities and one parcel of land under operating leases. At December 31, 2022, right-of-use assets and lease liabilities were recorded related to these operating leases totaling $1,541,000 and $2,029,000, respectively, in the consolidated balance sheets. Options to extend or terminate a lease may be included in our lease agreements. When it is reasonably certain that we will exercise those options, the right-of-use asset and lease liability will reflect the renewal or termination option. No significant assumptions or judgements were made in determining whether a contract contained a lease or in the consideration of lease versus non-lease components. None of the leases contained an implicit rate; therefore, our incremental borrowing rate was used for each of the leases.

The Corporation recognized total operating lease costs for the years ended December 31, 2022 and 2021 of $191,000 and $178,000, respectively. Cash payments totaled $177,000 and $156,000 for the years ended December 31, 2022 and 2021, respectively, in the consolidated statements of income.

The Corporation currently has one finance lease for equipment. At December 31, 2022, right-of-use assets and lease liabilities were recorded related to this finance lease totaling $34,000 and $6,000, respectively. Amounts recognized as right-of-use assets related to finance leases are included in premises and equipment, net in the accompanying consolidated balance sheets. Further options to extend or terminate the lease are not applicable. No significant assumptions or judgements were made in determining whether a contract contained a lease or in the consideration of lease versus non-lease components. The lease does not contain an implicit rate; therefore, our incremental borrowing rate was used for the lease.

Total finance lease costs that were recognized by the Corporation for the years ended December 31, 2022 and 2021 were immaterial. Cash payments totaled $10,000 for the years ended December 31, 2022 and 2021.

The following table displays the weighted-average term and discount rates for operating and finance leases outstanding as of December 31, 2022 and 2021.

	December 31, 2022 Operating	December 31, 2021 Operating	**December 31, 2022 Finance**	December 31, 2021 Finance
Weighted-average term (years)	**20.56**	24.51	**0.67**	1.67
Weighted-average discount rate	**4.23%**	3.89%	**0.68%**	0.68%

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total operating lease liability is as follows:

(Dollars in thousands) Minimum Lease Payments due:	**December 31, 2022 Operating**	December 31, 2021 Operating	**December 31, 2022 Finance**	December 31, 2021 Finance
Within one year	**$ 175**	$ 120	**$ 7**	$ 10
After one but within two years	**140**	68	**—**	7
After two but within three years	**140**	68	**—**	—
After three but within four years	**140**	68	**—**	—
After four but within five years	**154**	68	**—**	—
After five years	**2,474**	2,190	**—**	—
Total undiscounted cash flows	**3,223**	2,582	**7**	17
Discount on cash flows	**(1,194)**	(1,083)	**(1)**	(1)
Total lease liability	**$ 2,029**	$ 1,499	**$ 6**	$ 16

NOTE 12 — RELATED PARTY TRANSACTIONS

Certain directors, executive officers and immediate family members of First Keystone Corporation and its subsidiary, and companies in which they are principal owners (i.e., at least 10% ownership), were indebted to the Corporation at December 31, 2022 and 2021. The loans do not involve more than the normal risk of collectability nor present other unfavorable features.

A summary of the activity on the related party loans consists of the following:

(Dollars in thousands)

	2022	2021
Balance at January 1	**$ 11,184**	$ 14,824
Additions	**3,645**	9,558
Deductions	**(5,182)**	(13,198)
Balance at December 31	**$ 9,647**	$ 11,184

The summary of activity on the related party loans represent funds drawn and outstanding at the date of the consolidated financial statements. Commitments by the Bank to related parties on lines of credit and letters of credit for 2022 and 2021, presented an additional off-balance sheet risk to the extent of undisbursed funds in the amounts of $4,492,000 and $4,896,000 respectively, on the above loans.

Deposits from certain officers, directors and immediate family members and/or their related companies held by the Bank amounted to $27,248,000 and $25,995,000 at December 31, 2022 and 2021, respectively.

NOTE 13 — REGULATORY MATTERS

Under Pennsylvania banking law, the Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2022, $24,319,000 of retained earnings were available for dividends without prior regulatory approval, subject to the regulatory capital requirements discussed below. Regulations also limit the amount of loans and advances from the Bank to the Corporation to 10% of consolidated net assets.

