Table Of Contents

Annual Meeting

Monday, April 25, 2022
5:30 pm
Rozsa Center for the Performing Arts
Michigan Technological University
1400 Townsend Drive
Houghton, MI 49931

AHP
CPAs & ADVISORS

ANDREWS HOOPER PAVLIK PLC
5300 GRATIOT ROAD | SAGINAW, MI 48638
p: 989.497.5300 | f: 989.497.5353 | www.ahpplc.com

Report of Independent Auditors

Board of Directors and Stockholders
Keweenaw Financial Corporation
Hancock, Michigan

We have audited the accompanying consolidated financial statements of Keweenaw Financial Corporation and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Keweenaw Financial Corporation and Subsidiary as ofDecember 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of Keweenaw Financial Corporation and Subsidiary 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 the 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.

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 Keweenaw Financial Corporation and Subsidiary'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 auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantiallikelihood 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 GAAS, 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 Keweenaw Financial Corporation and Subsidiary'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 Keweenaw Financial Corporation andSubsidiary'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.

Andrews Hooper Pavlik PLC

Saginaw, Michigan
February 25, 2022

Consolidated Balance Sheets

	Year Ended December 31 2021	2020
Assets		
Cash and cash equivalents		
Cash and due from banks	$ 39,875,076	$ 33,395,513
Federal funds sold	49,533,545	69,332,131
Total cash and cash equivalents	**89,408,621**	**102,727,644**
Interest-bearing time deposits in other financial institutions	3,850,554	7,600,801
Investment securities available for sale	333,396,892	229,145,756
Federal Reserve and Federal Home Loan Bank stock	4,495,500	4,378,750
Loans held for sale	9,687,233	22,996,949
Loans, less allowance for loan losses of $9,680,262 in 2021 and $9,054,535 in 2020	592,109,022	570,955,380
Bank premises and equipment, net	6,971,744	7,287,158
Accrued interest receivable	3,263,813	3,530,873
Goodwill	19,615,774	19,615,774
Other assets	11,333,769	10,062,974
Total assets	**$ 1,074,132,922**	**$ 978,302,059**
Liabilities and stockholders' equity		
Liabilities		
Deposits		
Demand	$ 242,836,248	$ 208,365,343
NOW	139,252,371	105,307,942
Money market	56,739,563	57,415,213
Savings	319,563,273	264,584,235
Time	184,333,820	225,386,720
Total deposits	**942,725,275**	**861,059,453**
Borrowed funds	8,460,057	16,800,000
Subordinated debentures	15,000,000	-
Accrued interest payable and other liabilities	11,476,981	10,415,949
Total liabilities	**977,662,313**	**888,275,402**
Stockholders' equity		
Preferred stock: no par value, 50,000 shares authorized; none issued or outstanding in 2021 and 2020	-	-
Common stock: no par value; 2,000,000 shares authorized in 2021 and 2020; 1,159,350 shares issued and outstanding in 2021 and 2020	515,549	515,549
Retained earnings	97,506,072	85,959,784
Accumulated other comprehensive income (loss)	(1,551,012)	3,551,324
Total stockholders' equity	**96,470,609**	**90,026,657**
Total liabilities and stockholders' equity	**$ 1,074,132,922**	**$ 978,302,059**

See accompanying notes.

Consolidated Statements Of Income

	Year Ended December 31 2021	2020
Interest income:		
Loans, including fees	$ 33,235,150	$ 33,200,595
Securities	71,845	45,318
U.S. Treasury securities	1,845,955	2,150,854
U.S. Government agencies	2,013,630	1,695,918
Obligations of states and political subdivisions	575,680	500,267
Other securities	441,894	553,504
Other interest income	**38,184,154**	**38,146,456**
Interest expense:		
Deposits	3,609,055	6,121,197
Borrowed funds and subordinated debentures	886,025	474,271
	4,495,080	6,595,468
Net interest income	**33,689,074**	**31,550,988**
Provision for loan losses	922,000	3,835,812
Net interest income after provision for loan losses	**32,767,074**	**27,715,176**
Noninterest income:		
Trust fees	1,935,214	1,763,693
Service charges on deposit accounts	818,677	901,731
Other service charges and fees	1,531,901	1,171,006
Net gain on sale of investment securities	1,699	26,823
Net gain on sale of loans	17,057,476	18,606,660
Other	1,654,241	2,336,714
	22,999,208	**24,806,627**
Noninterest expenses:		
Salaries and wages	21,676,965	20,973,830
Pensions and other employee benefits	4,640,227	4,344,515
Occupancy expenses, net	6,485,486	6,491,730
Postage and supplies	241,347	285,403
FDIC and general insurance	418,426	438,126
Legal and professional	1,050,588	1,336,405
Loan related expense	2,158,672	2,659,771
Marketing	402,147	173,768
Net cost of operations of other real estate – including write downs and gains/losses on sales	440,850	130,282
Other operating expenses	1,942,188	2,255,245
	39,456,896	**39,089,075**
Income before income tax expense	**16,309,386**	**13,432,728**
Income tax expense	3,209,568	2,783,083
Net income	**$ 13,099,818**	**$ 10,649,645**
Net income per share of common stock	**$ 11.30**	**$ 9.19**

See accompanying notes.

Consolidated Statements Of Comprehensive Income

	Year ended December 31 2021	2020
Net income	$ 13,099,818	$ 10,649,645
Other comprehensive income (loss), net of tax		
Unrealized holding gains (losses) arising during the period	(5,100,994)	2,815,219
Reclassification adjustment for net gains included in net income	(1,342)	(21,190)
Total other comprehensive income (loss)	**(5,102,336)**	**2,794,029**
Total comprehensive income	**$ 7,997,482**	**$ 13,443,674**

Consolidated Statements Of Changes In Stockholders' Equity

Years Ended December 31, 2021 and 2020

	Common Stock Number of Shares	Common Stock Assigned Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at January 1, 2020	1,159,350	$ 515,549	$ 76,817,295	$ 757,295	$ 78,090,139
Net income for 2020			10,649,645		10,649,645
Other comprehensive income, net of tax				2,794,029	2,794,029
Cash dividends paid ($1.30 per share)			(1,507,156)		(1,507,156)
Balance at December 31, 2020	**1,159,350**	**515,549**	**85,959,784**	**3,551,324**	**90,026,657**
Net income for 2021			13,099,818		13,099,818
Other comprehensive loss, net of tax				(5,102,336)	(5,102,336)
Cash dividends paid ($1.34 per share)			(1,553,530)		(1,553,530)
Balance at December 31, 2021	**1,159,350**	**$ 515,549**	**$97,506,072**	**$ (1,551,012)**	**$ 96,470,609**

See accompanying notes.

Consolidated Statements Of Cash Flows

	Year Ended December 31 2021	2020
Cash flows from operating activities:		
Net income	$ 13,099,818	$ 10,649,645
Adjustments to reconcile net income from operating activities:		
Depreciation and amortization of right-of-use assets	1,568,260	1,412,334
Amortization of core deposit intangibles	156,143	143,131
Accretion of time deposit purchased	(98,833)	(1,087,167)
Accretion of loans purchased	(1,230,974)	(943,427)
Net amortization of investment securities	964,318	785,842
Deferred taxes (benefit)	(56,000)	(709,000)
Fair value increase at transfer of other real estate owned	(10,739)	(3,635)
Valuation write-downs of other real estate owned	21,510	57,120
Net gain on sale of other real estate owned	(58,522)	(27,845)
Loss on disposal of premises and equipment	398,977	104,317
Realized net investment security gains	(1,699)	(26,823)
Repayment of lease liabilities	(677,996)	(616,524)
Gain on sale of loans	(17,057,476)	(18,606,660)
Proceeds from sale of mortgage loans held for sale	455,573,903	510,424,632
Origination of mortgage loans held for sale	(425,206,711)	(505,819,712)
Provision for loan losses	922,000	3,835,812
Net change in:		
Accrued interest receivable and other assets	(87,997)	(1,694,536)
Accrued interest payable and other liabilities	1,301,349	538,164
Net cash from operating activities	29,519,331	(1,584,332)
Cash flows from investing activities		
Purchase of Main Street Bank, net of cash acquired	–	(36,615,891)
Decrease in interest-bearing time deposits in other financial institutions	3,750,247	1,500,757
Activity in investment securities available for sale:		
Purchases	(170,707,994)	(120,389,633)
Maturities, prepayments, calls, and sales	59,035,586	94,464,418
Purchase of Federal Reserve and Federal Home Loan Bank stock	(116,750)	(1,057,650)
Loan originations and payments, net	(20,957,182)	(20,859,631)
Proceeds from sales of other real estate owned	254,465	354,718
Additions to bank premises and equipment, net	(967,908)	(444,645)
Net cash from investing activities	(129,709,536)	(83,047,557)
Cash flows from financing activities		
Net change in demand, NOW, money market, and savings deposits	122,718,722	180,913,439
Net change in time deposits	(40,954,067)	(48,034,276)
Proceeds from borrowings and subordinated debentures	15,000,000	25,000,000
Principal payments on notes payable	(8,339,943)	(10,000,000)
Net draws on line of credit	–	1,800,000
Net repayments on short-term borrowings	–	(6,000,000)
Cash dividends	(1,553,530)	(1,507,156)
Net cash from financing activities	86,871,182	142,172,007
Net change in cash and cash equivalents	(13,319,023)	57,540,118
Cash and cash equivalents at beginning of year	102,727,644	45,187,526
Cash and cash equivalents at end of year	**$ 89,408,621**	**$102,727,644**

See accompanying notes.

