GRAND RIVER
COMMERCE, INC.

FINANCIAL STATEMENTS

Year Ending

December 31, 2022

GRAND RIVER COMMERCE, INC.

Table of Contents

	Page
Management's Report	1
Key Ratios	4
Independent Auditors' Report	6
Consolidated Financial Statements for the Years Ended December 31, 2022 and 2021	
Consolidated Balance Sheets	9
Consolidated Statements of (Loss) Income	10
Consolidated Statements of Comprehensive (Loss) Income	11
Consolidated Statements of Shareholders' Equity	12
Consolidated Statements of Cash Flows	13
Notes to Consolidated Financial Statements	14

GRAND RIVER
COMMERCE, INC.

April 12, 2023

To our valued shareholders:

We present for your review the audited consolidated financial statements of Grand River Commerce, Inc. ("Company") and its subsidiary, Grand River Bank ("Bank"), for the twelve-month period ended December 31, 2022.

As of December 31, 2022, total assets of the Company stood at $530 million, an increase of $41 million, or 8%, from year-end 2021. Our loan portfolio grew $79 million, or 21%, net of the repayment of Paycheck Protection Program ("PPP") loans. This growth was primarily funded with existing cash and cash equivalents which declined $36 million and deposits, which increased by $34 million during the period, or 8%, from year-end 2021.

Asset quality at year-end remained exceptionally strong, with no charge-offs, negligible delinquency and one relatively small non-performing loan relationship. As has always been our practice, we continue to rigorously monitor our overall portfolio and communicate frequently with our customers. The majority of our commercial customers continue to report high demand for their products and services, and are performing well, with several posting record revenue and earnings. Our single non-performing borrowing relationship is well-secured, remains current on payments and poses virtually no risk of loss.

At year-end, our allowance for loan losses stood at 1.29%, compared to 1.27% as of December 31, 2021. In accordance with accounting standards, we calculate our reserve, in part, by analyzing portfolio mix and applying quantitative and qualitative factors, including lagging indicators that represent overall economic conditions and trends in our portfolio. The methodology will be changing for 2023 as we adopt "CECL", as required. Specifically, *ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* commonly referred to as CECL. This change was effective as of January 1, 2023.

As will be discussed in the following paragraphs, the Company, as of December 31, posted a net loss of $2.2 million, while the Bank, inclusive of GRMC, reported a consolidated net loss of $1.5 million. Consolidated performance was impacted by expenses associated with the development of Grand River Mortgage Company, LLC ("GRMC"). It's important to note that, excluding the investment in GRMC, the Bank generated solid net income of $2.1 million. The following table provides additional detail:

Total interest income	$ 19,075
Total interest expense	3,626
Net interest income	**15,449**
Provision expense	1,062
Non interest income	925
Non interest expense	12,679
Income before income tax	**2,633**
Income tax expense	509
Net income	**$ 2,124**

Grand River Bank is known for consistent growth, strong earnings, pristine asset quality and a uniquely-attractive position in the markets we serve. As we've shared in previous communications, our investment in GRMC, a nationwide mortgage lending subsidiary, is intended to create future income diversification, provide additional financial resources to support the continued expansion of our core West Michigan banking franchise, increase the value of the Company for the benefit of our shareholders, and provide the Bank and our team members with even greater opportunities. The decision to proceed with GRMC was made following a year of rigorous evaluation, financial modeling, and thorough stress testing of a variety of environmental conditions, including market contraction and rapidly rising interest rates. The Bank's directors were advised during their evaluation by a group of nationally-known CPA's, compensation consultants, project managers, and attorneys.

GRMC is led by an industry-leading team with deep experience and a track record of success in all market conditions. The operating platform was largely completed in 2022. Experienced lenders were hired, and loan production began ramping up at the end of the year. As is the case with virtually all start-ups, GRMC is experiencing losses, as production revenue has not had time to catch up with fixed costs. While we cannot predict with certainty the ultimate trajectory of the overall economy and we acknowledge that there are factors beyond our control, our expectation, based upon the experience of our board of directors and combined leadership team – is that Grand River Bank will continue to perform well and that GRMC will achieve its anticipated potential.

Our most-current forecast anticipates that GRMC will begin to generate a meaningful contribution to the Company's consolidated net income by the 4th quarter of 2023. This forecast has been revised to reflect actual performance and current market conditions experienced at the time of this letter. As the steep interest rate increases from the last two quarters of 2022 and early 2023 have begun to abate, market stability provides the basis for our continued confidence. This position is shared by leading US banks with significant stakes in the national mortgage market, leading us to continue our support for the development of our platform.

The future of Grand River Bank as a leading institution in our market is backed by the directors' commitment to a level of performance that rivals our competition. The most recent financial plan approved by the board of directors factors the strength of our market, the skill of our team and the need to provide our stakeholders with a return on investment commensurate with the size and age of our institution.

Led by rising interest rates and growth in earning assets, net interest income increased $1.4 million, or 10.6%, on a year-over-year basis. Overall, this increase compensated for the $1.2 million year-over-year decrease in PPP-related fee income which, in accordance with accounting standards, was recognized over the life of the loans. From the Bank's perspective, the program worked as intended and, as of December 31, 2022, all PPP loans that we originated have been forgiven. As a result, all net fees on those loans have been reflected in interest income.

Non-interest income declined $2.0 million, or 64%, from last year, primarily due to a reduction in the volume of residential mortgage loans sold to secondary market investors and lower aggregate fees realized from those sales. Rising interest rates and other economic factors may further distort local market dynamics, contribute to production limitations over which we have no control and continue to diminish the contribution from our West Michigan mortgage unit in future reporting periods.

GRAND RIVER
COMMERCE, INC.

Non-interest expense (NIE) increased $5.5 million, or 45%, year-over-year. Approximately $4.8 million of the increase is attributable to startup expenses for GRMC. Of the remaining $779,000 increase, approximately $159,000 is from deferred salaries and benefit expenses associated with the second round of PPP lending in 2021. As with PPP-related fee income, origination costs are recognized over the lives of the loans. Funds for PPP expired in 2021 and no additional loans will be made under that program. The remaining NIE increase of $620,000 represents greater occupancy expenses, investments in software, and other operational items.

Maintaining capital ratios that meet or exceed the regulatory definition of well-capitalized continues to be a priority. As has been the case since its inception, the Bank again met those requirements as of December 31, 2022. The Company holds some reserves that can further support the growth of the Bank and the Company and is prepared to obtain additional funding should it become necessary to provide a cushion in the event of excessive or sustained economic pressure.

Grand River Bank continues to be a West Michigan employer-of-choice and GRMC is quickly earning that distinction among nationwide mortgage companies. Our team members and our board of directors make our Bank a premier financial partner to all those who rely upon us and we're deeply grateful to each of them.

At year-end, Liz Bracken, President and CFO of Grand River Bank, closed out her highly successful career with the Company. Liz was team member number two and joined the Company while it was in formation. Over the course of 15 eventful years, Liz provided a wealth of knowledge and was a role model for servant leadership. We are beyond grateful for her countless contributions, and we wish her all the best.

Following an extensive search that involved a number of outstanding candidates, Drew Ysseldyke has been named president of Grand River Bank. An exceptional individual, an inspirational leader and a 25-year West Michigan banker, Drew is ideally suited for our Bank and our culture. In partnership with our team members and our directors, Drew will play an integral role in delivering on the promise of our potential.

Our financial results are always available via the Investor Relations section of our website, www.grandriverbank.com. We encourage you to use this comprehensive resource to track our performance and to gain valuable information about your investment in our Company. Thank you for your investment and your continued support.

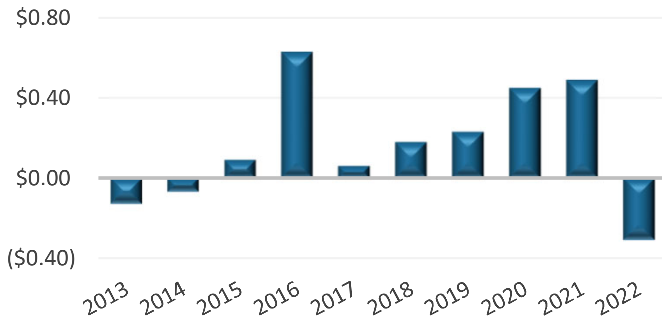
Sincerely,

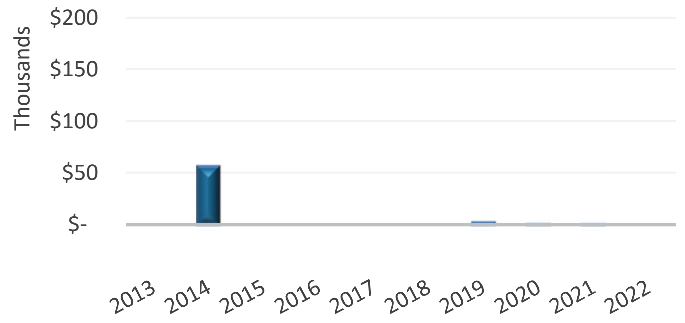
Robert P. Bilotti
Chairman, President & CEO
Grand River Commerce, Inc.
(616) 929-1600
robert.bilotti@grandriverbank.com