The Corporation 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 material effect on the Corporation's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Management believes, as of December 31, 2022 and 2021, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

On July 2, 2013, the Board of Governors of the Federal Reserve System finalized its rule implementing the Basel III regulatory capital framework, which the FDIC adopted on July 9, 2013. Under the rule, minimum requirements increased both the quantity and quality of capital held by banking organizations. Consistent with the Basel III framework, the rule included a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent, and a common equity tier 1 conservation buffer of 2.5 percent of risk-weighted assets, that applies to all supervised financial institutions, which was phased in over a three year period beginning January 1, 2016, with the full 2.5 percent required as of January 1, 2019. The rule also raised the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total capital, tier I capital and common equity tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of tier I capital (as defined) to average assets (as defined).

As of December 31, 2022 the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as Well Capitalized under the regulatory framework for prompt corrective action. To be categorized as Well Capitalized, the Bank must maintain minimum total risk-based, tier 1 risk-based, common equity tier 1 risk-based and tier 1 leverage ratios as set forth in the table. There are no conditions or events since the notification that management believes have changed the Bank's category.

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		Minimum Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2022:								
Total Capital (to Risk-Weighted Assets)	**$ 148,223**	**16.15 %**	**$ 73,429**	**8.00 %**	**$ 96,375**	**10.50 %**	**$ 91,786**	**10.00 %**
Tier 1 Capital (to Risk-Weighted Assets)	**$ 139,881**	**15.24 %**	**$ 55,071**	**6.00 %**	**$ 78,018**	**8.50 %**	**$ 73,429**	**8.00 %**
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	**$ 139,881**	**15.24 %**	**$ 41,304**	**4.50 %**	**$ 64,250**	**7.00 %**	**$ 59,661**	**6.50 %**
Tier 1 Capital (to Average Assets)	**$ 139,881**	**10.38 %**	**$ 53,908**	**4.00 %**	**$ 53,908**	**4.00 %**	**$ 67,385**	**5.00 %**

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		Minimum Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2021:								
Total Capital (to Risk-Weighted Assets)	$ 139,811	16.57 %	$ 67,484	8.00 %	$ 88,572	10.50 %	$ 84,355	10.00 %
Tier 1 Capital (to Risk-Weighted Assets)	$ 130,954	15.52 %	$ 50,613	6.00 %	$ 71,701	8.50 %	$ 67,484	8.00 %
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	$ 130,954	15.52 %	$ 37,960	4.50 %	$ 59,048	7.00 %	$ 54,831	6.50 %
Tier 1 Capital (to Average Assets)	$ 130,954	10.14 %	$ 51,638	4.00 %	$ 51,638	4.00 %	$ 64,548	5.00 %

The capital conservation buffer phase-in began January 1, 2016. The capital conservation buffer of 2.50% was fully phased in effective January 1, 2019.

The Corporation's capital ratios are not materially different from those of the Bank.

NOTE 14 — FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

Financial Instruments with Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation does not engage in trading activities with respect to any of its financial instruments with off-balance sheet risk.

The Corporation's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments.

The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Corporation may require collateral or other security to support financial instruments with off-balance sheet credit risk.

The contract or notional amounts at December 31, 2022 and 2021 were as follows:

(Dollars in thousands)	**December 31, 2022**	December 31, 2021
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	**$ 121,938**	$ 142,335
Financial standby letters of credit	**$ 2,124**	$ 2,000
Performance standby letters of credit	**$ 3,472**	$ 3,727

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 that may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, owner-occupied income-producing commercial properties, and residential real estate.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee payment to a third party when a customer either fails to repay an obligation or fails to perform some non-financial obligation. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation may hold collateral (similar to the items held as collateral for commitments to extend credit) to support standby letters of credit for which collateral is deemed necessary.

Financial Instruments with Concentrations of Credit Risk

The Corporation originates primarily commercial and residential real estate loans to customers in northeastern Pennsylvania. The ability of the majority of the Corporation's customers to honor their contractual loan obligations is dependent on the economy and real estate market in this area. At December 31, 2022, the Corporation had $766,056,000 in loans secured by real estate, which represented 89.2% of total loans. The real estate loan portfolio is largely secured by lessors of residential buildings and dwellings, lessors of non-residential buildings, and lessors of hotels/motels. As of December 31, 2022 and 2021, management is of the opinion that there were no concentrations exceeding 10% of total loans with regard to loans to borrowers who were engaged in similar activities that were similarly impacted by economic or other conditions.