Consolidated Statements Of Cash Flows (continued)

	Year ended December 31	
	2021	2020
Supplemental cash flow information		
Transfer of loans to other real estate loans	$ 149,514	$ 282,240
Loans originated from sale of other real estate owned	37,000	333,857
Lease liabilities arising from obtaining right-of-use assets	437,679	3,024,876
Income taxes paid	3,524,568	3,209,000
Interest paid	4,622,488	6,606,750

Notes To Consolidated Financial Statements • December 31, 2021

1. Summary of Significant Accounting Policies and Nature of Operations

The accounting policies followed by Keweenaw Financial Corporation (Corporation) and its wholly owned subsidiary and the methods of applying these policies, which materially affect the determination of financial position, results of operations, and cash flows are summarized below.

Nature of Operations

The Corporation provides a variety of financial and trust services to individuals and corporate customers through Superior National Bank (SNB or Bank) and branches located in the Upper Peninsula and Southeast Michigan. The Bank provides a wide range of traditional banking products and services, including automated teller machines, online banking, telephone banking, and automated bill-paying services, to both individual and corporate customers. SNB's wholly owned subsidiary, Practical Security Solutions, LLC, provides cybersecurity consulting services.

The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America (U.S. GAAP) and to general practices within the banking and mortgage banking industries.

Principles of Consolidation

The consolidated financial statements include the accounts of Keweenaw Financial Corporation and its wholly owned subsidiary, Superior National Bank. All material intercompany transactions and balances have been eliminated in consolidation. See the Acquisition of North Star Financial Holding, Inc. section for further details regarding subsidiary consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. The significant estimates incorporated into the Corporation's consolidated financial statements, which are susceptible to change in the near term, include the adequacy of the allowance for loan losses, the fair value of financial instruments, impaired loans, investments, deferred tax assets, other real estate, and the fair value of acquired assets and liabilities. Accordingly, actual results could differ from those estimates.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Labor Subject to Collective Bargaining Agreements

Approximately 12% of SNB's employees are subject to a collective bargaining agreement, which expires on September 25, 2024.

Cash Flow Reporting

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined to include cash on hand, demand deposits in other institutions, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest-bearing time deposits, and bank premises and equipment.

Cash and Cash Equivalents

The Corporation maintains deposit accounts with other financial institutions, which generally exceed federally insured limits or are uninsured.

Interest-Bearing Time Deposits in Other Financial Institutions

Interest-bearing time deposits in other financial institutions are certificates of deposit which mature in the years ending 2022 through 2032 and are carried at cost.

Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. In determining fair value, the Corporation uses various methods including market, income, and cost approaches. Based on these approaches, the Corporation often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Corporation utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Corporation is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

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

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

- Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Fair Value Measurements (continued)

In determining the appropriate levels, the Corporation performs a detailed analysis of the assets and liabilities. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3. For the years ended December 31, 2021 and 2020, the application of valuation techniques applied to similar assets and liabilities has been consistent.

Acquisition of North Star Financial Holdings, Inc.

On February 4, 2020, the Corporation acquired 100% of North Star Financial Holdings, Inc. (North Star), a Michigan corporation, located in Bingham Farms, in exchange for $42,000,000. Under the terms of the acquisition, all assets of North Star were distributed to the Corporation, and the separate corporate existence of North Star then ceased. All shares of North Star common stock were converted automatically into the right to receive a proportionate amount of cash equal to the merger consideration less adjustments. The transaction was consummated by the filing of a Certificate of Merger on February 4, 2020. Main Street Bank, a state-chartered bank previously owned by North Star, became a subsidiary of the Corporation as of the acquisition date.

The acquisition provided a great growth opportunity for the Bank and enabled the expansion of banking services in a growing Michigan market. The two banks are geographically located in different regions of the state, but share the same culture, values, and commitment to their customers and communities. Operational synergies assisted in providing customers with excellent mortgage loan opportunities and a broader base of products throughout the past two years. Trust and financial services have been introduced in the new market. The banks merged and combined technology systems effective February 19, 2021, resulting in one bank, Superior National Bank. The merger was approved by the Office of the Comptroller of Currency (OCC), the Bank's primarily regulator, on November 12, 2020.

See Note 20 Business Combination, for further information on the details of the acquisition.

Investment Securities

Management determines the appropriate classification of securities at the time of purchase. Securities classified as available for sale are reported at fair value, with unrealized gains and losses, net of related deferred income taxes, included in other comprehensive income. Unrealized gains and losses on investment securities available for sale are based on the difference between book value and fair value of each security. Securities available for sale consist of those securities that management intends to use as part of its asset and liability management strategy which might be sold prior to maturity due to changes in interest rates, prepayment risks, and yields in addition to the availability of alternative investments, liquidity needs, or other factors. Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment.

Fair value is based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to the limited market activity of the instrument.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Investment Securities (continued)

Interest income on securities includes amortization of purchase premium or accretion of discount. The amortized cost amount is the acquisition cost adjusted for amortization of premiums and accretions of discounts. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Realized gains and losses on dispositions are recorded on the trade date and are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Debt securities are written down to fair value when a decline in fair value is other than temporary.

The entire amount of impairment is recognized through earnings for debt securities with unrealized losses that management intends to sell or will more likely than not be required to sell before an anticipated recovery in fair value. Otherwise, declines in the fair value of debt securities below their cost that are other than temporary are split into two components as follows: (1) other-than-temporary impairment (OTTI) related to credit loss, which must be recognized in the statements of income; and (2) OTTI related to other factors, which is recognized in other comprehensive income. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost; (2) the financial condition and near term prospects of the issuer; and (3) the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Federal Reserve Bank Stock

The Bank is a member of its regional Federal Reserve Bank (FRB). FRB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank (FHLB) System and is required to invest in capital stock of the FHLB of Indianapolis. The amount of the required investment is determined and adjusted by the FHLB and is carried at cost.

Loans Held for Sale

Loans held for sale are reported at the lower of cost or fair value in the aggregate, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold without servicing rights being retained.

Loans

The Bank's loan portfolio includes residential real estate, commercial real estate, commercial, and consumer installment segments and classes.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses.

Notes to Consolidated Financial Statements • December 31, 2021

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Loans (continued)

Interest income is reported on the simple interest method on the daily balance of the principal amount outstanding and includes amortization of net deferred loan fees and costs over the loan term. Accrual of interest is generally discontinued on (1) commercial loans 90 days past due as to either principal or interest, (2) real estate mortgage loans which are past due 90 days or more and on which collateral is inadequate to cover principal and interest, and (3) any loans, which management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection is doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income at the time the loan is assigned nonaccrual status. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. 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 continues to be accrued over the term of the loan based on the principal amount outstanding.

Loans classified as troubled debt restructurings (TDRs) are accounted for in generally the same manner as all other loans. If the loan is in accrual status at the time of the restructuring, the borrower has the ability to make the payments under the restructured terms, and the restructuring does not forgive principal, the loan remains on an accrual basis under the new terms. If there is a forgiveness of debt or partial charge-off, the loan will generally be placed on nonaccrual status with any accrued interest reversed against interest income. If a loan is in nonaccrual status at the time of a restructuring or subsequently becomes nonaccrual, it will remain in nonaccrual status until the borrower has demonstrated the ability to make the payments under the restructured terms by making a minimum of six months of payments. If the borrower makes the six months of payments without becoming past due 30 days or more, it will be returned to accrual status.

Purchase Credit Impaired Loans

SNB purchased individual loans and groups of loans, some of which have shown evidence of credit deterioration since origination. These purchased credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Such purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as credit score, loan type, and date of origination. SNB estimated the amount and timing of expected cash flows for each loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Notes to Consolidated Financial Statements • December 31, 2021

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses, and decreased by charge-offs. Subsequent recoveries, if any, are credited to (increase) the allowance. The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management's periodic review of the collectability of the loans in light of historical loss experience, the nature and volume of the loan portfolio, information about specific borrower's ability to repay, estimated collateral values, prevailing local and national economic conditions, and other factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the collectability of a loan balance is confirmed.

Regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans and other real estate. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is possible that the estimated losses on loans and other real estate may change in the near term. However, the amount of the change cannot be estimated. The allowance consists of general, specific, and unallocated components as further described as follows:

General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: commercial, residential real estate, commercial real estate, and consumer installment loans. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels and trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and staff; national and local economic trends and conditions; changes in loan review and oversight; impact of competition and legal and regulatory requirements; changes in the value of underlying collateral; and the impact and effects of concentrations.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential Real Estate Loans – Loans in this segment are collateralized by residential real estate and repayment is dependent on the credit quality of the borrower and the value of the underlying collateral. Changes in business conditions, including unemployment rates and housing prices, and the local real estate market can affect the credit quality of this segment.

Commercial Real Estate Loans – Loans in this segment are collateralized by commercial real estate and repayment is dependent on the income-generating capacity of the business, the credit quality of the borrower, and the value of the underlying collateral. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy. Changes in business conditions and cash flows and the value of the underlying collateral can affect the credit quality of this segment.

Notes to Consolidated Financial Statements • December 31, 2021

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

General Component (continued)

Commercial Loans – Loans in this segment are generally collateralized by the assets of the business. Repayment is dependent on the income-generating capacity of the business. Changes in business conditions, a weakened economy, and resulting decreased consumer spending will affect the credit quality of this segment.

Consumer Installment Loans – Loans in this segment are generally collateralized by vehicles, other personal property, or are unsecured. Repayment is dependent on the credit quality of the borrower and their intent to repay and the value of the underlying collateral, if any. Changes in business conditions, unemployment rates, and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Specific Component

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

An allowance is established when the discounted cash flows (or collateral value) of the impaired loan are lower than the carrying value of the loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual residential real estate and consumer installment loans for impairment, unless such loans are subject to a troubled debt restructuring, collateral repossession, bankruptcy, or management has concerns about the borrower's ability to repay or concerns about the value of the underlying collateral.

The Bank may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. All TDRs are classified as impaired loans.

Unallocated Component

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

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, 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 the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. If the transfer does not meet the conditions for sale accounting, the transfer is accounted for as secured borrowings with a pledge of collateral.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Additions and major replacements or improvements that extend useful lives are capitalized. Maintenance, repairs, and minor improvements are charged to expense as incurred. Depreciation is computed using the straight-line method over estimated useful lives for book purposes and is charged to operations. Depreciation is generally computed for tax purposes using an accelerated method. Deferred income taxes are provided on such differences. Gains and losses on bank premises and equipment disposed of are included in other noninterest income. Depreciation expense totaled $884,345 and $795,810 and includes accretion related to the recognition of a service provider credit for future expenses of $147,142 at December 31, 2021 and 2020, respectively.

Goodwill

Goodwill is an intangible asset established only at the time of a business combination when the purchase price of an acquisition exceeds the fair value of the net underlying assets and liabilities. At the time of the North Star Financial Holdings, Inc. acquisition, the fair value of the underlying assets was equal to $269.5 million and the fair value of the liabilities was valued at $247.3 million. The purchase price of the acquisition exceeded the net fair value of the assets and liabilities by $19.8 million, thereby establishing the goodwill value as of February 4, 2020. Goodwill acquired in a business combination is determined to have an indefinite useful life and is not amortized, but tested for impairment at least annually. No impairment was recorded in 2021 or 2020.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Other Real Estate Owned

Other real estate acquired through, or in lieu of, loan foreclosure is initially recorded at fair market value less estimated selling costs at the date of foreclosure establishing a new cost basis. At the date of acquisition or physical possession, and the following 90 days, losses are charged to the allowance for loan losses and increases in value are recorded as a recovery to the allowance for loan loss up to the extent of prior charge-offs and then to noninterest income. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed. After acquisition, valuations are periodically performed by management, and any subsequent writedowns are recorded as a charge to operations, if necessary, to reduce the carrying value of a property. Other real estate owned is included in other assets on the consolidated balance sheets.

Bank-Owned Life Insurance

The Corporation purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at its cash surrender value and is included in other assets on the consolidated balance sheets.

Intangible Assets, Net

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Intangible assets of $500,000 were acquired with the 2019 purchase of Practical Security Solutions, LLC, and a core deposit intangible value of $1,093,000 was established with the 2020 acquisition of North Star Financial Holdings, Inc. and its subsidiary Main Street Bank. Intangible assets were recorded at fair value at the time of acquisition. The Practical Security Solutions intangible balance is amortized over a remaining useful life of fifteen years. The Main Street Bank core deposit intangible is amortized over a remaining useful life of seven years. Amortization expense was $189,476 in 2021 and $176,464 in 2020. These intangible assets are tested for impairment annually. There was no impairment recorded in 2021 or in 2020.

Long-Term Assets

Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Pension and Profit Sharing Plans

Bank contributions to the plans are charged to current operations.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. The Corporation records interest and penalties related to tax positions as interest expense or other expense, respectively, in the consolidated statements of income.

Common Stock Repurchases

The Board approved the Keweenaw Financial Corporation Stock Repurchase Plan of 2016, which authorized the repurchase up to 37,000 of its outstanding shares of common stock upon privately negotiated terms, conditions, and prices. The Stock Repurchase Plan was extended for one-year periods in January 2021 and 2020. The Corporation repurchased no shares of common stock in 2021 and 2020. In January 2022, the Stock Repurchase Plan was approved by the Board for an additional year.

Earnings Per Common Share

Earnings per share are computed based on the weighted-average number of shares of common stock outstanding. The weighted-average number of shares of common stock outstanding was 1,159,350 shares as of December 31, 2021 and 2020.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commitments under credit arrangements, and letters of credit. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded in the consolidated financial statements when they become payable.

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Advertising

The Bank expenses advertising costs as incurred.

1. Summary of Significant Accounting Policies and Nature of Operations (continued)

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes the net change in unrealized gains and losses on securities available for sale, net of tax, which are also recognized as separate components of equity. Other comprehensive income (loss) also includes a reclassification adjustment for net gains and losses included in net income.

Restrictions on Cash

Cash on hand or on deposit with the Federal Reserve Bank was not required at December 31, 2021 or 2020, due to Federal Reserve changes effective March 26, 2020 when reserve requirements for all financial institutions were eliminated due to the COVID-19 pandemic and impact to the financial world.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Corporation or by the Corporation to shareholders.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the consolidated financial statements.

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Subsequent Events

Subsequent events were evaluated through February 25, 2022 which was the date the financial statements were available to be issued.

2. Investment Securities

The amortized cost and fair values of investment securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) at December 31, were as follows:

2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government & federal agencies	$ 113,281,232	$ 176,271	$ (1,800,272)	$ 111,657,231
Corporate debt	35,950,289	206,092	(608,801)	35,547,580
Mortgage-backed securities	69,724,501	388,029	(1,505,066)	68,607,464
State and local governments	116,404,176	1,836,103	(655,662)	117,584,617
	$ 335,360,198	**$ 2,606,495**	**$ (4,569,801)**	**$ 333,396,892**

2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government & federal agencies	$ 53,702,377	$ 498,173	$ (253,856)	$ 53,946,694
Corporate debt	16,853,083	553,578	(20,506)	17,386,155
Mortgage-backed securities	50,824,113	1,087,296	(114,610)	51,796,799
State and local governments	103,270,836	2,791,810	(46,538)	106,016,108
	$ 224,650,409	**$ 4,930,857**	**$ (435,510)**	**$ 229,145,756**

The amortized cost and fair values of investment securities available for sale by contractual maturity at December 31, 2021, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

	Amortized Cost	Fair Value
Due in one year or less	$ 6,755,105	$ 6,787,514
Due in one year through five years	57,595,428	58,074,574
Due after five years through ten years	130,968,916	129,737,112
Due after ten years	70,316,248	70,190,228
Mortgage-backed securities	69,724,501	68,607,464
	$ 335,360,198	**$ 333,396,892**

2. Investment Securities (continued)

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

	Less Than Twelve Months		Twelve Months or More		Total	Total
2021	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Government and federal agencies	$ 86,009,401	$ 1,214,480	$ 13,634,952	$ 585,792	$ 99,644,353	$ 1,800,272
Corporate debt	20,134,736	377,065	3,774,725	231,736	23,909,461	608,801
Mortgage-backed securities	39,539,773	1,001,165	9,637,869	503,901	49,177,642	1,505,066
State and local governments	37,807,808	510,397	5,055,535	145,265	42,863,343	655,662
	$183,491,718	**$3,103,107**	**$ 32,103,081**	**$ 1,466,694**	**$215,594,799**	**$ 4,569,801**

	Less Than Twelve Months		Twelve Months or More		Total	Total
2020	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Government and federal agencies	$ 20,694,878	$ 253,856	$ –	$ _	$ 20,694,878	$ 253,856
Corporate debt	3,004,933	20,506	–	–	3,004,933	20,506
Mortgage-backed securities	16,508,236	114,610	–	–	16,508,236	114,610
State and local governments	6,981,745	46,538	–	–	6,981,745	46,538
	$ 47,189,792	**$ 435,510**	**$ –**	**$ –**	**$ 47,189,792**	**$ 435,510**

At December 31, 2021, 213 debt securities had unrealized losses with aggregate depreciation of approximately 2.1% from the Bank's amortized cost basis, and 68 of the 213 securities were issued by a federal agency. Unrealized losses on obligations of U.S. Government and federal agencies, corporate debt, state and local governments, and mortgage-backed securities were not recognized into income because the securities were not deemed to be of low investment grade, management has the intent and ability to hold for the foreseeable future, and the decline in fair value is due to general economic conditions.