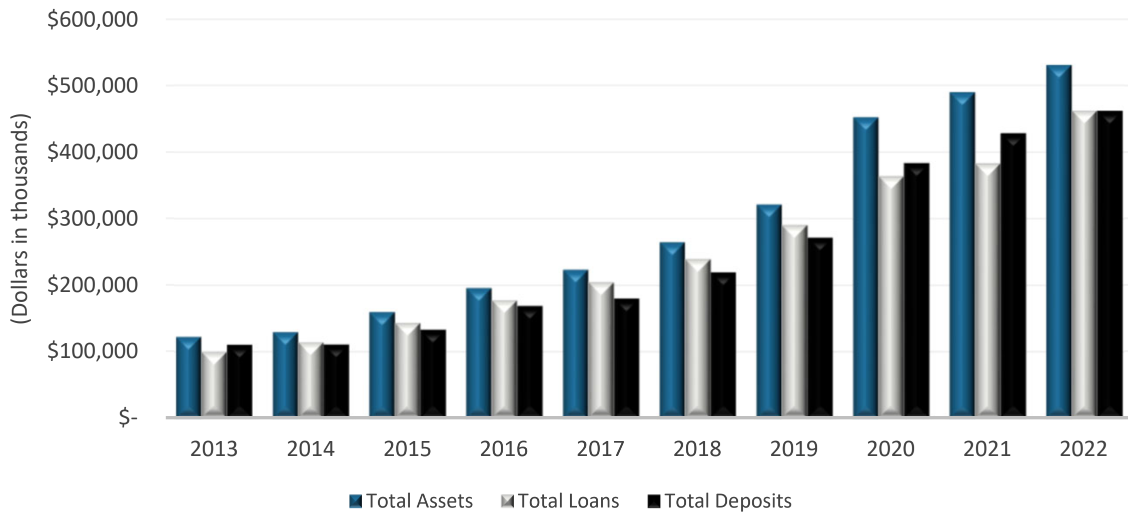
Patrick K. Gill
President & CEO
Grand River Bank
(616) 929-1611
pat.gill@grandriverbank.com

Kevin J. VanSingel
VP / Interim CFO
Grand River Bank
(616) 259-1301
kevin.vansingel@grandriverbank.com

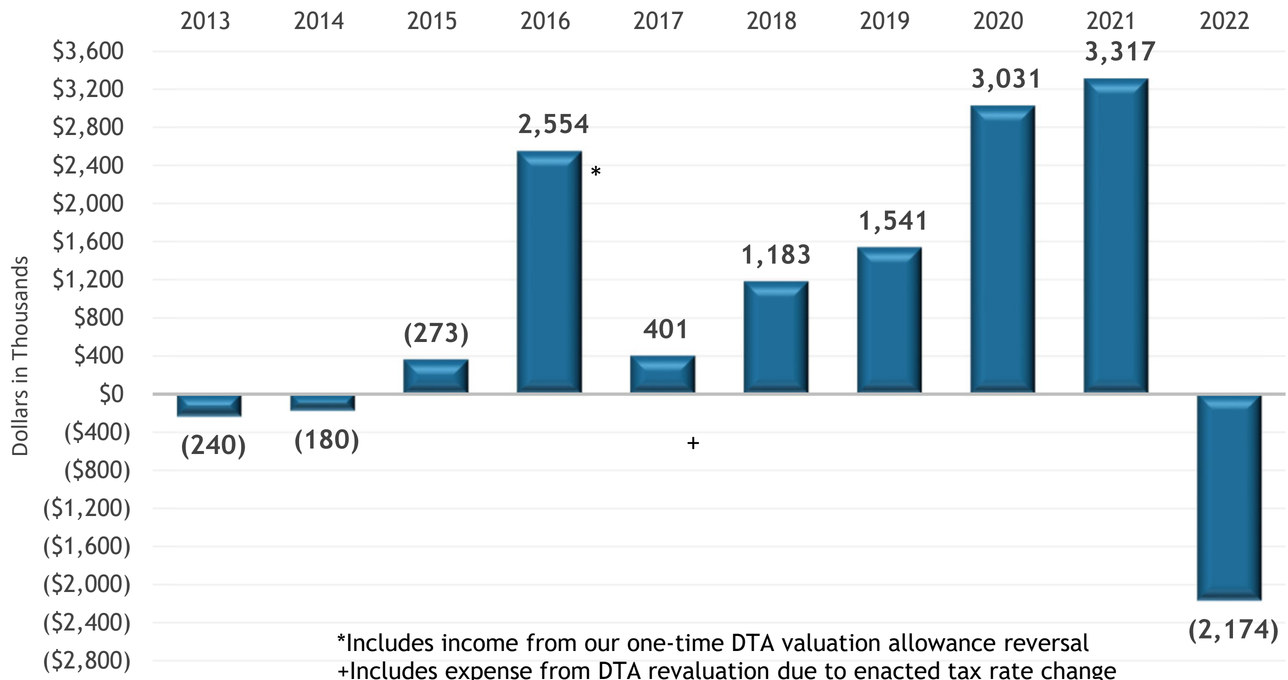
Key ratios

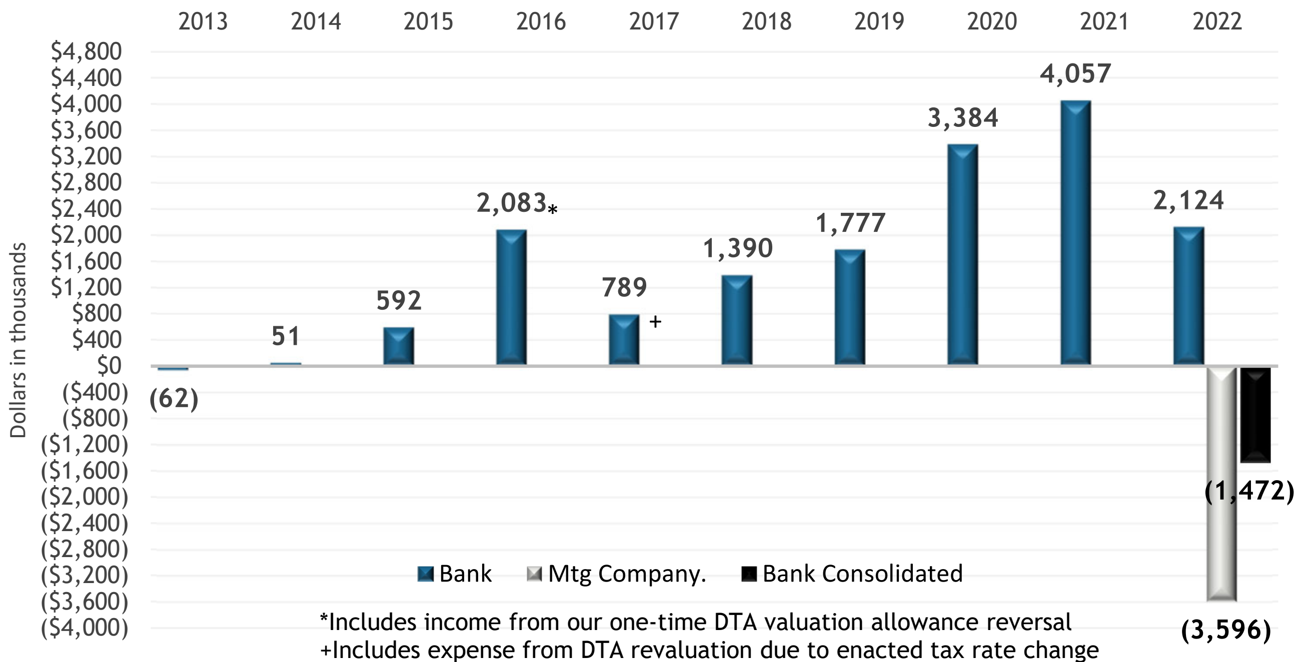






Key ratios (continued)





INDEPENDENT AUDITORS' REPORT

April 12, 2023

Board of Directors and Shareholders
Grand River Commerce, Inc.
Grandville, Michigan

Opinion

We have audited the accompanying consolidated financial statements of Grand River Commerce, Inc. (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of (loss) income, comprehensive (loss) income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (the "financial statements").

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

Basis for Opinion

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

Responsibilities of Management for the Consolidated Financial Statements

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

2330 E. Paris Ave SE, Grand Rapids, MI 49546 616.975.4100

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

In performing an audit in accordance with generally accepted auditing standards, we:

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

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

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

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

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

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

Other Information included in the Annual Report

Management is responsible for the other information included in the annual report. The other information comprises Management's Report and Key Ratios but does not include the consolidated financial statements and our auditors' report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audits of the consolidated financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the consolidated financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Rehmann Robson LLC

GRAND RIVER COMMERCE, INC.

Consolidated Balance Sheets

(Dollars in thousands)

	December 31	
ASSETS	**2022**	**2021**
Cash and cash equivalents		
Cash and due from banks	$ 47,731	$ 83,586
Federal funds sold	648	737
Total cash and cash equivalents	**48,379**	**84,323**
Investment securities, available-for-sale	15,036	18,101
Restricted investments	1,788	1,488
Mortgage loans held for sale	433	1,014
Loans		
Total loans	461,290	382,209
Less: allowance for loans losses	5,928	4,866
Net loans	**455,362**	**377,343**
Premises and equipment (net)	2,472	2,335
Deferred tax asset (net)	2,191	1,001
Interest receivable and other assets	4,589	3,847
Total assets	**$ 530,250**	**$ 489,452**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 124,424	$ 107,899
Interest-bearing	337,253	319,960
Total deposits	461,677	427,859
Interest payable and other liabilities	3,189	3,637
Other debt	14,500	4,500
Subordinated debt (net of issuance costs)	8,045	8,019
Total liabilities	**487,411**	**444,015**
Commitments and contingencies (Note 1, 10, 11, 12 and 17)		
Shareholders’ equity		
Common stock		
$0.01 par value; authorized 10,000,000 shares; issued and outstanding 7,026,423 shares in 2022 and 6,761,758 shares in 2021	70	68
Additional paid-in capital	38,614	38,236
Additional paid-in capital-warrants	2,542	1,256
Accumulated surplus	3,822	5,996
Accumulated other comprehensive loss	(2,209)	(119)
Total shareholders’ equity	**42,839**	**45,437**
Total liabilities and shareholders' equity	**$ 530,250**	**$ 489,452**

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

GRAND RIVER COMMERCE, INC.