As all financial instruments are subject to some level of credit risk, the Corporation requires collateral and/or guarantees for all loans. Collateral may include, but is not limited to property, plant, and equipment, commercial and/or residential real estate property, land, and pledge of securities. In the event of a borrower's default, the collateral supporting the loan may be seized in order to recoup losses associated with the loan. The Corporation also establishes an allowance for loan losses that constitutes the amount available to absorb losses within the loan portfolio that may exist due to deficiencies in collateral values.

NOTE 15 — STOCKHOLDERS' EQUITY

The Corporation also offers to its shareholders a Dividend Reinvestment and Stock Purchase Plan. Participation in this plan by shareholders began in 2001. The plan provides First Keystone shareholders a convenient and economical way to purchase additional shares of common stock by reinvesting dividends. A plan participant can elect full dividend reinvestment or partial dividend reinvestment provided at least 25 shares are enrolled in the plan. In addition, plan participants may make additional voluntary cash purchases of common stock under the plan of not less than $100 per calendar quarter or more than $2,500 in any calendar quarter.

Shares transferred under this Dividend Reinvestment and Stock Purchase Plan were 71,928 in 2022 and 63,554 in 2021. Remaining shares authorized in the plan were 322,607 as of December 31, 2022.

Shares of First Keystone common stock are purchased for the plan either in the open market by an independent broker on behalf of the plan, directly from First Keystone as original issue shares, or through negotiated transactions. A combination of the previous methods could also occur.

NOTE 16 — FAIR VALUE MEASUREMENTS

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. This guidance provides additional information on determining when the volume and level of activity for the asset or liability has significantly decreased. The guidance also includes information on identifying circumstances when a transaction may not be considered orderly.

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with the fair value measurement and disclosure guidance.

This guidance clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own belief about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances. Fair value measurement and disclosure guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Inputs: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 Inputs: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth as follows.

Financial Assets Measured at Fair Value on a Recurring Basis

At December 31, 2022 and 2021, securities measured at fair value on a recurring basis and the valuation methods used are as follows:

(Dollars in thousands)

December 31, 2022	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt Securities Available-for-Sale:				
U.S. Treasury securities	$ 6,801	$ —	$ —	$ 6,801
Obligations of U.S. Government Agencies and Sponsored Agencies:				
Mortgaged-backed	—	131,675	—	131,675
Other	—	11,180	—	11,180
Other mortgage backed debt securities	—	33,688	—	33,688
Obligations of state and political subdivisions	—	110,689	—	110,689
Asset-backed securities	—	36,418	—	36,418
Corporate debt securities	—	42,993	—	42,993
Total debt securities available-for-sale	6,801	366,643	—	373,444
Marketable equity securities	1,699	—	—	1,699
Total recurring fair value measurements	$ 8,500	$ 366,643	$ —	$ 375,143

(Dollars in thousands)

December 31, 2021	Level 1	Level 2	Level 3	Total
Debt Securities Available-for-Sale:				
U.S. Treasury securities	$ 7,729	$ —	$ —	$ 7,729
Obligations of U.S. Government Agencies and Sponsored Agencies:				
Mortgaged-backed	—	114,911	—	114,911
Other	—	7,576	—	7,576
Other mortgage backed debt securities	—	39,550	—	39,550
Obligations of state and political subdivisions	—	186,176	—	186,176
Asset-backed securities	—	36,542	—	36,542
Corporate debt securities	—	45,432	—	45,432
Total debt securities available-for-sale	7,729	430,187	—	437,916
Marketable equity securities	1,962	—	—	1,962
Total recurring fair value measurements	$ 9,691	$ 430,187	$ —	$ 439,878

The estimated fair values of equity securities and US Treasury debt securities classified as Level 1 are derived from quoted market prices in active markets; the equity securities consist mainly of stocks held in other banks. The estimated fair values of all other debt securities classified as Level 2 are obtained from nationally-recognized third-party pricing agencies. The estimated fair values are derived primarily from cash flow models, which include assumptions for interest rates, credit losses, and prepayment speeds. The significant inputs utilized in the cash flow models are based on market data obtained from sources independent of the Corporation (observable inputs), and are therefore classified as Level 2 within the fair value hierarchy. The Corporation does not have any Level 3 inputs for securities. There were no transfers between Level 1 and Level 2 during 2022 and 2021.