2. Investment Securities (continued)

Proceeds from sales and maturities of investment securities available for sale during 2021 were $59,035,586. Net gains on those sales and maturities totaled $1,699.

Proceeds from sales and maturities of investment securities available for sale during 2020 were $94,464,418. Net gains on those sales and maturities totaled $26,823.

Investment securities with a book value of $30,525,765 at December 31, 2021, and investment securities with a book value of $18,802,473 at December 31, 2020, were pledged as collateral to secure repurchase agreements, public deposits, and for other purposes required by law.

3. Loans and Allowance for Loan Losses

Loan segments at December 31 were as follows:

	2021	2020
Commercial	$ 117,446,382	$ 134,410,997
Commercial real estate	260,957,772	229,850,386
Residential real estate	173,417,397	169,255,877
Consumer installment	49,967,733	46,492,655
	601,789,284	580,009,915
Allowance for loan losses	(9,680,262)	(9,054,535)
Net loans	**$ 592,109,022**	**$ 570,955,380**

Changes in the allowance for loan losses by loan segment for the year ended December 31, 2021 were as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Balance at beginning of year	$ 1,128,631	$ 2,475,143	$ 1,992,149	$ 532,073	$ 2,926,539	$ 9,054,535
Provision charged to operations	605,977	1,859,387	25,451	161,664	(1,730,479)	922,000
Loans charged off	(340,966)	(62,873)	(7,233)	(144,093)	–	(555,165)
Recoveries	62,486	129,778	9,230	57,398	–	258,892
Balance at end of year	**$ 1,456,128**	**$ 4,401,435**	**$2,019,597**	**$ 607,042**	**$1,196,060**	**$9,680,262**

3. Loans and Allowance for Loan Losses (continued)

The following table presents the balance of loans by loan segment based on impairment method at December 31, 2021:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 257,994	$ 185,699	$ 395,757	$ 1,833	$ –	$ 841,283
Collectively evaluated for impairment	1,102,688	4,215,736	1,623,840	605,209	–	7,547,473
Acquired with deteriorated credit quality	95,446	–	–	–	–	95,446
Unallocated to specific loan segments	–	–	–	–	1,196,060	1,196,060
Ending allowance balance	**$ 1,456,128**	**$ 4,401,435**	**$ 2,019,597**	**$ 607,042**	**$ 1,196,060**	**$ 9,680,262**
Loans:						
Individually evaluated for impairment	$ 6,672,338	$ 7,492,495	$ 3,829,458	$ 204,215	$ –	$ 18,198,506
Collectively evaluated for impairment	110,537,929	252,170,333	169,559,400	49,763,518	–	582,031,180
Acquired with deteriorated credit quality	236,115	1,294,944	28,539	–	–	1,559,598
Ending loan balance	**$117,446,382**	**$260,957,772**	**$173,417,397**	**$49,967,733**	**$ –**	**$601,789,284**

3. Loans and Allowance for Loan Losses (continued)

Changes in the allowance for loan losses by loan segment for the year ended December 31, 2020 were as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Balance at beginning of year	$ 310,593	$ 1,584,850	$ 1,608,404	$ 413,215	$ 1,442,663	$ 5,359,725
Provision charged to operations	798,358	875,921	512,995	164,662	1,483,876	3,835,812
Loans charged off	(28,612)	–	(139,710)	(310,209)	–	(478,531)
Recoveries	48,292	14,372	10,460	264,405	–	337,529
Balance at end of year	**$ 1,128,631**	**$ 2,475,143**	**$ 1,992,149**	**$ 532,073**	**$ 2,926,539**	**$ 9,054,535**

The following table presents the balance of loans by loan segment based on impairment method at December 31, 2020:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 402,847	$ 90,474	$ 466,083	$ 10,370	$ –	$ 969,774
Collectively evaluated for impairment	725,429	2,327,512	1,526,066	521,703	–	5,100,710
Acquired with deteriorated credit quality	355	57,157	–	–	–	57,512
Unallocated to specific loan segments	–	–	–	–	2,926,539	2,926,539
Ending allowance balance	**$ 1,128,631**	**$ 2,475,143**	**$ 1,992,149**	**$ 532,073**	**$ 2,926,539**	**$ 9,054,535**

3. Loans and Allowance for Loan Losses (continued)

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Loans:						
Individually evaluated for impairment	$ 2,714,955	$ 11,010,238	$ 4,936,675	$ 284,091	$ –	$ 18,945,959
Collectively evaluated for impairment	130,734,875	218,284,393	164,319,202	46,180,471	–	559,518,941
Acquired with deteriorated credit quality	961,167	555,755	–	28,093	–	1,545,015
Ending loan balance	**$134,410,997**	**$ 229,850,386**	**$169,255,877**	**$ 46,492,655**	**$ –**	**$580,009,915**

The following table presents impaired loans individually evaluated for impairment by loan segment at December 31, 2021. The table below does not include those impaired loans acquired with deteriorated credit quality:

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Commercial	$ 11,075,210	$ 5,858,717	$ –	$ 3,047,101	$ 1,155,425
Commercial real estate	7,010,227	6,637,915	–	6,296,010	539,453
Residential real estate	1,583,180	1,577,970	–	1,537,776	78,953
Consumer installment	163,003	163,003	–	167,209	13,816
Total impaired loans without a valuation allowance	**$19,831,620**	**$14,237,605**	**$ –**	**$11,048,096**	**$ 1,787,647**
Impaired loans with a valuation allowance:					
Commercial	$ 976,325	$ 813,621	$ 257,994	$ 763,726	$ 66,423
Commercial real estate	931,119	854,580	185,699	656,381	59,010
Residential real estate	2,251,488	2,251,488	395,757	2,264,367	126,647
Consumer installment	41,212	41,212	1,833	49,196	4,256
Total impaired loans with a valuation allowance	**$ 4,200,144**	**$ 3,960,901**	**$ 841,283**	**$ 3,733,670**	**$ 256,336**
Total impaired loans	**$24,031,764**	**$18,198,506**	**$ 841,283**	**$ 14,781,766**	**$ 2,043,983**

3. Loans and Allowance for Loan Losses (continued)

The following table presents impaired loans individually evaluated for impairment by loan segment at December 31, 2020. The table below does not include those impaired loans collectively evaluated for impairment:

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Commercial	$ 659,852	$ 659,852	$ –	$ 679,149	$ 23,277
Commercial real estate	7,742,765	7,654,841	–	5,798,152	503,049
Residential real estate	1,906,807	1,881,404	–	1,827,408	109,031
Consumer installment	129,295	129,295	–	112,777	9,360
Total impaired loans without a valuation allowance	**$10,438,719**	**$ 10,325,392**	**$ –**	**$ 8,417,486**	**$ 644,717**
Impaired loans with a valuation allowance:					
Commercial	$ 2,060,257	$ 2,055,103	$ 402,847	$ 1,527,059	$ 226,564
Commercial real estate	3,373,636	3,355,397	90,474	2,544,221	172,222
Residential real estate	3,077,704	3,055,271	466,083	3,099,289	177,438
Consumer installment	154,796	154,796	10,370	152,516	10,155
Total impaired loans with a valuation allowance	**$ 8,666,393**	**$ 8,620,567**	**$ 969,774**	**$ 7,323,085**	**$ 586,379**
Total impaired loans	**$19,105,112**	**$18,945,959**	**$ 969,774**	**$15,740,571**	**$1,231,096**

The following table presents TDRs that occurred during 2021 by loan segment:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Valuation Allowance
Commercial	2	$ 1,255,307	$ 1,255,307	$ 65,271

3. Loans and Allowance for Loan Losses (continued)

The modification of the terms of such loans to borrowers with financial difficulty includes one or a combination of the following: a reduction in the stated interest rate of the loan; an extension of the maturity date; or some other modification deeming the loan a TDR. All TDRs are considered impaired loans in the calculation of the allowance for loan losses; therefore, management performs a reserve analysis on all loans that have been determined to be TDRs. The Corporation had a total TDR portfolio of $4,908,299 with a total valuation allowance of $376,599 as of December 31, 2021.