Consolidated Statements of (Loss) Income

(Dollars in thousands)

	Year Ended December 31	
	2022	2021
Interest income		
Loans, including fees	$ 17,602	$ 15,677
Securities	389	305
Federal funds sold and other income	1,082	103
Total interest income	**19,073**	**16,085**
Interest expense		
Deposits	3,450	1,910
Borrowings	633	620
Total interest expense	**4,083**	**2,530**
Net interest income	**14,990**	**13,555**
Provision for loan losses	1,062	160
Net interest income, after provision for loan losses	**13,928**	**13,395**
Noninterest income		
Service charges and other fees	40	37
Gain on sale of mortgage loans	696	2,914
Other	398	230
Total noninterest income	**1,134**	**3,181**
Noninterest expenses		
Salaries and benefits	11,930	8,536
Occupancy and equipment	1,307	896
Data processing and computer support	369	310
Professional services	1,075	665
Insurance	416	355
Software	750	395
Other	2,022	1,176
Total noninterest expenses	**17,869**	**12,333**
Net (loss) income before income tax (benefit) expense	(2,807)	4,243
Income tax (benefit) expense	(633)	926
Net (loss) income	**$ (2,174)**	**$ 3,317**
Basic (loss) income per share	**$ (0.31)**	**$ 0.49**
Diluted (loss) income per share	**$ (0.31)**	**$ 0.47**

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

GRAND RIVER COMMERCE, INC.

Consolidated Statements of Comprehensive (Loss) Income
(Dollars in thousands)

	Year Ended December 31	
	2022	2021
Net (loss) income	$ (2,174)	$ 3,317
Unrealized loss on investment securities arising during the year	(2,647)	(373)
Income tax benefit related to other comprehensive loss	557	78
Other comprehensive loss	(2,090)	(295)
Comprehensive (loss) income	**$ (4,264)**	**$ 3,022**

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

GRAND RIVER COMMERCE, INC.

Consolidated Statements of Shareholders' Equity

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Additional Paid-in Capital- Warrants / Options	Accumulated Surplus	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2021	**$ 67**	**$ 38,123**	**$ 1,199**	**$ 2,679**	**$ 176**	**$ 42,244**
Warrants exercised						
10,796 shares @ $5.30 per share	-	-	57	-	-	57
Share-based payment awards under						
equity compensation plans	1	113	-	-	-	114
Comprehensive income	-	-	-	3,317	(295)	3,022
Balances, December 31, 2021	**68**	**38,236**	**1,256**	**5,996**	**(119)**	**45,437**
Warrants exercised						
238,229 shares @ $5.30 per share	2	-	1,260	-	-	1,262
Options exercised						
5,000 shares @ $5.30 per share	-	-	26	-	-	26
Share-based payment awards under						
equity compensation plans	-	378	-	-	-	378
Comprehensive loss	-	-	-	(2,174)	(2,090)	(4,264)
Balances, December 31, 2022	**$ 70**	**$ 38,614**	**$ 2,542**	**$ 3,822**	**$ (2,209)**	**$ 42,839**

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

GRAND RIVER COMMERCE, INC.

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Year Ended December 31	
	2022	2021
Cash flows from operating activities		
Net (loss) income	$ (2,174)	$ 3,317
Adjustments to reconcile (loss) net income to net cash (used in) provided by operating activities		
Share-based compensation	378	114
Provision for loan losses	1,062	160
Net amortization of investment securities	40	42
Originations of loans held for sale	(26,237)	(81,004)
Proceeds from loan sales	27,514	90,292
Net gain on sale of loans	(696)	(2,914)
Depreciation and amortization	529	270
Amortization of debt issuance costs	26	26
Net change in		
Net deferred tax asset	(633)	173
Interest receivable and other assets	(742)	(2,234)
Interest payable and other liabilities	(448)	2,224
Net cash (used in) provided by operating activities	**(1,381)**	**10,466**
Cash flows from investing activities		
Activity in available-for-sale securities		
Maturities and pre-payments	1,878	2,505
Purchase of securities	(1,500)	(13,547)
Loan principal origination, net	(79,081)	(19,003)
Purchase of Federal Reserve Bank restricted stock	(300)	-
Purchase of fixed assets	(666)	(1,458)
Net cash used in investing activities	**(79,669)**	**(31,503)**
Cash flows provided by financing activities		
Acceptances and withdrawals of deposits, net	33,818	44,995
Federal Home Loan Bank borrowings	10,000	-
Paycheck Protection Program Liquidity Facility repayments	-	(12,827)
Proceeds from exercise of warrants and options	1,288	57
Net cash from financing activities	**45,106**	**32,225**
Net (decrease) increase in cash and cash equivalents	(35,944)	11,188
Cash and cash equivalents at beginning of year	84,323	73,135
Cash and cash equivalents at end of year	**$ 48,379**	**$ 84,323**
Supplemental cash flow information		
Cash paid for interest	$ 3,883	$ 2,577

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

Notes to Consolidated Financial Statements

1. ORGANIZATION, BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Grand River Commerce, Inc. ("GRCI") was incorporated under the laws of the State of Michigan on August 15, 2006, to organize a Bank in Michigan. GRCI's fiscal year ends on December 31. Upon receiving regulatory approvals to commence business in April 2009, GRCI chartered Grand River Bank as a de novo Bank, (the "Bank") which also has a December 31 fiscal year end. The Bank is a wholly-owned subsidiary of GRCI (the "Company"). In late 2021, Grand River Mortgage Company, LLC ("GRMC"), a wholly owned subsidiary of the Bank, was formed and in 2022 GRMC commenced operations.

The Bank is a full-service commercial bank headquartered in Grandville, Michigan, serving the communities of Grandville, Grand Rapids and the surrounding areas in Kent and Ottawa counties in Michigan, offering a broad range of commercial and consumer banking services to businesses, professionals, and local residents who are particularly responsive to the style of service which the Bank provides.

GRMC is a direct to consumer national mortgage lender that has built a digital platform designed to simplify the mortgage experience. GRMC's team of mortgage lenders are located all around the country. GRMC offers a variety of lending products including purchase, cash out and re-finance. All loans originated by GRMC are sold on the secondary market.

Active competition, principally from other commercial banks, savings banks credit unions, and mortgage companies exists in all of the Bank's primary markets. The Bank's results of operations can be significantly affected by changes in interest rates or changes in the industries which comprise a significant portion of the local economic environment which currently include medical, manufacturing, automotive and professional services. Management expects the investment in GRMC to further diversify income streams in future years.

The Bank is chartered by the State of Michigan and is a member of the Federal Deposit Insurance Corporation ("FDIC") and the Federal Reserve. The Bank is subject to the regulations and supervision of the Federal Reserve as well as state regulators and undergoes periodic examinations by these regulatory authorities while still maintaining insurance governed by the FDIC. In addition, GRMC is subject to certain other state regulatory authorities specific to the consumer lending line of business in the states where they are required to be licensed. GRCI is also subject to regulations of the Federal Reserve governing bank holding companies.

The Bank was a participating lender in the Small Business Administration's (“SBA”) Paycheck Protection Program (“PPP”) through the CARES Act. Fees generated based on the origination of PPP loans were deferred and amortized into interest income over the contractual period of 24 months or 60 months, as applicable. Upon SBA forgiveness, unamortized fees were then recognized into interest income. Details of the Bank's PPP origination and forgiveness activity are detailed below:

In 2020, the Bank originated 374 loans totaling $61.2 million in principal, generating fees of $2.3 million, of which $1.2 million were recognized into interest income in 2020. The Bank began submitting loans for forgiveness in the 4th quarter of 2020. A total of 27 loans were forgiven representing $12.5 million of principal.

In 2021, the Bank originated 209 loans totaling $31.2 million in principal, generating fees of $1.4 million, of which $1.2 million were recognized into interest income in 2021. A total of 537 loans were forgiven in 2021 representing $75.6 million of principal.

In 2022, the Bank recognized into interest income the balance of PPP fees totaling $110,000. The remaining 19 loans were forgiven during 2022, totaling $4.3 million of principal.

Concentration Risks
The Bank’s primary deposit products are interest and noninterest-bearing checking accounts, savings accounts and time deposits and its primary lending products are real estate mortgages, commercial and consumer loans. The majority of the Bank’s loan portfolio is comprised of commercial real estate and commercial and industrial loans. Commercial real estate loans represented 74% and 76% of total loans at December 31, 2022 and 2021, respectively, while commercial and industrial loans represent 9% and 10% total loans at December 31, 2022 and 2021, respectively. While the Bank has a concentration in loans secured by real estate, management believes that the Bank does not have significant concentrations with respect to any one industry, customer, or depositor.

Principles of Consolidation
The accompanying consolidated financial statements include the accounts of GRCI, the Bank and GRMC (collectively, the “Company”). All significant intercompany accounts and transactions have been eliminated in consolidation. When Bank is used throughout these statements it is inclusive of GRMC as applicable.

Use of Estimates
The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheets and the reported amounts of income and expenses during the year. Actual results could differ from those estimates and assumptions.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties.

Management believes that the allowance for loan losses is adequate to absorb losses inherent in the portfolio. As there is minimal historical loss information, future additions to the allowance may be necessary based on changes in local economic conditions.

Regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term.

Finally, significant estimates include obligations associated with share-based compensation related arrangements. The Company estimates the fair value of share-based compensation awards using the Black-Scholes option pricing model. Further detail is available in Note 13.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Company are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, and federal funds sold, all of which mature within ninety days. Generally, federal funds are sold for a one-day period. The Company maintains deposit accounts in various financial institutions which generally exceed FDIC insured limits. Management does not believe the Company is exposed to any significant interest, credit, or other financial risk as a result of these deposits.