Financial Assets Measured at Fair Value on a Nonrecurring Basis

At December 31, 2022 and 2021, impaired loans measured at fair value on a nonrecurring basis and the valuation methods used are as follows:

(Dollars in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets at December 31, 2022				
Impaired loans:				
Commercial Real Estate	**$ —**	**$ —**	**$ 5,167**	**$ 5,167**
Residential Real Estate	**—**	**—**	**30**	**30**
Total impaired loans	**$ —**	**$ —**	**$ 5,197**	**$ 5,197**

(Dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets at December 31, 2021				
Impaired loans:				
Commercial Real Estate	$ —	$ —	$ 5,954	$ 5,954
Residential Real Estate	—	—	30	30
Total impaired loans	$ —	$ —	$ 5,984	$ 5,984

The Corporation's impaired loan valuation procedure for any loans greater than $250,000 requires an appraisal to be obtained and reviewed annually at year end unless the Board of Directors waives such requirement for a specific loan, in favor of obtaining a Certificate of Inspection instead, defined as an internal evaluation completed by the Corporation. A quarterly collateral evaluation is performed which may include a site visit, property pictures and discussions with realtors and other similar business professionals to ascertain current values. For impaired loans less than $250,000 upon classification and annually at year end, the Corporation completes a Certificate of Inspection, which includes an onsite inspection, and considers value indicators such as insured values, tax assessed values, recent sales comparisons and a review of the previous evaluations. These assets are included as Level 3 fair values, based upon the lowest level that is significant to the fair value measurements. The fair value consists of the impaired loan balances less the valuation allowance and/or charge-offs. There were no transfers between valuation levels in 2022 and 2021.

Nonfinancial Assets Measured at Fair Value on a Nonrecurring Basis

There were no foreclosed assets held for resale measured at fair value on a nonrecurring basis at December 31, 2022 or December 31, 2021.

The Corporation's foreclosed asset valuation procedure requires an appraisal or a Certificate of Inspection, which considers the sales prices of similar properties in the proximate vicinity, to be completed periodically with the exception of those cases in which the Bank has obtained a sales agreement. These assets are included as Level 3 fair values, based upon the lowest level that is significant to the fair value measurements. There were no transfers between valuation levels in 2022 and 2021.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Corporation has utilized Level 3 inputs to determine the fair value:

(Dollars in thousands)	Quantitative Information about Level 3 Fair Value Measurements				
December 31, 2022	Fair Value Estimate	Valuation Technique	Unobservable Input	Range	Weighted Average
Impaired loans - collateral dependent	**$ 2,370**	**Appraisal of collateral[1,3] Certificate of Inspection[1,3]**	**Appraisal adjustments[2] Qualitative Adjustments[4]**	**(0%) – (5%)**	**(5%)**
Impaired loans - other	**$ 2,827**	**Discounted cash flow**	**Discount rate**	**(4%) – (7%)**	**(6%)**
December 31, 2021					
Impaired loans - collateral dependent	$ 3,120	Appraisal of collateral[1,3] Certificate of Inspection[1,3]	Appraisal adjustments[2] Qualitative Adjustments[4]	(15%) – (44%)	(15%)
Impaired loans - other	$ 2,864	Discounted cash flow	Discount rate	(7%) – (7%)	(7%)

1. Fair value is generally determined through independent appraisals or Certificates of Inspection of the underlying collateral, as defined by Bank regulators.
2. Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The typical range of appraisal adjustments are presented as a percent of the appraisal value.
3. Includes qualitative adjustments by management and estimated liquidation expenses.
4. Collateral values may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses.

Fair Value of Financial Instruments Measured on a Nonrecurring Basis

(Dollars in thousands)	Carrying Amount	Fair Value Measurements at December 31, 2022			
		Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS:					
Cash and due from banks	**$ 9,441**	**$ 9,441**	**$ —**	**$ —**	**$ 9,441**
Interest-bearing deposits in other banks	**1,297**	**—**	**1,297**	**—**	**1,297**
Time deposits with other banks	**—**	**—**	**—**	**—**	**—**
Restricted investment in bank stocks	**7,136**	**—**	**7,136**	**—**	**7,136**
Net loans	**850,195**	**—**	**—**	**810,104**	**810,104**
Mortgage servicing rights	**319**	**—**	**—**	**319**	**319**
Accrued interest receivable	**4,391**	**—**	**4,391**	**—**	**4,391**
FINANCIAL LIABILITIES:					
Demand, savings and other deposits	**827,399**	**—**	**827,399**	**—**	**827,399**
Time deposits	**166,100**	**—**	**160,472**	**—**	**160,472**
Short-term borrowings	**153,418**	**—**	**153,209**	**—**	**153,209**
Long-term borrowings	**25,000**	**—**	**24,090**	**—**	**24,090**
Subordinated debentures	**25,000**	**—**	**22,365**	**—**	**22,365**
Accrued interest payable	**563**	**—**	**563**	**—**	**563**
OFF-BALANCE SHEET FINANCIAL INSTRUMENTS	—	—	—	—	—