The following table presents TDRs by loan segment that had a payment default in 2021 within 12 months following modification:

	Number of Loans	Amount in Default
Commercial real estate	1	$ 1,175,286
Consumer installment	1	1,997

The following table presents TDRs that occurred during 2020 by loan segment:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Valuation Allowance
Commercial	5	$ 955,774	$ 955,774	$ –
Residential real estate	3	52,144	52,144	–
Consumer installment	5	49,331	49,331	–

The modification of the terms of such loans to borrowers with financial difficulty includes one or a combination of the following: a reduction in the stated interest rate of the loan; an extension of the maturity date; or some other modification deeming the loan a TDR. All TDRs are considered impaired loans in the calculation of the allowance for loan losses; therefore, management performs a reserve analysis on all loans that have been determined to be TDRs. The Corporation had a total TDR portfolio of $4,402,858 with a total valuation allowance of $459,405 as of December 31, 2020.

The following table presents TDRs by loan segment that had a payment default in 2020 within 12 months following modification:

	Number of Loans	Amount in Default
Commercial	2	$ 64,372
Residential real estate	1	16,842

3. Loans and Allowance for Loan Losses (continued)

During 2021 and 2020, the Corporation has not committed to lend additional funds to any borrowers whose loan terms have been modified as a TDR.

The Coronavirus Aid, Relief, and Economic Security Act, also known as the CARES Act, is an economic stimulus bill signed into law on March 27, 2020, in response to the economic fallout of the COVID-19 pandemic in the United States. The creation of the Paycheck Protection Program (PPP) enacted under the CARES Act provides forgivable loans to small businesses for payroll obligations, emergency grants to cover immediate operating costs, and a mechanism for loan forgiveness by the Small Business Administration should all criteria be met. Included in commercial loan balances are approximately $9.6 million in PPP loans outstanding as of December 31, 2021, and $38.4 million outstanding as of December 31, 2020. These loans are fully guaranteed by the Small Business Administration (SBA). During the past two years, total PPP loans of $76.2 million were granted to 860 business customers within the Bank's communities. Interest rates on PPP loans were set by the SBA and assigned a modest rate of 1%, to minimize customer expense. The SBA paid fees to lenders for each processed loan to compensate for low interest earned. PPP fee income is deferred at loan origination and recognized over the life of the underlying loans. Fee balances remaining at loan payoff or forgiveness are fully recognized into income at that time. PPP fee income of $1.8 million for 2021 and $1.1 million for 2020 is included in loan interest income in the consolidated statements of income.

Additionally, the Bank is working with borrowers impacted by COVID-19 and providing modifications to include principal and interest deferral. These modifications are excluded from troubled debt restructuring classification under Section 4013 of the CARES Act. As of December 31, 2021, the Bank modified 36 commercial loans with outstanding balances of $18.2 million. As of December 31, 2020, the Bank modified 39 commercial loans with outstanding balances of $18.9 million.

Loans greater than 90 days past due and still accruing and nonaccrual loans were as follows at December 31:

	2021		2020	
	Past Due 90 days or more still accruing	**Nonaccrual**	**Past Due 90 Days or More Still Accruing**	**Nonaccrual**
Commercial	$ –	$ 1,973,458	$ –	$ 477,151
Commercial real estate	–	168,891	–	1,676,018
Residential real estate	–	357,699	–	453,566
Consumer installment	–	6,578	–	8,376
	$ –	**$ 2,506,626**	**$ –**	**$ 2,615,111**

3. Loans and Allowance for Loan Losses (continued)

The following table presents the aging of all loans by segment at December 31, 2021:

	Past Due 30-89 Days	Past Due 90 Days or More	Total Past Due	Current	Loan Total Balance
Commercial	$ 357,960	$ –	$ 357,960	$ 117,088,422	$ 117,446,382
Commercial real estate	629,483	–	629,483	260,328,289	260,957,772
Residential real estate	2,822,759	137,031	2,959,790	170,457,607	173,417,397
Consumer installment	170,065	–	170,065	49,797,668	49,967,733
	$ 3,980,267	**$ 137,031**	**$ 4,117,298**	**$ 597,671,986**	**$ 601,789,284**

The following table presents the aging of all loans by segment at December 31, 2020:

	Past Due 30-89 Days	Past Due 90 Days or More	Total Past Due	Current	Loan Total Balance
Commercial	$ 358,850	$ –	$ 358,850	$ 134,052,147	$ 134,410,997
Commercial real estate	1,403,236	–	1,403,236	228,447,150	229,850,386
Residential real estate	860,000	–	860,000	168,395,877	169,255,877
Consumer installment	163,082	–	163,082	46,329,573	46,492,655
	$ 2,785,168	**$ –**	**$ 2,785,168**	**$ 577,224,747**	**$ 580,009,915**

Credit Quality Information

The Bank uses the following eight grade, risk-rating system for all commercial and commercial real estate loans:

Grades 1 through 4B
Loans in these categories exhibit an acceptable level of credit risk, ranging from "Exceptional" to "Satisfactory." These are pass-rated loans.

Grade 5
"Other/Special Mention." Loans in this category have potential weaknesses that deserve Bank management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects or in the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

3. Loans and Allowance for Loan Losses (continued)

Grade 6
"Substandard." Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Grade 7
"Doubtful." Doubtful loans have all the weaknesses inherent in "Substandard" loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important pending events that may strengthen the loan, its classification as loss is deferred until its exact status is known.

Grade 8
"Loss." Loans in this category are considered uncollectible and of such little value, that their continuance as bankable assets is not warranted. This does not mean that the loan has absolutely no recovery or salvage value; rather, it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

At origination, grades are assigned to each commercial and commercial real estate loan by assessing information about the borrower's situation including cash flow analysis and estimated collateral values. The loan grade is reassessed at each renewal or refinance but any credit may receive a review based on lender identification of changes in the situation or behavior of the borrower. In addition to these methods of assigning loan grades, changes may occur through the loan review program or regulatory examination process.

The loan grades as of December 31, 2021 were as follows:

	Commercial	**Commercial Real Estate**
Pass (Grades 1-4B)	$ 108,635,064	$ 253,116,768
Other/Special mention	1,712,038	6,430,400
Substandard	7,099,280	1,410,604
Total	**$117,446,382**	**$260,957,772**

3. Loans and Allowance for Loan Losses (continued)

The loan grades as of December 31, 2020, were as follows:

	Commercial	Commercial Real Estate
Pass (Grades 1-4B)	$ 128,636,762	$ 217,167,037
Other/Special mention	1,643,522	9,286,235
Substandard	4,130,713	3,397,114
Total	**$ 134,410,997**	**$ 229,850,386**

The following table presents the balance of residential real estate and consumer installment loans based on payment activity as of December 31, 2021:

	Residential Real Estate	Consumer Installment
Performing	$ 171,613,106	$ 49,915,385
Nonperforming	1,804,291	52,348
Total	**$ 173,417,397**	**$ 49,967,733**

The following table presents the balance of residential real estate and consumer installment loans based on payment activity as of December 31, 2020:

	Residential Real Estate	Consumer Installment
Performing	$ 167,145,310	$ 46,415,684
Nonperforming	2,110,567	76,971
Total	**$ 169,255,877**	**$ 46,492,655**

3. Loans and Allowance for Loan Losses (continued)

Purchased Credit Impaired Loans

The Bank has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans was as follows for the year ended December 31:

	2021	2020
Commercial	$ 236,156	$ 961,167
Commercial real estate	1,294,944	555,755
Consumer installment	28,539	28,093
Outstanding balance	1,559,639	1,545,015
Less allowance	95,446	57,512
Carrying amount of net allowance	**$ 1,464,193**	**$ 1,487,503**

Accretable yield or income expected to be collected, is as follows:		
Balance at beginning of year	$ 82,142	$ –
New loans	–	65,285
Accretion of income	(348,874)	(45,125)
Reclassifications from nonaccretable differences	305,437	76,059
Disposals	(5,354)	(14,077)
End of year	**$ 33,351**	**$ 82,142**

4. Other Real Estate Owned

Other real estate owned activity was as follows for the year ended December 31:

	2021	2020
Beginning balance	$ 120,800	$ 350,275
Main Street Bank purchased other real estate owned	–	529,744
Loans transferred to real estate owned	149,514	282,240
Fair value increases at transfer	10,739	3,635
Direct writedowns	(21,510)	(57,120)
Sales of real estate owned	(232,943)	(987,974)
End of year	**$ 26,600**	**$ 120,800**

4. Other Real Estate Owned (continued)

The balance of other real estate owned, included in other assets on the consolidated balance sheets, includes foreclosed residential real estate properties of approximately $30,000 at December 31, 2021, and $100,000 at December 31, 2020. These properties were recorded as a result of obtaining physical possession of the property. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process is approximately $200,000 at December 31, 2021, and $0 at December 31, 2020.