Fair Value

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets which the Company can participate.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement, and include inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2.

Investment Securities
All marketable securities are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported as a component of other comprehensive (loss) income. Purchased premiums and discounts are recognized in interest income using methods approximating the interest method over the terms of the securities. Realized gains and losses on the sale of securities are included in earnings on the trade date using the specific identification method.

Debt securities are reviewed quarterly for possible other-than-temporary impairment ("OTTI"). In determining whether an other–than-temporary impairment exists, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Company must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For these debt securities, the Company separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Company calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover.

The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive (loss) income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Restricted Investments

Restricted investments include stock issued by the Federal Reserve Bank of Chicago (FRB) as well as stock issued by the Federal Home Loan Bank (FHLB). Holdings of FRB stock are $1,135,000 and $1,015,500 as of December 31, 2022 and 2021 respectively. Holdings of FHLB stock are $652,500 and $472,500 as December 31, 2022 and 2021 respectively. These nonmarketable equity securities are recorded at cost as they do not have a readily determinable fair value as ownership is restricted and lacks a market.

Mortgage Loans Held for Sale

Mortgage loans originated and held for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Estimated fair value is determined using forward commitments to sell loans to permanent investors, or current market rates for loans of similar quality and type. Net unrealized losses, if any, are recognized in a valuation allowance by charges to earnings. Discounts or premiums on loans held for sale are deferred until the related loan is sold. Loans held for sale are sold with servicing rights released.

Loans are considered sold when the Bank surrenders control over the transferred assets to the purchaser, with standard representations and warranties. At such time, the loan is removed from the Bank's loan portfolio and a gain or loss is recorded on the sale. Gains and losses on loan sales are determined based on the difference between the carrying value of the assets sold, the estimated fair value of any assets or liabilities that are newly created as a result of the transaction and the proceeds from the sale.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loan losses, and unamortized premiums or discounts on purchased loans. Interest is credited to income on a daily basis based upon the principal amount outstanding. Except for fees associated with originated PPP loans, management estimates that direct costs incurred in originating loans classified as held-to-maturity approximate the origination fees generated on these loans. Therefore, net deferred loan origination fees on loans classified as held-to-maturity are not included on the accompanying consolidated balance sheets. As of December 31, 2022 and 2021, the unamortized balance of PPP fees net of costs were $0 and $110,000, respectively.

Interest income on all classes of loans is discontinued when management believes, after consideration of economic and business conditions and collection efforts, that the borrowers' financial condition is such that collection of interest is doubtful, typically 90 days past due, unless the credit is well secured or is in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans, loans past due 90 days still on accrual, and troubled debt restructurings are considered in a nonperforming status for purposes of credit quality evaluation and are individually evaluated for impairment.

All interest accrued but not received for loans placed on nonaccrual in the current year is reversed against interest income. Interest accrued but not received for loans placed on nonaccrual due from prior years is charged against the allowance for loan losses. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

A loan is accounted for as a troubled debt restructuring if management, for economic or legal reasons related to the borrower's financial condition, grants a significant concession to the borrower that would not otherwise be considered. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, or a modification of terms such as a reduction of the stated interest rate or balance of the loan, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings generally remain categorized as nonperforming loans until a six-month payment history has been maintained.

Allowance for Loan Losses

The allowance for loan losses is established through provisions for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collection of the principal is unlikely. Subsequent recoveries are added to the allowance. The allowance for loan losses is evaluated by management on a regular basis and is maintained at a level believed to be appropriate by management to absorb loan losses based upon evaluations of known and inherent risks in the loan portfolio.

Due to stable economic conditions during much of our operating history, the loans in our loan portfolio have not experienced a full economic downturn. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process known as seasoning. As a result, a portfolio of older loans that has been through varied economic cycles will usually behave more predictably than a portfolio that hasn't been through such cycles.

Because our loan portfolio consists of loans issued primarily in the past ten years, the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio is exposed to more varied economic cycles, which may be higher than current levels. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition. Management's periodic evaluation of the adequacy of the allowance is based on 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.

The allowance consists primarily of specific and general components. The specific component relates to loans that are individually reviewed. All loans are subject to individual evaluation should the facts and circumstances pertinent to a particular loan suggest that such evaluation is necessary. Factors considered by management in determining whether a loan will be individually reviewed include, among others, 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 reviewed individually. 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.

The specific allowance established for these loans is based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flows, the loan's estimated market value, or the estimated fair value of the underlying collateral. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses. One loan is classified as impaired as of December 31, 2022 and 2021 which had a balance of $1.3 million and $1.2 million, respectively.

The general component covers all other loans not classified as impaired or individually reviewed. The balances of these loans are pooled based on their underlying characteristics. Generally speaking, these include Commercial Real Estate, Commercial and Industrial, and Consumer groupings. An allowance for each pool is then determined by applying 1) the actual historical loss rate for the pool over a 24-month lookback period; and 2) adjustments for environmental factors such as changes in lending policy, economic conditions, volume of the portfolio and loan terms, experience and depth of the lending staff, past due trends, quality of the loan review program, underlying collateral values for collateral dependent loans, concentrations of credit, and other external factors. Management reviews these factors on a periodically and makes adjustments as necessary.

Paycheck Protection Program (PPP) loans issued under the CARES Act are included in commercial and industrial loans. As of December 31, 2022, there were no PPP loans outstanding and as of December 31, 2021 there were $4.3 million of PPP loans outstanding. These loans received no allowance allocation as they were fully guaranteed by the SBA and subject to forgiveness under the SBA forgiveness criteria.

The unallocated portion of the allowance relates to inherent losses that are not otherwise evaluated in the first two elements. The qualitative factors associated with unallocated allowance are subjective and require a high degree of management judgment. These factors include the inherent imprecision in mathematical models and credit quality statistics, recent economic uncertainty, losses incurred from recent events, and lagging or incomplete data.

The Bank categorizes commercial loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk.

- **Prime Rating-1.** Borrower demonstrates exceptional credit fundamentals, including stable and predictable profit margins and cash flows, strong liquidity and a conservative balance sheet with superior asset quality. Historic and projected performance indicates that borrower is able to meet obligations under almost any economic circumstance.

- **High Quality-2.** Borrower consistently and internally generates sufficient cash flow to fund debt service. Management has successful experience with this company or with similar business activities in a similar market. Current and projected trends are positive and superior. Management breadth and depth indicates high degree of stability.

- **Average Quality-3.** Balance sheet is comprised of good capital base, acceptable leverage, and liquidity. Ratios are at or slightly above peers. Operation generates sufficient cash to fund debt service and some working assets or capital expansion. Loans have excellent collateral with standard advance rates. Current trends are positive or stable.

- **Acceptable Quality-4.** Borrower generates sufficient cash flow to fund debt service, but most working assets and all capital expansion needs are funded by other sources. Borrower is able to meet interest payments but could not term out evergreen credit lines in a reasonable period of time. Earnings may be trending down; a loss may be shown indicating some volatility in earnings. However, management is acceptable and long-term trends are positive or neutral. Borrower may be able to obtain similar financing from other institutions.

- **Watch-5.** Borrowers may exhibit declining earnings, strained cash flow, increasing leverage, and/or weakening market position. They generally have limited additional debt capacity, modest coverage, and/or weakness in asset quality. Loans may be currently performing as agreed but could be adversely affected by factors such as deteriorating economic conditions, operating problems, pending litigation, or declining value of collateral. Management may be of good character, but weak. Borrower may have some limited ability to obtain similar financing with comparable or somewhat worse terms at other lending institutions.

- **Special Mention-6.** Loans classified as special mention have a potential for weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

- **Substandard-7.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

- **Doubtful-8.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

- **Loss-9.** Loans are considered uncollectible and of little or no value as a Bank asset. Such loans are charged off when classified as loss.

- **Pass.** Meets the qualities of the definition of loan grades 1-6 listed above.

The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Current and projected cash flows are reviewed to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory and may incorporate a personal guarantee. In limited circumstances, loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Bank avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Bank also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan.

In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. The outstanding principal balance of the Bank's commercial real estate loans were secured by the following categories at December 31:

	2022	2021
Owner occupied properties	35.1%	35.7%
Non-owner occupied properties	39.3	42.8
Multifamily properties	7.8	4.4
1–4 family residential properties	6.9	7.1
Other properties	10.9	10.0
Total	**100.0%**	**100.0%**

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Bank may originate from time to time, the Bank generally requires the borrower to have had an existing relationship with the Bank and have a proven record of success. Commercial real estate construction and land development ("Construction") loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Bank monitors and manages consumer loan risk through its policies and procedures. These policies and procedures are developed and modified, as needed, by management. The majority of this portfolio is made up of residential real estate loans. As such, underwriting standards are heavily influenced by statutory requirements, which include, but are not limited to, generally conservative loan-to-value percentages, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

The Bank has implemented an independent loan review that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management, the Audit Committee, and the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Bank, 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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. The Bank transfers of financial assets are generally limited to commercial loan participations sold to other banks and residential mortgage loans sold in the secondary market.

The Bank sold to unrelated third parties residential mortgage loans with proceeds of $27.5 million and $90.3 million in 2022 and 2021, respectively, which resulted in gains of $696,000 and $2.91 million for 2022 and 2021, respectively. There is no substantive continuing involvement related to these loans.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less estimated selling costs at the date of foreclosure establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets, a component of other noninterest expense. As of December 31, 2022 and 2021, the Company had no foreclosed real estate properties or properties in the process of foreclosure.