(Dollars in thousands)	Carrying Amount	Fair Value Measurements at December 31, 2021			
		Level 1	Level 2	Level 3	Total
FINANCIAL ASSETS:					
Cash and due from banks	$ 9,600	$ 9,600	$ —	$ —	$ 9,600
Interest-bearing deposits in other banks	51,738	—	51,738	—	51,738
Time deposits with other banks	247	—	247	—	247
Restricted investment in bank stocks	1,919	—	1,919	—	1,919
Net loans	744,161	—	—	762,914	762,914
Mortgage servicing rights	367	—	—	367	367
Accrued interest receivable	4,361	—	4,361	—	4,361
FINANCIAL LIABILITIES:					
Demand, savings and other deposits	904,877	—	904,877	—	904,877
Time deposits	173,092	—	172,897	—	172,897
Short-term borrowings	27,377	—	27,380	—	27,380
Long-term borrowings	35,000	—	35,987	—	35,987
Subordinated debentures	25,000	—	24,384	—	24,384
Accrued interest payable	251	—	251	—	251
OFF-BALANCE SHEET FINANCIAL INSTRUMENTS	—	—	—	—	—

NOTE 17 — REVENUE RECOGNITION

The Corporation has elected to apply the guidance outlined in FASB ASC 606 regarding the measurement or recognition of revenue. The main types of revenue contracts included in non-interest income within the Consolidated Statements of Income which are subject to ASC 606 are as follows:

Deposit related fees and service charges

Service charges and fees on deposits, which are included as liabilities in the consolidated balance sheets, consist of fees related to monthly fees for various retail and business checking accounts, automated teller machine ("ATM") fees (charged for withdrawals by our deposit customers from other bank ATMs) and insufficient funds fees ("NSF") (which are charged when customers overdraw their accounts beyond available funds). All deposit liabilities are considered to have one-day terms and therefore related fees are recognized in income at the time when the services are provided to the customers. The Corporation elected to adopt practical expedient related to incremental costs of obtaining deposit contracts. As such, any costs associated with acquiring the deposits, except for certificate of deposits ("CDs") with maturities in excess of one year, are recognized as an expense within the non-interest expense in the consolidated statements of income when incurred as the amortization period of the deposit liabilities that otherwise would have been recognized is one year or less.

Wealth/Asset/Trust Management Fees

Wealth management services are delivered to individuals, corporations and retirement funds located primarily within our geographic markets. The Trust Department of the Corporation conducts the wealth management operations, which provides a broad range of personal and corporate fiduciary services, including the administration of estates.

Assets held in a fiduciary capacity by the Trust Department are not assets of the Corporation and, therefore, are not included in our Consolidated Financial Statements. Wealth management fees, which are contractually agreed with each customer, are earned each month and recognized on a cash basis based on average fair value of the trust assets under management. The services provided under such a contract are considered a single performance obligation under ASC 606 because they embody a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Wealth management fees charged by the Trust Department follow a tiered structure based on the type and size of the assets under management. Wealth management fees are included within non-interest income in the consolidated statements of income. As of December 31, 2022 and 2021, the fair value of trust assets under management was $111,172,000 and $108,339,000, respectively. The costs of acquiring asset management customers are incremental and recognized within the non-interest expense of the consolidated statements of income.

Interchange Fees and Surcharges

Interchange fees are related to the acceptance and settlement of debit card transactions, both point-of-sale and ATM, to cover operating costs and risks associated with the approval and settlement of the transactions. Interchange fees vary by type of transaction and each merchant sector. Net income recognized from interchange fees is included in non-interest income on the consolidated statements of income. A surcharge is assessed for use of the Corporation's ATMs by non-customers. All interchange fees and surcharges are recognized as received on a daily basis for the prior business day's transactions. All expenses related to the settlement of debit card transactions (both point-of-sale and ATM) are recognized on a monthly basis and included in non-interest expense on the consolidated statements of income.