Expenses related to foreclosed assets for the year ended December 31 include:

	2021	2020
Net gain on sales	$ (58,522)	$ (27,845)
Operating expenses, net of rental income	78,885	139,524
	$ 20,363	**$ 111,679**

5. Bank Premises and Equipment

The major classifications of Bank premises and equipment assets at December 31 are summarized as follows:

	2021	2020
Land and improvements	$ 1,236,175	$ 1,512,581
Buildings and improvements	8,467,716	8,982,507
Equipment (including software)	5,886,045	4,986,107
Leasehold improvements	569,565	716,093
	16,159,501	16,197,288
Accumulated depreciation/amortization	(9,187,757)	(8,910,130)
Bank premises and equipment, net	**$ 6,971,744**	**$ 7,287,158**

6. Time Deposits

The aggregate amount of time deposit accounts exceeding $250,000 was $102,511,165 at December 31, 2021, and $101,268,047 at December 31, 2020.

The contractual annual maturities of time deposits at December 31, 2021, were as follows:

2022	$ 121,540,373
2023	27,219,727
2024	17,436,258
2025	9,415,442
2026	8,722,020
	$ 184,333,820

7. Short-Term Borrowings

Short-term borrowings are generally comprised of FHLB advances, FRB borrowings and federal funds purchased. FHLB advances are borrowings from the Federal Home Loan Bank, FRB borrowings are obtained through the Federal Reserve Bank discount window, and federal funds purchased are overnight borrowings from various correspondent banks. Short-term borrowings as of December 31 were as follows:

	FHLB Advances and FRB Borrowings	Federal Funds Purchased
2021		
Average interest rate at year end	N/A	N/A
Average balance at year end	943	288
Average interest rate during the year	.31%	.56%
Maximum balances during the year	$ 250,000	$ 105,000
2020		
Average interest rate at year end	N/A	N/A
Average balance during the year	$ 11,971,421	$ 276
Average interest rate during the year	.35%	.52%
Maximum balance during the year	$ 34,000,000	$ 101,000

8. Pension and Profit Sharing Plans

All eligible non-officer employees of Superior National Bank have the following employee benefit plans available to them:

Pension Plan

Through November 28, 2015, the Bank contributed to a multiemployer defined benefit pension plan (Plan) established and maintained pursuant to a collective bargaining agreement between SNB and the United Food and Commercial Workers Union (Union) to cover its union-represented employees.

On November 28, 2015, SNB and the collective bargaining unit agreed to terminate participation in and withdraw from the Plan. Upon termination of its Plan, SNB was subject to a withdrawal liability of $12,672,705. However, under ERISA 4219(c)(1)(B), the amount was subject to the 20-year payment cap. Therefore, SNB's liability was computed to be $4,377,252, payable in monthly installments of $18,239, including interest of 7.5%, for a period of 20 years. As a result, SNB recorded a liability and pension expense of $2,583,128 at November 28, 2015. This amount represents the net present value of the payment stream discounted at 2.64%. As payments are made, SNB will reduce the liability and record pension expense based on the effective interest method. The remaining liability was $1,724,377 as of December 31, 2021, and $1,864,657 as of December 31, 2020, and total pension expense was $78,583 for the year ended December 31, 2021, and $76,536 for the year ended December 31, 2020. The first scheduled payment on the liability was made February 26, 2016. SNB made payments to the Plan totaling $218,863 for the years ended December 31, 2021 and 2020, all of which related to the withdrawal from the Plan. If SNB is in default on the payment of the liability or if the Plan's Board of Trustees determines that SNB will not be able to make the payments due to bankruptcy or other events involving SNB's credit, the entire liability may become payable in full.

In accordance with laws governing SNB's termination of participation in and withdrawal from the Plan, if the Plan cannot meet its future obligations, SNB may be required to pay additional amounts. If SNB is required to pay any additional amount, that amount would be material to SNB. As of December 31, 2021, SNB has not been required to pay an additional amount to the Plan.

<u>401(k) Plan</u>

For bargaining unit employees and certain non-bargaining employees, the Bank contributes to a 401(k) plan. Employees may voluntarily contribute to the 401(k) plan a portion of their salary up to the maximum allowed under the Internal Revenue Code. The Bank's contributions for bargaining unit employees totaled $19,085 for 2021 and $34,662 for 2020. Contributions for non-bargaining employees totaled $491,309 for 2021 and $525,749 for 2020.

8. Pension and Profit Sharing Plans (continued)

The following employee benefit plans are available to officers of Superior National Bank:

Profit Sharing Plan

Superior National Bank has a defined contribution profit sharing plan for the benefit of all salaried officers meeting the eligibility requirements as defined in the plan document. Employees may voluntarily contribute to the plan via salary deferrals, up to the maximum allowed under the Internal Revenue Code. SNB's contributions are based on a percentage of SNB's net income before federal and state income taxes and totaled $546,698 for 2021 and $421,099 for 2020.

Other

Superior National Bank has entered into deferred compensation agreements with certain officers. Some agreements call for payments to be made over a 10- to 15-year period. Employees become eligible for full benefits at the age of 62, or a reduced payment if the individual elects an earlier retirement date. This program is being funded by the purchase of life insurance policies. Some agreements allow for employees to voluntarily defer a portion of their salary and bonuses to an account where SNB contributes the earnings on the account. The net amount of the premium SNB contributions charged to expense was $190,258 for 2021 and $99,756 for 2020.

9. Interest Payments and Borrowings

SNB has unsecured federal funds credit facilities of $10,000,000 and $10,000,000 made available by two financial institutions. Under the terms of agreements, SNB may borrow amounts at the financial institutions' federal funds interest rate at the time of the borrowings. There were no amounts outstanding as of December 31, 2021 or 2020. In addition, SNB has borrowing windows with the Federal Home Loan Bank of Indianapolis and the Federal Reserve Bank of Minneapolis, which have limits based on collateral pledged. There were no advances outstanding at December 31, 2021, or December 31, 2020.

In 2016, the Corporation established a $10,000,000 line-of-credit with a non-affiliated bank. In 2020, the line-of-credit was amended to $3,000,000 and an additional secured $15,000,000 five-year term loan was also established. Annual interest payments for the loans totaled $439,318 in 2021 and $442,478 in 2020. Balances outstanding for the term loan were $6,961,386 and $15,000,000 at December 31, 2021 and 2020, respectively. Balances outstanding for the line-of-credit facility were $1,498,671 and $1,800,000 as of December 31, 2021 and 2020, respectively.

In 2021, the Corporation offered $15,000,000 of subordinated debt through an established agent, to raise capital and support general corporate purposes. The debt meets Tier 2 regulatory capital requirements at the corporate level. The offering was completed through a private placement of fixed-to-floating rate subordinated notes. The facility has an initial fixed five-year term with interest paid semi-annually to individual note holders. The notes are redeemable in the first five years, only for emergent needs. Interest payments for the notes totaled $446,702 in 2021. After five years, the Corporation may redeem the notes at its option, or continue up to another five-year term based on a floating rate. There was no subordinated debt outstanding in 2020.

10. Regulatory Capital Matters

The Bank is subject to regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet capital requirements can initiate regulatory action. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes as of December 31, 2021, the Corporation and Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of December 31, 2021, and 2020, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the Bank's category.

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (CBLR framework), for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank as of June 30, 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rules the community bank leverage ratio minimum requirement is 8.0% as of December 31, 2020, 8.5% for calendar year 2021, and 9.0% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the requirement amount, provided that the Bank maintains a leverage ratio of 7.0% as of December 31, 2020, 7.5% for calendar year 2021, and 8.0% for calendar year 2022 and beyond.

10. Regulatory Capital Matters (continued)

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2021, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

The Bank's actual and required capital amounts (in thousands) and ratios under the CBLR framework as of December 31, 2021 are presented in the following table:

	Actual		Minimum Required to be Well Capitalized under the CBLR Framework	
	Amount	**Ratio**	**Amount**	**Ratio**
SNB Tier I (Core) Capital (to average total assets)	$ 97,798	9.25%	$ 89,873	8.50%

The Bank's actual and required capital amounts (in thousands) and ratios under the CBLR framework as of December 31, 2020 are presented in the following table:

	Actual		Minimum Required to be Well Capitalized under the CBLR Framework	
	Amount	**Ratio**	**Amount**	**Ratio**
SNB Tier I (Core) Capital (to average total assets)	$ 52,664	8.06%	$ 52,272	8.00%
MSB Tier I (Core) Capital (to average total assets)	$ 29,087	9.43%	$ 24,676	8.00%

The Banks are restricted, under applicable laws, in the payment of cash dividends. Approval from regulatory authorities was obtained for SNB distribution of dividends approximating $3.2 million in 2021 and $29.3 million in 2020.

11. Commitments and Contingencies

In the ordinary course of business, the Bank makes commitments for possible future extensions of credit that are not reflected in the financial statements. The Bank was obligated on commercial standby letters of credit of approximately $467,000 as of December 31, 2021 and $968,000 as of December 31, 2020, and committed, but as yet undisbursed, loan proceeds and lines of credit of approximately $72,590,000 as of December 31, 2021 and $65,422,000 as of December 31, 2020. The Bank does not anticipate losses in connection with the commitments.