Premises and Equipment

Equipment is carried at cost less accumulated depreciation. Depreciation is computed principally by the straight-line method based upon the estimated useful lives of the assets, which range generally from 3 to 8 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

Share-Based Compensation

The Company recognizes the cost of employee services or certain performance metrics received in exchange for awards of equity instruments based on the grant-date fair value of those awards. An expense equal to the fair value of the awards over the requisite service period of the awards is recognized in the consolidated statements of (loss) income.

The Company estimates the per share fair value of option grants and stock only appreciation rights (SOSARs) on the date of grant using the Black-Scholes pricing model using assumptions for the expected dividend yield, expected stock price volatility, risk-free interest rate and expected option term. These assumptions are subjective in nature, involve uncertainties and, therefore, cannot be determined with precision. The Black-Scholes option pricing model also contains certain inherent limitations when applied to options that are not traded on public markets. The per share fair value of options and SOSARs is highly sensitive to changes in assumptions. In general, the per share fair value of options and SOSARs will move in the same direction as changes in the expected stock price volatility, risk-free interest rate and expected term, and in the opposite direction as changes in the expected dividend yield occur. For example, the per share fair value of options and SOSARs will generally increase as expected stock price volatility increases, risk-free interest rate increases, expected term increases and expected dividend yield decreases. The use of different assumptions or different option pricing models could result in materially different per share fair values of options.

The Company estimates the fair value of restricted stock awards and performance based restricted stock units (PRSUs) is based upon the quoted market price of the common stock on the date of grant.

Mortgage Banking Derivatives

Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and mandatory and best efforts sales commitments for the future delivery of these mortgage loans are accounted for as free standing derivatives. The fair value of the interest rate lock is recorded at the time the commitment is executed and is adjusted for the expected exercise of the commitment before the loan is funded. In order to the hedge the change in interest rates resulting from its commitments to fund loans, the Bank enters into forward commitments for the future delivery of mortgage loans when the interest rate locks are entered into. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. Changes in the fair values of these derivatives are include in net gain on sales of residential mortgage loans included in the Consolidated Statements of (Loss) Income. Further information on the Bank's mortgage banking derivatives is included in Note 11.

Income Taxes

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and federal income tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the period in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce the deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period plus, or minus the change during the period in deferred tax assets and liabilities.

Revenue Recognition

The Company recognizes revenues as they are earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. The Company's primary source of revenue is interest income from the Bank's loans and investment securities. The Company also earns noninterest revenue from various banking services offered by the Bank.

Interest Income: The Company's largest source of revenue is interest income which is primarily recognized on an accrual basis based on contractual terms written into loans and investment contracts.

Noninterest Income: The Company derives the majority of its noninterest revenue from: (1) gains related to mortgage loan sales, (2) service charges for deposit related services (3) commissions on interest rate swap contracts, and (4) debit and credit card interchange income. Most of these services are transaction based and revenue is recognized as the related service is provided.

Comprehensive Income (loss)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investment securities, are reported as a separate component of the equity section in the consolidated balance sheets. Such items, along with net income, are components of accumulated other comprehensive income (loss).

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting primarily of commitments to extend credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

Net Income per Share

Basic and diluted income per share have been computed by dividing net income by the weighted-average number of common shares outstanding for the year. Weighted-average common shares outstanding in 2022 totaled 6,962,466 and in 2021 totaled 6,749,388. Common stock equivalents consisting of Restricted Stock Awards, Common Stock Options and Common Stock Purchase Warrants as described in Notes 13 and 14 are considered dilutive and therefore included for 2022 and 2021.

Reclassifications

Certain amounts as reported in the 2021 consolidated financial statements have been reclassified to conform to the 2022 presentation.

Accounting Standards Updates

ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, was issued with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions. The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates. The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an institution's portfolio. In addition, the ASU amends existing guidance on accounting for credit losses on available-for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures. The ASU on credit losses will take effect for fiscal years beginning after December 15, 2022. Management is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Company's consolidated financial statements.

Subsequent Events

In preparing these consolidated financial statements, the Company has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2022, the most recent balance sheet presented herein, through April 12, 2023, the date these consolidated financial statements were available to be issued.

No significant events or transactions were identified except as disclosed in Notes 7, 12, and 16.

2. FAIR VALUE MEASUREMENTS

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

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Investment Securities

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are unavailable, fair values are based on quoted market prices of comparable instruments or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss and liquidity assumptions. As such, all investment securities are classified as Level 2.

Loans Held for Sale

The fair value loans held for sale are based upon valuation models which use the market price for similar loans sold in the secondary market. (Level 2 inputs).

Mortgage Banking Derivatives

A description of the various derivative instruments the Company utilizes to manage interest rate risk is as follows:

Forward contracts: The Company enters into forward loan sales commitments to sell certain residential mortgage loans which are recorded at fair value based on valuation models. The Company's expectation of the amount of its interest rate lock commitments that will ultimately close is a factor in determining the position. The valuation models utilize the fair value of related residential mortgage loans determined using observable market data and are classified as level 2.

Interest rate lock commitments: The Company's interest rate lock commitments are derivative instruments that are recorded at fair value based on valuation models that use the market price for similar loans sold in the secondary market. The interest rate lock commitments are adjusted for expectations of exercise and funding and are classified as level 2.

Impaired Loans

The fair value of impaired loans is measured in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, fair value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the impaired loan as nonrecurring Level 3.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets Recorded at Fair Value on a Recurring Basis

As of December 31, 2022 and 2021, there were $15.0 million and $18.1 million, respectively, of marketable securities recorded in Level 2 of the fair value hierarchy and measured at fair value on a recurring basis.

As of December 31, 2022 there were $7.2 million of residential mortgage loans subject to interest rate lock commitments and best efforts forward sales commitments. The fair value of interest rate lock commitments and best efforts forward sales commitments as of December 31, 2022 amount to $57,000 and $80,000 respectively. Activity as of and for the year ended December 31, 2021 was not significant.

Assets Recorded at Fair Value on a Nonrecurring Basis

As of both December 31, 2022 and December 31, 2021 there was no other real estate owned in which to measure at fair value on a nonrecurring basis.

Impaired loans as of December 31, 2022 and 2021, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $1.2 million and $1.3 million, respectively, recorded in level 2 of the fair value hierarchy resulting in no specific allocation to the allowance for loan losses for 2022 and 2021, respectively.

Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Company's consolidated balance sheets are as follows as of December 31 (dollars in thousands):

	2022		2021	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 48,379	$ 48,379	$ 84,323	$ 84,323
Restricted investments	1,788	1,788	1,488	1,488
Net loans	455,362	424,655	377,343	379,179
Interest receivable	1,273	1,273	875	875
Financial liabilities				
Noninterest-bearing deposits	124,424	124,424	107,899	107,899
Interest-bearing deposits	337,253	328,722	319,960	324,033
Federal Home Loan Bank advances	14,500	14,394	4,500	4,678
Subordinated debt	8,045	8,347	8,019	8,166
Interest payable	259	259	59	59

The estimated fair values of financial instruments disclosed above as of December 31, 2022 and 2021 follow the guidance in ASU No. 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity and marketability factors.

3. INVESTMENT SECURITIES

The amortized cost and fair value of available-for-sale debt securities, including gross unrealized gains and losses, are summarized as follows as of December 31 (dollars in thousands):

2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities	$ 10,755	$ -	$ 1,709	$ 9,046
Small business administration program securities	4,659	-	746	3,913
Municipal securities	1,920	-	255	1,665
Corporate securities	500	-	88	412
Total	$ 17,834	$ -	$ 2,798	$ 15,036

2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-backed securities	$ 12,340	$ 108	$ 217	$ 12,231
Small business administration program securities	3,468	4	27	3,445
Municipal securities	1,944	2	21	1,925
Corporate securities	500	-	-	500
Total	$ 18,252	$ 114	$ 265	$ 18,101

All securities are held as available-for-sale. The amortized cost and fair value of securities grouped by contractual maturity at December 31, 2022, are summarized as follows:

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Securities with Variable Periodic Payments	Total
Mortgage-backed securities	$ -	$ -	$ -	$ 10,755	$ 10,755
Small business administration program securities	-	-	-	4,659	4,659
Municipal securities	-	-	1,920	-	1,920
Corporate securities	-	-	500	-	500
Total amortized cost	$ -	$ -	$ 2,420	$ 15,414	$ 17,834
Fair value	$ -	$ -	$ 2,077	$ 12,959	$ 15,036

There were no sales of investment securities in 2022 or 2021.

As of December 31, 2022 and 2021, there were no pledged securities.

Securities with unrealized losses, not recognized in income, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31 are as follows (dollars in thousands):

2022	Less than 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Losses
Mortgage-backed securities	$ 3,012	$ 345	$ 6,034	$ 1,364	$ 9,046	$ 1,709
Small business administration program securities	1,586	323	2,327	423	3,913	746
Municipal securities	544	57	1,121	198	1,665	255
Corporate securities	412	88	-	-	412	88
Total	$ 5,554	$ 813	$ 9,482	$ 1,985	$ 15,036	$ 2,798

2021	Less than 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Losses
Mortgage-backed securities	$ 7,082	$ 184	$ 851	$ 33	$ 7,933	$ 217
Small business administration program securities	1,439	27	-	-	1,439	27
Municipal securities	1,310	21	-	-	1,310	21
Total	$ 9,831	$ 232	$ 851	$ 33	$ 10,682	$ 265

As of December 31, 2022, all individual marketable securities held by the Company were in an unrealized loss position.