NOTE 18 – GOODWILL

Goodwill resulted from the acquisition of the Pocono Community Bank in November 2007 and of certain fixed and operating assets acquired and deposit liabilities assumed of the branch of another financial institution in Danville, Pennsylvania, in January 2004. Such goodwill represents the excess cost of the acquired assets relative to the assets' fair value at the dates of acquisition. In accordance with current accounting standards, goodwill is not amortized. Goodwill totaled $19,133,000 at December 31, 2022 and December 31, 2021.

Impairment testing is performed on an annual basis, using either a qualitative or quantitative approach. The assumptions used in the impairment test of goodwill are susceptible to change based on changes in economic conditions and other factors, including our stock price. Any change in the assumptions utilized to determine the carrying value of goodwill could adversely affect our results of operations. Management notes that the emergence of COVID-19 as a global pandemic in 2020 and throughout 2021 resulted in significant deterioration in general economic conditions and the environment in which the Company operates. This uncertainty resulted in significant decreases in the market prices for the stock of institutions in the financial services industry, including the Company, however, many stock prices recovered throughout 2021 and 2022.

Goodwill was evaluated for impairment at December 31, 2022, and it was determined that goodwill was not impaired. Management evaluated the need for an interim goodwill impairment analysis and determined that there were no triggering events or negative factors affecting goodwill since the previous test that would indicate goodwill was impaired as of December 31, 2022.

NOTE 19 — PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for First Keystone Corporation (parent company only) was as follows:

BALANCE SHEETS

(Dollars in thousands)

	December 31,	
	2022	2021
ASSETS		
Cash	**$ 13,860**	$ 13,788
Investment in banking subsidiary	**129,456**	157,675
Marketable equity securities	**1,699**	1,962
Prepaid expenses and other assets	**854**	894
TOTAL ASSETS	**$ 145,869**	$ 174,319
LIABILITIES		
Advances from banking subsidiary	**$ 168**	$ 413
Subordinated Debentures	**25,000**	25,000
Accrued expenses and other liabilities	**315**	351
TOTAL LIABILITIES	**25,483**	25,764
STOCKHOLDERS' EQUITY		
Common stock	**12,502**	12,358
Surplus	**42,439**	40,940
Retained earnings	**100,712**	93,378
Accumulated other comprehensive (loss) income	**(29,558)**	7,588
Treasury stock, at cost	**(5,709)**	(5,709)
TOTAL STOCKHOLDERS' EQUITY	**120,386**	148,555
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 145,869**	$ 174,319

STATEMENTS OF INCOME

(Dollars in thousands)

	Years Ended December 31, 2022	2021
INCOME		
Dividends from subsidiary bank	**$ 6,102**	$ 6,043
Net securities (losses) gains	**(93)**	323
Other income	**98**	105
TOTAL INCOME	**6,107**	6,471
EXPENSE		
Interest on subordinated debt	**1,091**	1,094
Other expense	**195**	187
TOTAL EXPENSE	**1,286**	1,281
INCOME BEFORE INCOME TAX BENEFIT	**4,821**	5,190
INCOME TAX BENEFIT	**(275)**	(186)
	5,096	5,376
EQUITY IN UNDISTRIBUTED EARNINGS OF BANKING SUBSIDIARY	**8,928**	9,312
NET INCOME	**$ 14,024**	$ 14,688

STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Dollars in thousands)

	Years Ended December 31, 2022	2021
Net Income	**$ 14,024**	$ 14,688
Other comprehensive loss:		
Equity in other comprehensive loss of banking subsidiary	**(37,146)**	(5,282)
Total other comprehensive loss	**(37,146)**	(5,282)
Total Comprehensive (Loss) Income	**$ (23,122)**	$ 9,406

STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended December 31,	
	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 14,024**	$ 14,688
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses (gains) on securities	**93**	(323)
Deferred income tax (benefit) expense	**(34)**	91
Equity in undistributed earnings of banking subsidiary	**(8,928)**	(9,312)
Increase (decrease) in prepaid/accrued expenses and other assets/liabilities	**47**	(168)
Decrease in advances from banking subsidiary	**(245)**	(110)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**4,957**	4,866
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of equity securities	**170**	6
NET CASH PROVIDED BY INVESTING ACTIVITIES	**170**	6
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	**1,635**	1,511
Dividends paid	**(6,690)**	(6,617)
NET CASH USED IN FINANCING ACTIVITIES	**(5,055)**	(5,106)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**72**	(234)
CASH AND CASH EQUIVALENTS, BEGINNING	**13,788**	14,022
CASH AND CASH EQUIVALENTS, ENDING	**$ 13,860**	$ 13,788

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

First Keystone Corporation maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) designed to ensure that information required to be disclosed in the reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those disclosure controls and procedures performed as of the end of the period covered by this report, the Chief Executive Officer and Chief Financial Officer of the Corporation concluded that the Corporation's disclosure controls and procedures were effective as of December 31, 2022.