12. Income Taxes

The consolidated provision for federal income taxes for the year ended December 31 is comprised of the following components:

	2021	2020
Current expense	$ 3,266,000	$ 3,245,000
Deferred expense (benefit)	(56,000)	(462,000)
	$ 3,210,000	**$ 2,783,000**

As of December 31, 2021, and 2020, the net deferred tax asset recorded is included in other assets. The net deferred tax assets include the following amounts as of December 31:

	2021	2020
Deferred tax assets:		
Nonaccrual interest	$ 45,000	$ 75,000
Deferred compensation	300,000	257,000
Other real estate	1,000	-
Allowance for loan losses	2,033,000	1,901,000
Unrealized losses on investment securities	411,000	-
Pension withdrawal liability	362,000	392,000
Purchasing accounting adjustments, net	210,000	456,000
Other assets	417,000	81,000
	3,779,000	3,162,000
Deferred tax liabilities:		
Depreciation	519,000	387,000
Unrealized gains on investment securities	-	945,000
Discount accretion	38,000	24,000
Other deferred liabilities	29,000	25,000
	586,000	1,381,000
Net deferred tax assets	**$ 3,193,000**	**$ 1, 781,000**

12. Income Taxes (continued)

A reconciliation of federal income tax expense to the amount of tax expense computed by applying the statutory federal income tax rate of 21% to income before income taxes for the year ended December 31 is as follows:

	2021	2020
Tax expense at statutory rate	$ 3,425,000	$ 2,821,000
Tax-exempt interest	(393,000)	(325,000)
Other	178,000	287,000
Federal income tax expense	**$ 3,210,000**	**$ 2,783,000**

SNB acquired a net operating loss (NOL) of approximately $2,566,000 with the acquisition of Main Street Bank in 2020. The NOL is being used to recuperate prior year taxes paid. SNB recorded a receivable of approximately $873,000 in recognition of the expected tax refund related to NOL carryback. The $873,000 receivable is included in other assets in the consolidated balance sheets as of December 31, 2021 and 2020.

Any potential liability for uncertain tax positions, including interest and penalties, has been recorded in deferred tax liabilities and has not been reclassified as a separate liability.

All tax years from 2018 and subsequent, remain open to examination by the Internal Revenue Service. The Corporation does not believe that the results from any examination of these open years would have a material adverse effect on the Corporation.

13. Related Party Transactions

In the ordinary course of business, the Bank makes loans to its officers and directors and its affiliated businesses, and it expects to continue making such loans in the future. These loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability.

The activity in loans to officers and directors, including unused line of credit, for the year ended December 31, was as follows:

	2021	2020
Balances at January 1	$ 2,824,080	$ 3,429,040
New loans	2,166,127	327,419
Repayments	(1,847,265)	(932,379)
Balances at December 31	**$ 3,142,942**	**$ 2,824,080**

The amount of deposits of employees, officers, and directors approximated $10,188,000 as of December 31, 2021 and $11,319,000 as of December 31, 2020.

Subordinated debentures of the Corporation, issued in 2021 for $15.0 million, require interest be paid to debt holders twice annually. Directors, and related interests of directors, invested in $600,000 of subordinated debentures with the Corporation and received interest payments of $18,267 for the year ended December 31, 2021.

14. Concentration of Credit

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area located in the Upper Peninsula and Southeast Michigan. Investments in state and municipal securities also involve governmental entities within the Bank's market area. The concentrations of credit by type of loan are set forth in Note 3. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers.

15. Leases

The Bank enters into leases in the normal course of business, maintaining a total of nine operating leases for retail and mortgage locations as of December 31, 2021. Bank leases have remaining terms ranging from 0.8 years to 5.3 years, some of which include renewal or termination options to extend the lease for up to 20 years. The Bank's leases do not include residual value guarantees or covenants.

The Bank includes lease extension and termination options in the lease term if, after considering relevant economic factors, it is reasonably certain the Bank will exercise the option. In addition, the Bank has elected to account for any non-lease components in its real estate leases as part of the associated lease component.

The Bank has elected not to recognize leases with original lease terms of 12 months or less or recognize annual lease amounts of $5,000 or less on the consolidated balance sheet.

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the Bank's right to use an underlying asset for the lease term and lease liabilities represent the Bank's 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 using a weighted average discount rate between 3.00% and 3.99%.

Right-of-use assets totaled $2,162,116 as of December 31, 2021 and $2,408,352 as of December 31, 2020. Lease liabilities are operating leases and totaled $ 2,168,036 as of December 31, 2021 and $2,408,352 as of December 31, 2020. The right-of-use asset is recorded in other assets and the lease liability is recorded in other liabilities on the consolidated balance sheets. The components of total lease costs were as follows as of December 31:

		2021		**2020**
Operating lease cost	$	810,564	$	616,524
Short-term lease cost		98,935		225,173
Total lease cost, net	**$**	**909,499**	**$**	**841,697**

15. Leases (continued)

A lease maturity table with costs for the next five years and thereafter is provided below:

	Lease Costs
2022	$ 877,078
2023	484,823
2024	287,446
2025	291,733
2026	267,633
Thereafter	88,652

16. Fair Values of Financial Instruments

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

Cash and Other Items: The carrying value of cash and cash equivalents, interest-bearing time deposits in other financial institutions, loans held for sale, accrued interest receivable, and accrued interest payable approximate fair value.

Investment Securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying amount is the estimated fair value for the investment in Federal Reserve and Federal Home Loan Bank stock.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for certain mortgage loans (e.g., one-to-four family residential), consumer loans, and other loans (e.g., commercial real estate and rental property mortgage loans, commercial and industrial loans, and agricultural loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values.

Deposits: The fair values disclosed for demand deposits (e.g., interest-bearing and non-interest-bearing checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

16. Fair Values of Financial Instruments (continued)

The approximate carrying amount and estimated fair values of the Bank's financial instruments at December 31 were as follows:

	2021		2020	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Assets				
Cash and cash equivalents	$ 89,409,000	$ 89,409,000	$102,728,000	$102,728,000
Interest-bearing time deposits in other financial institutions	3,851,000	3,851,000	7,601,000	7,601,000
Investment securities available for sale	333,397,000	333,397,000	229,146,000	229,146,000
Federal Reserve and Federal Home Loan Bank stock	4,496,000	4,496,000	4,379,000	4,379,000
Loans held for sale	9,687,000	9,687,000	22,997,000	22.997,000
Loans, less allowance for loan losses	592,109,000	603,362,000	570,955,000	581,023,000
Accrued interest receivable	3,264,000	3,264,000	3,531,000	3,531,000
Liabilities				
Deposits	942,725,000	954,780,000	861,059,000	889,518,000
Accrued interest payable	192,000	192,000	320,000	320,000

17. Comprehensive Income

The Comprehensive Income topic of FASB ASC 220 requires the reporting of comprehensive income in addition to net income. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that, historically, has not been recognized in the calculation of net income.

The only item included in comprehensive income is the change in unrealized gains (losses) on investment securities classified as available for sale. The reclassification adjustment for gains (losses) is recorded as a separate line item on the consolidated statements of income. The before-tax and after-tax amounts for the year ended December 31 are summarized on the next page:

17. Comprehensive Income (continued)

	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
2021			
Unrealized losses on securities:			
Unrealized holding losses arising during the period	$ (6,456,954)	$ 1,355,960	$ (5,100,994)
Reclassification adjustment for net gains realized in net income	(1,699)	357	(1,342)
Total other comprehensive loss	**$(6,458,653)**	**$1,356,317**	**$(5,102,336)**
2020			
Unrealized gains on securities:			
Unrealized holding gains arising during the period	$ 3,563,568	$ (748,349)	$ 2,815,219
Reclassification adjustment for net losses realized in net income	(26,823)	5,633	(21,190)
Total other comprehensive income	**$ 3,536,745**	**$ (742,716)**	**$ 2,794,029**

18. Fair Value

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, impaired loans, foreclosed assets, mortgage servicing rights, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting write downs of individual assets.

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

Investment Securities: Investment securities available for sale are recorded at fair value on a recurring basis. Level 1 fair value measurement is based upon quoted prices for identical instruments, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss and liquidity assumptions and are considered Level 2. The values for Level 1 and Level 2 investment securities are generally obtained from an independent third party without making any adjustments. The third party generally obtains direct market prices; however, there are several market prices that are determined on a basis other than a direct market price, such as benchmark curves, sector groupings or matrix pricing. Because of these modeling techniques, the third party generally designates the investment securities as Level 2.