As of December 31, 2022 and 2021, management conducted an analysis to determine whether all securities currently in an unrealized loss position should be considered other-than-temporarily impaired ("OTTI"). Such analyses considered, among other factors, the following criteria:

- Has the value of the Investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Company will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

Based on the Company's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Company will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2022 or 2021.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The components of the outstanding loan balances are summarized as follows at December 31 (dollars in thousands):

	2022	2021
Commercial and industrial		
Commercial and industrial	$ 39,400	$ 35,406
Paycheck Protection Program (PPP) (net of unearned fees and costs)	-	4,177
Total commercial and industrial	39,400	39,583
Commercial real estate		
Commercial	304,837	262,410
Construction and land development	38,878	27,689
Total commercial real estate	343,715	290,099
Consumer		
Residential and other	73,026	44,204
Construction	5,149	8,323
Total consumer	78,175	52,527
Gross loans	461,290	382,209
Less allowance for loan losses	5,928	4,866
Total loans, net	**$ 455,362**	**$ 377,343**

The following tables present the balance in the allowance for loan losses and the balance in loans by portfolio segment and based on the impairment method used for the year ended December 31 (dollars in thousands):

2022	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses					
Balance at beginning of year	$ 409	$ 3,748	$ 644	$ 65	$ 4,866
Loans charged-off	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision for loan losses	32	685	409	(64)	1,062
Balance at end of year	$ 441	$ 4,433	$ 1,053	$ 1	$ 5,928
Allowance for loan losses					
Individually evaluated for impairment	$ -	$ -	$ 98	$ -	$ 98
Collectively evaluated for impairment	441	4,433	955	1	5,830
Total allowance for loan losses	$ 441	$ 4,433	$ 1,053	$ 1	$ 5,928
Financing receivables					
Individually evaluated for impairment	$ 966	$ 1,244	$ 476		$ 2,686
Collectively evaluated for impairment	38,434	342,471	77,699		458,604
Total ending balance	**$ 39,400**	**$ 343,715**	**$ 78,175**		**$ 461,290**

2021	Commercial and Industrial	Commercial Real Estate	Consumer	Unallocated	Total
Allowance for loan losses					
Balance at beginning of year	$ 285	$ 3,769	$ 651	$ 1	$ 4,706
Loans charged-off	-	-	-	-	-
Recoveries	-	-	-	-	-
Provision for loan losses	124	(21)	(7)	64	160
Balance at end of year	$ 409	$ 3,748	$ 644	$ 65	$ 4,866
Allowance for loan losses					
Collectively evaluated for impairment	$ 409	$ 3,748	$ 644	$ 65	$ 4,866
Financing receivables					
Individually evaluated for impairment	$ -	$ 1,311	$ -		$ 1,311
Collectively evaluated for impairment	39,583	288,788	52,527		380,898
Total ending balance	**$ 39,583**	**$ 290,099**	**$ 52,527**		**$ 382,209**

The following table shows the loans allocated by management's internal risk ratings as of December (dollars in thousands):

2022	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction and Land Development	Total
Risk rating definitions				
1-2 Prime/high quality	$ 1,900	$ 9,157	$ -	$ 11,057
3 Average quality	10,288	93,256	6,704	110,248
4 Acceptable quality	25,022	196,414	32,174	253,610
5 Watch	2,190	4,766	-	6,956
6 Special mention	-	1,244	-	1,244
7 Substandard	-	-	-	-
8 Doubtful	-	-	-	-
9 Loss	-	-	-	-
				-
Total	**$ 39,400**	**$ 304,837**	**$ 38,878**	**$ 383,115**

2021	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction and Land Development	Total
Risk rating definitions				
1-2 Prime/high quality	$ 1,702	$ 9,160	$ -	$ 10,862
3 Average quality	7,593	85,050	5,809	98,452
4 Acceptable quality	27,834	161,203	21,880	210,917
5 Watch	2,454	5,686	-	8,140
6 Special mention	-	1,311	-	1,311
7 Substandard	-	-	-	-
8 Doubtful	-	-	-	-
9 Loss	-	-	-	-
				-
Total	**$ 39,583**	**$ 262,410**	**$ 27,689**	**$ 329,682**

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For consumer loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. A loan is considered performing if loan payments are timely. The following table presents the recorded investment in consumer loans based on payment activity as of December 31 (dollars in thousands):

2022	Consumer Residential and Other	Consumer Construction	Total
Grade			
Performing	$ 73,026	$ 5,149	$ 78,175
Nonperforming	-	-	-
Total	**$ 73,026**	**$ 5,149**	**$ 78,175**

2021	Consumer Residential and Other	Consumer Construction	Total
Grade			
Performing	$ 44,204	$ 8,323	$ 52,527
Nonperforming	-	-	-
Total	**$ 44,204**	**$ 8,323**	**$ 52,527**

There were no recorded investments in nonaccrual loans as of December 31, 2022 and 2021. There were no loans past due over 90 days still on accrual as of December 31, 2022 and 2021. As of December 31, 2022 and December 31, 2021, $1.2 million and $1.3 million, respectively, of loans were classified as impaired.

The following table presents the aging of the recorded investments in past due loans by class as of December 31 (dollars in thousands):

2022	30-90 Days	Greater Than 90 Days	Total Past Due	Current	Total
Commercial and industrial	$ 50	$ -	$ 50	$ 39,350	$ 39,400
Commercial real estate	-	-	-	304,837	304,837
Commercial real estate construction and land development	-	-	-	38,878	38,878
Consumer residential and other	-	-		73,026	73,026
Consumer construction	-	-	-	5,149	5,149
Total	**$ 50**	**$ -**	**$ 50**	**$ 461,240**	**$ 461,290**

2021	30-90 Days	Greater Than 90 Days	Total Past Due	Current	Total
Commercial and industrial	$ -	$ -	$ -	$ 39,583	$ 39,583
Commercial real estate	-	-	-	262,410	262,410
Commercial real estate construction and land development	-	-	-	27,689	27,689
Consumer residential and other	55	-	55	44,149	44,204
Consumer construction	-	-	-	8,323	8,323
Total	**$ 55**	**$ -**	**$ 55**	**$ 382,154**	**$ 382,209**

In late March 2020, the federal banking regulators issued guidance that modifications made to a borrower affected by the COVID-19 pandemic and governmental shutdown orders do not need to be identified as a TDR if the loan was current at the time a modification plan was implemented. Section 4013 of the CARES Act also addressed COVID-19 related modifications and specified that such modifications made on loans that were current as of December 31, 2019 are not TDRs. At December 31, 2022, there were no loans still in this modification and as of December 31, 2021, one such loan with a book balance of $980,000.

There was one loan modified as a TDR in 2022 that was paid off prior to December 31, 2022. There was one loan modified as a TDR in 2021 that continues to pay as agreed; there were no TDR's that defaulted during 2022 or 2021.

Notes to Consolidated Financial Statements

5. PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows at December 31 (dollars in thousands):

	2022	2021
Leasehold improvements	$ 1,656	$ 1,655
Furniture, fixtures and equipment	3,131	2,466
Accumulated depreciation	(2,315)	(1,786)
Premises and equipment, net	**$ 2,472**	**$ 2,335**

Depreciation and amortization expense was $529,000 and $270,000 for 2022 and 2021, respectively.

6. DEPOSITS

The components of the outstanding deposit balances are as follows as of December 31 (dollars in thousands):

	2022	2021
Noninterest-bearing		
Demand	$ 124,424	$ 107,899
Interest-bearing		
Checking	51,457	34,468
Savings	182,184	198,003
Time, $250,000 and under	58,868	54,959
Time, over $250,000	44,744	32,530
Total deposits	**$ 461,677**	**$ 427,859**

Scheduled maturities of time deposits for each of the years succeeding December 31, 2022, are as follows (dollars in thousands):

Year	Amount
2023	$ 84,392
2024	15,982
2025	673
2026	151
2027	2,414
Total	**$ 103,612**

7. BORROWED FUNDS *(including subsequent event)*

Federal Funds Borrowed Lines

As of December 31, 2022 and December 31, 2021, the Bank had available $23 million in unsecured Federal Funds Purchased lines of credit with correspondent banks. No amounts were outstanding on these lines for either period.

Federal Reserve Bank Borrowings

The Bank pledges eligible agricultural and commercial and industrial loans to secure a borrowing arrangement with the Federal Reserve Bank of Chicago. Capacity totaled $10.9 million and $5.5 million as of December 31, 2022 and December 31, 2021 respectively with no balance outstanding during either period.

Federal Home Loan Bank of Indianapolis

The Bank pledges eligible real estate loans to secure a borrowing arrangement with the Federal Home Loan Bank of Indianapolis. Borrowing capacity totaled $84.3 million and $45.1 million as of December 31, 2022 and December 31, 2021 respectively. As of December 31, 2022, the Bank had three outstanding advances supported by this collateral. One advance is for $10.0 million and carries a fixed rate of 4.39% maturing in February 2023, a $2.5 million advance that carries a fixed rate of 2.97% maturing in February 2024 and a $2 million advance which carries a fixed rate of 2.65%, and matures April 2024. The advance that matured in February of 2023 was renewed for one month at a fixed rate of 4.81% and was further renewed to May 2023 at a rate of 5.06%.

PPPLF Borrowings

As of December 31, 2020, the Bank had $10.8 million outstanding in borrowings under the Federal Reserve's Paycheck Protection Program Liquidity Facility (PPPLF). Advances under this program were collateralized by Paycheck Protection Program (PPP) loans. During 2021, all PPPLF advances were paid in full.

Subordinated Debt

In October 2020, the Company issued $8.25 million of subordinated debt. The interest rate is fixed at 5.50% until December 2025, and then converts to 3-month Secured Overnight Financing Rate (SOFR) plus 5.38% (rate would be 9.96% based on December 31, 2022 3-month SOFR). Final maturity is December 2030, however, the Company has the option to redeem the debt at par following the fifth anniversary. This debt is carried on the consolidated balance sheet net of issuance costs, which are amortized over the life of the instrument. As of December 31, 2022 and December 31, 2021, the unamortized cost balances were $205,000 and $231,000 respectively.