Management's Report on Internal Control Over Financial Reporting

The management of First Keystone Corporation is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934). The Corporation's internal control system was designed to provide reasonable assurance to the Corporation's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

The management of First Keystone Corporation, along with participation of the Chief Executive Officer and the Chief Financial Officer, assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2022. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the *Internal Control — Integrated Framework (2013)*. Based on our assessment we believe that, as of December 31, 2022, the Corporation's internal control over financial reporting is effective based on those criteria.

First Keystone Corporation's independent registered public accounting firm that audited the consolidated financial statements has issued an audit report on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2022. This report can be found in Item 8 of this Form 10-K.

Changes in Internal Control over Financial Reporting

Other than the changes described above, there were no changes in the Corporation's internal control over financial reporting during the fiscal quarter ended December 31, 2022, that materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

There was no information required on Form 8-K during this quarter that was not reported.

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not Applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information under the captions "Information As To Directors and Nominees," "Principal Officers of the Bank and the Corporation," "Committees of the Board of Directors" and "Section 16(A) Beneficial Ownership Reporting Compliance" are incorporated here by reference from First Keystone Corporation's definitive proxy statement.

CODE OF ETHICS

The Corporation has adopted a Directors and Senior Management Code of Ethics, which applies to all members of the Board of Directors and to senior officers of the Corporation. It can be found on the Investor Relations section of our website at https://.firstkeystonecorp.fkc.bank.

ITEM 11. EXECUTIVE COMPENSATION

The information under the captions "Executive Compensation" and "Oversight of Executive Compensation and Director Nominations" are incorporated here by reference from First Keystone Corporation's definitive proxy statement.

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

The information under the caption "Share Ownership" is incorporated here by reference from First Keystone Corporation's definitive proxy statement.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans excluding securities reflected in column (a) (c)
Equity compensation plans approved by shareholders	—	$ —	—
Equity compensation plans not approved by shareholders	—	—	—
Total	—	$ —	—

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

The information under the captions "Related Person Transactions" and "Governance of the Company" are incorporated here by reference from First Keystone Corporation's definitive proxy statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information under the captions "Report of the Audit Committee" and "Proposal No. 2: Ratification of Independent Registered Public Accounting Firm" are incorporated here by reference from First Keystone Corporation's definitive proxy statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Financial Statements

The following consolidated financial statements are included in Part II, Item 8, of this Report:

First Keystone Corporation and Subsidiary.

2. Financial Statement Schedules

Financial statements schedules are omitted because the required information is either not applicable, not required, or is shown in the financial statements or in their notes.

ITEM 16. FORM 10-K SUMMARY

None.

3. Exhibits

Exhibits required by Item 601 of Regulation S-K:

Exhibit Number Referred to

Item 601 of Regulation S-K	Description of Exhibit
3i	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3(i) to the Registrant's Report on Form 8-K dated August 28, 2018).
3ii	By-Laws, as amended and restated (Incorporated by reference to Exhibit 3(ii) to the Registrant's Report on Form 8-K dated August 28, 2018).
10.1(a)	Supplemental Employee Retirement Plan – J. Gerald Bazewicz (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).*
10.1(b)	Supplemental Employee Retirement Plan – David R. Saracino (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).*
10.1(d)	Supplemental Employee Retirement Plan – Elaine Woodland (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013).*

Item 601 of Regulation S-K	Description of Exhibit
10.2	Management Incentive Compensation Plan (Incorporated by reference to Exhibit 10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018).*
10.4	First Keystone Corporation 1998 Stock Incentive Plan (Incorporated by reference to Exhibit 10 to Registrant's Report on Form 10-Q for the quarter ended September 30, 2006).*
14	First Keystone Corporation Directors and Senior Management Code of Ethics (Incorporated by reference to Exhibit 99.1 to Registrant's Report on Form 8-K dated August 27, 2013).
21	List of Subsidiaries of the Issuer, filed with this annual report on Form 10-K.**
23.1	Consent of Baker Tilly US, LLP.**
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.**
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.**
32.1	Section 1350 Certification of Chief Executive Officer.**
32.2	Section 1350 Certification of Chief Financial Officer.**
101.INS	XBRL Instance Document.**
101.SCH	XBRL Taxonomy Extension Schema Document.**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.**
104	Cover Page Interactive Data File (Formatted as Inline XBRL and Contained in Exhibit 101)

* Denotes a compensatory plan.
** Filed herewith.