18. Fair Value (continued)

Other Real Estate Owned: Upon transfer from the loan portfolio, other real estate owned is adjusted to and subsequently carried at the fair market value less cost to sell at the date of foreclosure. Fair value is based upon independent market prices, appraised values of the collateral, or management's estimate of the collateral. Level 3 other real estate owned assets consist primarily of properties in which the Bank has foreclosed but has not yet obtained physical possession. Therefore, the Bank determines the fair value of the properties based on an internal evaluation. The internal evaluation takes into consideration a combination of one or more of the following inputs: observation of condition of the exterior of the property; initial appraisals of the property when the loan was initially granted; comparable sales data; and list prices of comparable properties. After the Bank obtains physical possession, which typically occurs when the redemption period has expired, the Bank will obtain a current appraisal to determine the fair market value and the asset will generally be considered Level 2.

Loans: The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with FASB Codification Section 942-310. The fair value of impaired loans is estimated using one of several methods, including collateral value, market 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.

The Corporation reviews the net realizable values of the underlying collateral for collateral dependent impaired loans on a quarterly basis for all loan types. To determine the collateral value, management utilizes independent appraisals or internal evaluations.

These valuations are reviewed to determine whether additional discount should be applied given the age of market information that may have been considered as well as other factors such as costs to carry and sell an asset if it is determined that the collateral will be liquidated in connection with the ultimate settlement of the loan. These valuations are used to determine if any charge-offs or specific reserves are necessary. The Corporation may obtain new valuations in certain circumstances, including when there has been significant deterioration in the condition of the collateral, if the foreclosure process has begun, or if the existing valuation is deemed to be outdated.

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 Corporation records 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 Corporation records the impaired loan as nonrecurring Level 3.

18. Fair Value (continued)

The Corporation utilizes the following information when measuring Level 3 other real estate owned and impaired loans:

Valuation Technique	Fair value at December 31, 2021	Unobservable Inputs	Range
Other real estate			
Discounted appraisal value	$ 26,600	Real estate collateral appraisal marketability discount	30%
Impaired loans			
Discounted appraisal value	$ 3,036,674	Real estate collateral appraisal marketability discount	10-100%

Valuation Technique	Fair value at December 31, 2020	Unobservable Inputs	Range
Other real estate			
Discounted appraisal value	$ 120,800	Real estate collateral appraisal marketability discount	30%
Impaired loans			
Discounted appraisal value	$ 9,508,821	Real estate collateral appraisal marketability discount	10-30%
Discounted cash flows	$ 47,936	Duration of cash flows	238 months
		Reduction of interest rate from original loan terms	0%

Notes to Consolidated Financial Statements • December 31, 2021

18. Fair Value (continued)

Fair values of assets and liabilities measured on a recurring basis at December 31 were as follows:

	Fair Value Measurements at Reporting Date Using			
	Fair Value	**Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
2021				
U.S. Government and federal agencies	$ 111,657,231	$ -	$ 111,657,231	$ -
Corporate debt	35,547,580	-	35,547,580	-
Mortgage-backed securities	68,607,464	-	68,607,464	-
State and local governments	117,584,617	-	117,584,617	-
Total securities	**$ 333,396,892**	**$ -**	**$ 333,396,892**	**$ -**
2020				
U.S. Government and federal agencies	$ 53,946,694	$ -	$ 53,946,694	$ -
Corporate debt	17,386,155	-	17,386,155	-
Mortgage-backed securities	51,796,799	-	51,796,799	-
State and local governments	106,016,108	-	106,016,108	-
Total securities	**$ 229,145,756**	**$ -**	**$ 229,145,756**	**$ -**

Fair values of assets and liabilities measured on a nonrecurring basis at December 31 were as follows:

	Total	**Level 1**	**Level 2**	**Level 3**
2021				
Other real estate	$ 26,600	$ -	$ -	$ 26,600
Impaired loans	3,036,674	-	-	3,036,674
Total assets	**$ 3,063,274**	**$ -**	**$ -**	**$ 3,063,274**
2020				
Other real estate	$ 120,800	$ -	$ -	$ 120,800
Impaired loans	9,556,757	-	-	9,556,757
Total assets	**$ 9,677,557**	**$ -**	**$ -**	**$ 9,677,557**

19. Revenue From Contracts with Customers

The Corporation follows the revenue recognition principles in ASU 2014-09 Revenue from Contracts with Customers and all subsequent amendments to the ASU (collectively "ASC 606"). ASC 606 creates a single framework for recognizing revenue from contracts with customers that fell within its scope and revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as other real estate owned. The majority of the Corporation's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. The Corporation's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Corporation satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposit accounts, interchange fees, trust fees, Practical Security Solutions, LLC advisory fees, and the sale of Other Real Estate Owned (OREO).

Revenue from contracts with customers was as follows for the year ended December 31:

	2021	2020
Noninterest income		
Trust fees	$ 1,935,214	$ 1,763,693
Service charges on deposit accounts	818,677	901,731
Other service charges and fees		
Interchange fees	1,306,726	1,073,852
Other fees	225,175	97,154
Net gain on sale of investment securities*	1,699	26,823
Net gain on sale of loans*	17,057,476	18,606,660
Other income:		
Practical Security Solutions, LLC advisory fees	242,609	289,144
Other income*	1,411,632	2,047,570
	$ 22,999,208	**$ 24,806,627**

All of the Corporation's revenue from contracts with customers in the scope of ASC 606 is recognized within noninterest income, with the exception of gains on sales of OREO of $58,522 and $27,845 for 2021 and 2020, respectively, that are included in noninterest expense. The table above presents the Corporation's sources of noninterest income for the years ended December 31, 2021 and 2020. Items outside of the scope of ASC 606 are noted as such (*). The other fees category includes approximately $51,000 and $48,000 of miscellaneous deposit fees which are within the scope of ASC 606, for 2021 and 2020, respectively.

19. Revenue From Contracts with Customers (continued)

Trust Fees: The Corporation earns fee income through its agreements with trust customers, for the management of assets for investment and/or to transact on their accounts. These fees are primarily earned over time as the Corporation provides services which are generally assessed monthly based on a tiered scale of the market value of assets under management (AUM). Fees that are transaction based, including trade execution services, are recognized at the point in time the transaction is executed. Other related services provided include financial planning services, estate administrative services, and other services, which are defined by a fixed fee schedule. Such fees are recognized when services are rendered.

Service Charges on Deposit Accounts and Other Miscellaneous Deposit Fees: The Corporation earns fees, based on a fixed fee schedule, from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM usage fees, wire transfer fees, stop payment charges, statement rendering and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer’s request. Account maintenance fees, which relate primarily to monthly general maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft service fees are recognized when the overdraft occurs. Deposit service charges are withdrawn from the customer’s account balance. Safe deposit box rental fees are assessed and paid annually.

Interchange Fees: The Corporation earns interchange fees from cardholder transactions conducted through established payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Practical Security Solutions, LLC Advisory Fees: The Corporation earns advisory fees from businesses through contracted cybersecurity advisory services. Advisory services are customized to organizational needs and regulatory requirements based on the results of proprietary cybersecurity readiness assessments, and may include development of policies and strategic plans, security training, incident response plans, simulation testing, and more. Fees are recognized within noninterest income over time as customers are billed for services performed.

Gains/Losses on Sales of OREO: The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time the deed is executed. When the Corporation finances the sale of OREO to the buyer, the Corporation first estimates the potential gain or loss on sale. The Corporation will then assess whether the buyer is committed to perform their obligations under the loan agreement and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of property control to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

20. Business Combination

The acquisition of Main Street Bank was a valuable investment to the Corporation at $42 million, representing 54% of the Corporation's total capital as of January 1, 2020. The acquisition presented an opportunity to grow SNB's business by reaching new geographic markets and achieving operational synergies. The acquisition was made possible by the upstream of $27 million in equity from SNB to the Corporation, in addition to a $15 million loan from a reputable financial institution.

Accounting for the purchase transaction was completed in accordance with FASB ASC 805, Business Combinations, and reflected the transaction terms identified in the merger agreement. Measuring the assets acquired and the liabilities assumed was accomplished via a fair value assessment calculated by an independent, reputable firm. The assessment report used as the basis for recording the February 2020 transaction is summarized below.

	January 31, 2020 Adjusted Fair Value
Cash and due from banks	$ 5,384,109
Investments	6,380,430
Loans	252,982,158
Other assets	3,720,508
Core deposit intangible	1,093,000
Total Assets	269,560,205
Core deposits	106,460,053
Time deposits	133,715,435
Other liabilities	7,671,259
Deferred tax liability fair value adjustments	(506,312)
Total Liabilities	247,340,435
Net fair value of assets acquired	22,219,770
Purchase price	42,000,000
Implied fair value of goodwill	$ 19,780,230

As of December 31, 2021 and December 31, 2020, the goodwill balance has no impairment. A subsequent net operating loss carryback, available through the 2020 Cares Act, has since provided a $333,625 purchase accounting credit, which has reduced the carrying value of goodwill.

21. Subsequent Event

The current Coronavirus pandemic has had an economic impact on the United States and the international community. While the Bank has not experienced a material adverse impact as of the date of these financial statements, the future impact, if any, cannot be determined.