Outstanding borrowings and their contractual rates and maturities for each of the five years succeeding December 31, 2022 and thereafter are summarized as follows (dollars in thousands):

Year	Amount	Weighted Rate
2023	$ 10,000	4.39%
2024	4,500	2.83%
2025	-	-
2026	-	-
2027	-	-
Thereafter	8,250	8.84%
Total	**$ 22,750**	

8. FEDERAL INCOME TAXES

Deferred income tax assets and liabilities are computed annually for differences between the financial statement and federal income tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the period in which the differences are expected to affect taxable income. As of each reporting date, management considers new evidence, both positive and negative, that could affect its view of the future realization of deferred tax assets. A valuation allowance is established when necessary to reduce the deferred tax assets to the amount expected to be realized. As of December 31, 2022 and 2021, no valuation allowance was necessary.

Income tax expense is the tax payable or refundable for the period plus, or minus the change during the period in deferred tax assets and liabilities.

The provisions for income taxes are comprised of the following (dollars in thousands):

	2022	2021
Currently payable	$ -	$ 674
Deferred (benefit) expense	(633)	252
Income taxes	**$ (633)**	**$ 926**

Reconciliation of federal income taxes at statutory rate (21% for 2022 and 2021) to effective rate for the year end December 31 is as follows (dollars in thousands):

	2022	2021
Income tax provision at statutory rate	$ (589)	$ 891
Other	(44)	35
Federal income taxes	**$ (633)**	**$ 926**

Significant components of the Company's deferred tax assets and liabilities presented in the accompanying balance sheets are comprised of the following amounts as of December 31:

	2022	2021
Deferred tax assets		
Allowance for loan losses	$ 1,205	$ 982
Start-up costs	33	58
Non-employee stock option plan	48	48
Unrealized loss on securities available-for-sale	589	32
Net operating loss	369	-
Other	150	53
Total deferred tax assets	**2,394**	**1,173**
Deferred tax liabilities		
Depreciation	(203)	(172)
Net deferred tax asset	**$ 2,191**	**$ 1,001**

The Company has concluded that there are no significant uncertain tax positions requiring recognition or disclosure in these consolidated financial statements based on evaluation performed for 2019 through 2022, the years which remain subject to examination by major tax jurisdictions as of December 31, 2022. The Company does not expect to generate significant unrecognized tax benefits in the next twelve months. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company did not have any amounts accrued for interest and penalties at December 31, 2022 and 2021, and is not aware of claims for such amounts by federal income tax authorities.

9. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such credit extensions aggregated approximately $3.6 million at December 31, 2022 and 2021.

Deposits

Deposits of Company directors, executive officers and their affiliates were approximately $4.1 million and $4.9 million at December 31, 2022 and 2021, respectively.

10. OFF-BALANCE SHEET ACTIVITIES

To meet the financing needs of its customers, the Bank is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments are comprised of unused lines of credit, overdraft lines and loan commitments. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making these commitments as it does for on-balance sheet instruments. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit is based on management's credit evaluation of the borrower. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Risk to credit loss exists, up to the face amounts of these instruments, although material losses are not anticipated.

The contractual amount of financial instruments with off-balance sheet risk was as follows as of December 31 (dollars in thousands):

	2022		2021	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unfunded commitments under lines of credit and overdraft lines	$ 32,318	$ 96,126	$ 35,614	$ 77,756
Commitments to fund loans	9,850	5,194	14,849	2,610
Total	**$ 42,168**	**$ 101,320**	**$ 50,463**	**$ 80,366**

Unfunded commitments under commercial lines of credit, revolving home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments may expire without being drawn upon. These lines of credit may not be drawn upon to the total extent to which the Bank is committed.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

11. DERIVATIVE FINANCIAL INSTRUMENTS

Interest Rate Risk Management - Derivative Instruments Not Designated As Hedging Instruments

Certain derivative instruments do not meet the criteria for hedging requirements. These undesignated derivative instruments are generally recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in other noninterest income.

Interest Rate Lock Commitments

The Bank follows the provisions of derivatives and hedging accounting guidance, which requires it to recognize all derivative instruments on the consolidated balance sheet at fair value. Interest rate lock commitments on mortgage loans to be sold into the secondary market are considered to be derivative instruments. The Bank estimates the fair value based on the change in fair value since inception of the underlying commitment, adjusted for the probability that the loan will close within the terms of the commitment.

Interest rate lock commitments are agreements to lend to a customer as long as there is no violation of any condition in the rate lock agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The number of days from the date of the commitment to expiration of fixed rate lock commitments outstanding at December 31, 2022, was less than 30 days on average. The range of note rates for fixed rate commitments was 6.250% to 6.625%. The fair value of interest rate lock commitments was not significant at December 31, 2022 or 2021.

Forward Loan Sale Commitments

The Bank evaluates all loan sales agreements to determine whether they meet the definition of a derivative, as facts and circumstances may differ significantly. Forward commitments protect against the price risk inherent in derivative loan commitments and mortgage loans held for sale, and as such, the Bank utilizes "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments or from the fluctuation in value of mortgage loans held for sale. The fair value of forward loan commitments was not significant at December 31, 2022 and 2021.

12. LEASES *(including subsequent event)*

Lessee Arrangements

The Company enters into leases in the normal course of business. Existing leases have remaining terms ranging from 0 to 8 years and do not include residual value guarantees or covenants.

Leases are classified as operating or financing leases at the lease commencement date. Lease expense for short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

The Company includes lease extension and termination options in the lease term if, after considering relevant economic factors, it is reasonably certain the Company will exercise the option. In addition, the Company has elected to account for any non-lease components in its real estate leases as part of the associated lease component. The Company has also elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the Company's consolidated balance sheets.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors. The following table summarizes other information related to the Company's leases during the year ended December 31.

The following table summarizes other information related to the Company's leases during the years ended December 31:

	2022	2021
Cash paid for amounts included in the measurements of lease obligations:		
Operating cash flows from operating leases:	$ 549	$ 445
Right-of-use assets obtained in exchange for new operating lease obligations	326	2,424
Operating lease weighted average remaining lease term (years)	7.9	9.1
Operating lease weighted average discount rate	1.65%	1.56%

Right-of-use assets and lease liabilities tied to operating leases were $2.3 million as of December 31, 2022 and $2.2 million as of December 31, 2021. These amounts are included with other assets and other liabilities on the balance sheet presentation. Total lease expense for the years ended 2022 and 2021 were $559,000, and $423,000, respectively. These amounts included $289,000 and $214,000 of amortization expense for operating leases in 2022 and 2021, respectively. The Company had no financing leases as of December 31, 2022 or 2021.

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2022 are as follows (dollars in thousands):

Year	Operating Leases
2024	$ 330
2025	332
2026	308
2027	309
2028	310
Thereafter	856
	$ 2,445

On January 1, 2023, the Company extended the term of an existing lease beyond 12 months resulting in an operating lease. Right-of-use assets and lease liabilities based on the estimated present value of lease payments over the lease term total $457,000.

13. STOCK BASED COMPENSATION

On June 23, 2009, the Board of Directors of the Company approved the adoption of the Grand River Commerce, Inc. 2009 Stock Incentive Plan (the "2009 Plan") which provides for the reservation of 200,000 authorized shares of the Company's common stock, $0.01 par value per share, for issuance upon the exercise of certain common stock options, that may be issued pursuant to the terms of the 2009 Plan. The 2009 Plan was approved and adopted by our shareholders at our 2010 Annual Meeting. Effective March 1, 2017, the 2009 Plan was amended in part to add restricted stock as a type of award under the Plan. The plan expired on April 30, 2019, and as such no new awards can be granted under this plan.

Common Stock Options

During the second quarter of 2009, the Company awarded and issued options for the purchase of 100,000 shares of Company common stock. During 2013 and 2012, the Company awarded 500 and 35,000 common shares for additional employee options, respectively, to acquire 500 and 35,000 shares respectively, under the 2009 Plan. All such options expired ten years from date of original grant. Employee options had a 5 year vesting period and Director options had a 3 year vesting period.

The agreements were modified on December 30, 2016. The common stock option exercise price was modified from $10.00 to $5.30 for Director and Employee options resulting in compensation expense of $108,000 in 2016 and associated $12,000 of deferred income tax benefit. In addition, employee options were reset with a new 10-year term.

The total stock options outstanding at December 31, 2022 and 2021 under the 2009 plan were 60,000 and 65,000 respectively. Stock options totaling 5,000 shares were exercised in 2022 and no options were exercised in 2021.

The Company measures the cost of employee services received in exchange for equity awards, including stock options, based on the grant date fair value of the awards. The cost is recognized as compensation expense over the vesting period of the awards. The Company estimates the fair value of all stock options on each grant date and the modified date, using the Black-Scholes option pricing model.

The Company uses expected data to estimate option exercise and employee termination within the valuation model. The risk-free rate for periods within the contractual term of the option is based on the U.S. Treasury yield curve in effect at the time of grant and modification of the option.

A summary of option activity under the expired 2009 Plan is presented below for the year ended December 31:

	2022		2021	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at January 1	65,000	$ 5.30	70,000	$ 5.30
Granted	-	-	-	-
Exercised	(5,000)	5.30	-	
Expired or cancelled	-		(5,000)	5.30
Outstanding at December 31, including those modified	**60,000**	**$ 5.30**	**65,000**	**$ 5.30**

There are 60,000 common stock options able to be exercised at December 31, 2022 and 65,000 as of December 31, 2021. No further options have been granted since 2013. As of December 31, 2022 and 2021, there was no unrecognized compensation cost related to nonvested share-based compensation arrangements granted under this Plan.