The Corporation will provide a copy of any exhibit upon receipt of a written request for the particular exhibit or exhibits desired. All requests should be addressed to the Corporation's principal executive offices.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST KEYSTONE CORPORATION

/s/ Elaine A. Woodland

Elaine A. Woodland
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 15, 2023

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

/s/ John E. Arndt	March 15, 2023
John E. Arndt, Vice Chairman/Director	Date
/s/ D. Matthew Bower	March 15, 2023
D. Matthew Bower, Director	Date
/s/ Robert A. Bull	March 15, 2023
Robert A. Bull, Chairman/Director	Date
/s/ Whitney B. Holloway	March 15, 2023
Whitney B. Holloway, Director	Date
/s/ Michael L. Jezewski	March 15, 2023
Michael L. Jezewski, Director	Date
/s/ Nancy J. Marr	March 15, 2023
Nancy J. Marr, Director	Date
/s/ William E. Rinehart	March 15, 2023
William E. Rinehart, Director	Date
/s/ Diane C.A. Rosler	March 15, 2023
Diane C.A. Rosler, Chief Financial Officer (Principal Financial Officer)	Date
/s/ David R. Saracino	March 15, 2023
David R. Saracino, Secretary/Director	Date
/s/ Elaine A. Woodland	March 15, 2023
Elaine A. Woodland, President/ Chief Executive Officer/Director	Date

EXHIBIT 21

FIRST KEYSTONE CORPORATION

LIST OF SUBSIDIARIES OF THE ISSUER

Direct Subsidiary: First Keystone Community Bank, Pennsylvania state chartered commercial bank.

The consolidated financial statements include the accounts of the Corporation and its subsidiary.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-3D (No. 333-227152) and Form S-3/A (No. 333-228140) of First Keystone Corporation of our report dated March 15, 2023, relating to the consolidated financial statements and the effectiveness of First Keystone Corporation's internal control over financial reporting, which appears in this annual report on Form 10-K for the year ended December 31, 2022.

/s/ Baker Tilly US, LLP (formerly known as Baker Tilly Virchow Krause, LLP)

Iselin, New Jersey
March 15, 2023

EXHIBIT 31.1

FIRST KEYSTONE CORPORATION
CERTIFICATION

I, Elaine A. Woodland, certify that:

1. I have reviewed this annual report on Form 10-K for the period ended December 31, 2022, of First Keystone Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Elaine A. Woodland
Elaine A. Woodland
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 15, 2023

EXHIBIT 31.2

FIRST KEYSTONE CORPORATION
CERTIFICATION

I, Diane C.A. Rosler, certify that:

1. I have reviewed this annual report on Form 10-K for the period ended December 31, 2022, of First Keystone Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Diane C.A. Rosler
Diane C.A. Rosler
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: March 15, 2023

EXHIBIT 32.1

FIRST KEYSTONE CORPORATION

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of First Keystone Corporation (the “Corporation”) for the period ended December 31, 2022, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Elaine A. Woodland, President and Chief Executive Officer, certify, pursuant to and for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation as of and for the period covered by the Report.

/s/ Elaine A. Woodland

Elaine A. Woodland
President and Chief Executive Officer
(Principal Executive Officer)

March 15, 2023

A signed original of this written statement required by Section 906 has been provided to the Corporation and will be retained by the Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

FIRST KEYSTONE CORPORATION

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of First Keystone Corporation (the “Corporation”) for the period ended December 31, 2022, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Diane C.A. Rosler, Chief Financial Officer, certify, pursuant to and for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation as of and for the period covered by the Report.

/s/ Diane C.A. Rosler
Diane C.A. Rosler
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

March 15, 2023

A signed original of this written statement required by Section 906 has been provided to the Corporation and will be retained by the Corporation and furnished to the Securities and Exchange Commission or its staff upon request.