Restricted Stock Awards

In February 2021, the Company formalized a new restricted stock plan (the "2020 Plan") to replace the 2009 Plan, which had expired. The 2020 Plan provides for the reservation of 650,000 authorized shares of the Company's common stock, $0.01 par value per share. Unless terminated earlier, the 2020 Plan expires in February 2031. Under the provisions of the plan, the Company cannot be obligated to "cash settle" any of the restricted stock awards through redemption.

During 2022 and 2021, a total of 21,436 and 19,153 shares, respectively, were granted under this plan, of which 14,796 and 16,566 vested, with the remainder vesting over three years. The fair value of restricted stock awards is estimated by the market price of the Company's common stock at the date of grant. Total compensation expense of $143,000 and $56,000 was recognized in 2022 and 2021, respectively, for these restricted stock awards. During the period the shares are not vested, the participant may not sell, assign, transfer, pledge, or otherwise encumber the shares but has all other rights of a shareholder, including the right to receive dividends and the right to vote such shares. Unvested shares are immediately forfeited when the employment of a grantee is terminated and immediately become vested upon a change of control or the death or disability of the participant. There was $46,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted on the plan. These costs will be recognized through 2025.

A summary of restricted stock activity under the 2020 Plan is presented below for the year ended December 31:

	2022		2021	
	Shares	Weighted Average Grant-Date Fair Value	Shares	Weighted Average Grant-Date Fair Value
Nonvested at January 1	2,587	$ 5.80	-	$ -
Granted	21,436	7.05	19,153	5.74
Vested	14,796	7.05	16,566	5.74
Forfeited	-	-	-	-
Nonvested at December 31	**9,227**	**$ 7.00**	**2,587**	**$ 5.80**

PRSUs and SOSARs

In November 2021, the Company executed an executive employment agreement which includes equity based compensation awards for Stock Only Appreciation Rights ("SOSARs") and Performance based Restricted Stock Units ("PRSUs"). These awards are issued under the terms of the 2020 Plan. In accordance with ASC 718-10-25, the awards are classified as equity awards that settle in shares of the Company's common stock. The fair value of the awards was measured on the grant date. The fair value of the SOSARs was estimated using a Black Scholes model, and the value of the PRSU's was estimated using the stock price at the grant date multiplied by the units awarded. The cost of the awards will be spread over the performance period defined in the agreement.

Under the terms of the SOSAR, the recipient receives the right to receive payment in the form of shares of common stock equal to the difference, if any, in the fair market value of one share of common stock at the time of exercising the SOSAR and the exercise price. This SOSAR award vests in December 2026 and expires December 2031. Under the terms of the PRSU agreement, vesting of the award is based on the achievement of cumulative financial performance metrics over a performance period, which began in November 2021 and ends December 2026. Settlement in shares of the Company's stock may be deferred to December 2031 based on a one time election by the recipient. Expense recognized in 2022 and 2021 assumes actual performance will match targets established in the agreement. Adjustments will be made in future periods if actual performance lags the financial performance targets.

A total of 100,000 SOSARs were awarded in 2021 and remained outstanding as of December 31, 2022 with an average weighted exercise price of $7.23 each. A total of 125,000 PRSUs were granted in 2021 and remained outstanding as of December 31, 2022. Total compensation expense recognized in 2022 and 2021 for the SOSARs was $35,000 and $3,000, respectively, and expense for the PRSUs was $178,000 and $15,000, respectively.

	2022		2021	
SOSARs	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at January 1	100,000	$ 7.23	-	$ -
Granted	-	-	100,000	7.23
Exercised	-	-	-	-
Canceled / forfeited	-	-	-	-
Outstanding at December 31	100,000	$ 7.23	100,000	$ 7.23

	2022		2020	
PRSUs	Shares	Weighted Average Price at Grant Date	Shares	Weighted Average Price at Grant Date
Outstanding at January 1	125,000	$ 7.23	-	$ -
Granted	-	-	125,000	7.23
Forfeited	-	-	-	-
Shares delivered	-	-	-	-
Outstanding at December 31	125,000	$ 7.23	125,000	$ 7.23

14. COMMON STOCK PURCHASE WARRANTS

The Company measures the cost of equity instruments based on the grant-date fair value of the award (with limited exceptions). The Company estimates the fair value of all common stock purchase warrants on each grant date, using an appropriate valuation approach based on the Black-Scholes option pricing model.

In recognition of the substantial financial risks undertaken by the members of the Company's organizing group, the Company granted 305,300 common stock purchase warrants to such organizers. These warrants were originally exercisable at a price of $10.00 per share, the initial offering price, and were to be exercised within ten years from the date that the Bank opened for business. The warrants vested immediately. In connection with the issuance of these warrants in 2009, the Company determined a share-based payment value, using the Black Scholes option-pricing model, of $479,000. This amount was charged entirely to the additional paid in capital of the 2009 common stock offering. No additional warrants have been issued since 2009.

On December 30, 2016, the exercise price of the warrants was modified from $10.00 to $5.30. The resulting increase in the incremental fair value of the modified awards was recognized as an adjustment to paid in capital of $303,000, using the Black Scholes option-pricing model. The warrants are fully vested and were required to be exercised by April 30, 2019. On February 26, 2019, the Company modified the expiration date to require exercise within 3.2 years. The resulting increase in the incremental fair value of the modified awards was recognized as an adjustment to paid in capital of $417,021, using the Black Scholes option-pricing model.

The fair value of each warrant issued was estimated on the February 26, 2019, date of grant, using the Black Scholes option pricing model with the following weighted average assumptions.

Dividend yield or expected dividends	0.00%
Risk free interest rate	2.44%
Expected life	3.2 years
Expected volatility	44.05%

As of December 31, 2022 and 2021, a total of 238,229 and 10,796 warrants, respectively, had been exercised resulting in the issuance of 249,025 shares of common stock. The remaining 56,275 warrants expired unexercised.

15. EARNINGS PER SHARE

	2022	2021
Basic		
Net (loss) income (dollars in thousands)	$ (2,174)	$ 3,317
Weighted average common shares outstanding	6,962,466	6,749,388
Basic (loss) earnings per common share	$ (0.31)	$ 0.49
Diluted		
Net (loss) income (dollars in thousands)	$ (2,174)	$ 3,317
Weighted average common share outstanding	6,962,466	6,749,388
Plus dilutive stock options and warrants	60,000	354,504
Weighted average common share outstanding and potentially dilutive shares	7,022,466	7,103,892
Diluted (loss) earnings per common share	$ (0.31)	$ 0.47

There were no common stock options and warrants that were considered anti-dilutive to earnings per share as of December 31, 2022 or 2021.

16. MINIMUM REGULATORY CAPITAL REQUIREMENTS AND RESTRICTIONS ON CAPITAL (including subsequent event)

Banks and bank holding companies are subject to regulatory capital requirements administered by Federal banking agencies. Capital adequacy guidelines and, additionally for the Bank, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting policies. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The prompt corrective action regulations provide four classifications; well capitalized, adequately capitalized, undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, or worse, the institution would be subject to further regulatory restrictions. The Company is currently restricted from paying dividends until such time it has sufficient retained earnings to do so without negatively affecting its ability to support the Bank.

Quantitative measurements established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts of ratios (set forth in the following table). Management believes, as of December 31, 2022 and 2021, that the Bank met all capital adequacy requirements to which they are subject.

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As of December 31, 2022 and 2021, the minimum capital conservation buffer required was 2.500%. The Bank had a capital conservation buffer of 3.08% as of December 31, 2022. The Bank has elected not to include the net unrealized gain or loss on available for sale securities in computing regulatory capital.

As of December 31, 2022 and 2021, the most recent notifications 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, an institution must maintain minimum total risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are presented in the following tables (dollars in thousands).

December 31, 2022	Actual		Minimum Capital Requirements Plus Conservation Buffer		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total capital to risk weighted assets	$ 52,886	11.08%	$ 50,130	10.50%	$ 47,743	10.00%
Common equity tier 1 capital to risk weighted assets	46,958	9.84	33,420	7.00	31,033	6.50
Tier 1 capital to risk weighted assets	46,958	9.84	40,581	8.50	38,194	8.00
Tier 1 capital to average assets	46,958	8.86	21,199	4.00	26,499	5.00

December 31, 2021	Actual		Minimum Capital Requirements Plus Conservation Buffer		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total capital to risk weighted assets	$ 49,296	12.36%	$ 41,864	10.50%	$ 39,871	10.00%
Common equity tier 1 capital to risk weighted assets	44,430	11.14	27,909	7.00	25,916	6.50
Tier 1 capital to risk weighted assets	44,430	11.14	33,890	8.50	31,896	8.00
Tier 1 capital to average assets	44,430	8.87	20,047	4.00	25,059	5.00

Consistent with its policy that bank holding companies should serve as a source of financial strength for their subsidiary banks, the Federal Reserve has stated that, as a matter of prudence, Grand River Commerce, a bank holding company, generally should not maintain a rate of distributions to shareholders unless its available net income has been sufficient to fully fund the distributions, and the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition. In addition, the Company is subject to certain restrictions on the making of distributions as a result of the requirement that the Bank maintain an adequate level of capital as described above. As a Michigan company, the Company is restricted under the Michigan Business Company Act from paying dividends under certain conditions.

On January 31, 2023, Grand River Commerce downstreamed $2.5 million of additional capital to the Bank to further bolster its capital position.

17. CONTINGENCIES

Litigation

The Company is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

18. EMPLOYEE BENEFIT PLANS

The Company has a Safe Harbor 401(k) plan covering all employees. Contributions under the 401(k) plan are made by the employee with the Company contributing 100% of the employee deferral for the first 3% compensation and 50% of the deferral for the next 2% of the employee's deferral within IRS limits. The cost of the plan amounted to $255,000 and $221,000 for 2022 and 2021, respectively.