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Annual Meeting

Tuesday, April 25, 2023
5:30 pm
Rozsa Center for the Performing Arts
Michigan Technological University
1400 Townsend Drive
Houghton, MI 49931

AHP
CPAs & ADVISORS

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Report of Independent Auditors

Board of Directors and Stockholders
Keweenaw Financial Corporation
Hancock, Michigan

Report on the Consolidated Financial Statements and Internal Control

Opinions on the Consolidated Financial Statements and Internal Control over Financial Reporting

We have audited the consolidated financial statements of Keweenaw Financial Corporation and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, 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 accompanying consolidated financial statements present fairly, in all material respects, the financial position of Keweenaw Financial Corporation and Subsidiary as of December 31, 2022 and 2021, 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.

We also have audited Keweenaw Financial Corporation and Subsidiary's internal control over financial reporting, including controls over preparation of regulatory financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, Keweenaw Financial Corporation and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework*, issued by COSO.

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audits of the Consolidated Financial Statements and Internal Control over Financial Reporting 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 opinions.

Responsibilities of Management for the Consolidated Financial Statements and Internal Control over Financial Reporting

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 effective internal control over financial reporting relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management Report Regarding Statement of Management's Responsibilities, Compliance with Designated Laws and Regulations, and Management's Assessment of Internal Control Over Financial Reporting.

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.

Auditor's Responsibilities for the Audits of the Consolidated Financial Statements and Internal Control over Financial Reporting

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 about whether effective internal control over financial reporting was maintained in all material respects, and to issue an auditor's report that includes our opinions.

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of consolidated financial statements or an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit of the consolidated financial statements and an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audits.
- 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 consolidated financial statement audit in order to design audit procedures that are appropriate in the circumstances.

- Obtain an understanding of internal control over financial reporting relevant to the audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.
- 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 and Subsidiary'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 consolidated financial statement audit.

Definition and Inherent Limitations of Internal Control over Financial Reporting

A corporation's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of Keweenaw Financial Corporation and Subsidiary's internal control over financial reporting included controls over the preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y- 9C). A corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the consolidated financial statements in accordance with the accounting principles generally accepted in the United States of America, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use or disposition of the entity's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Andrews Hooper Pavlik PLC

Saginaw, Michigan
February 22, 2023

Consolidated Balance Sheets

	December 31	
	2022	**2021**
Assets		
Cash and cash equivalents		
Cash and due from banks	$ 12,064,160	$ 39,875,076
Federal funds sold	151,740	49,533,545
Total cash and cash equivalents	**12,215,900**	**89,408,621**
Interest-bearing time deposits in other financial institutions	2,600,301	3,850,554
Investment securities available for sale	290,888,457	333,396,892
Federal Reserve and Federal Home Loan Bank stock	2,676,350	4,495,500
Loans held for sale	4,097,986	9,687,233
Loans, less allowance for loan losses of $9,129,791 in 2022 and $9,680,262 in 2021	680,114,218	592,109,022
Bank premises and equipment, net	9,526,197	6,971,744
Accrued interest receivable	3,662,482	3,263,813
Goodwill	19,615,774	19,615,774
Other assets	19,395,802	11,333,769
Total assets	**$ 1,044,793,467**	**$ 1,074,132,922**
Liabilities and stockholders' equity		
Liabilities		
Deposits		
Demand	$ 228,781,522	$ 242,836,248
NOW	140,311,047	139,252,371
Money market	59,494,950	56,739,563
Savings	265,344,029	319,563,273
Time	186,167,008	184,333,820
Total deposits	**880,098,556**	**942,725,275**
Borrowed funds	72,785,705	8,460,057
Subordinated debentures	15,000,000	15,000,000
Accrued interest payable and other liabilities	9,161,064	11,476,981
Total liabilities	**977,045,325**	**977,662,313**
Stockholders' equity		
Preferred stock: no par value, 50,000 shares authorized; none issued or outstanding in 2022 and 2021	-	-
Common stock: no par value; 2,000,000 shares authorized in 2022 and 2021; 1,159,748 and 1,159,350 shares issued and outstanding in 2022 and 2021, respectively.	515,549	515,549
Retained earnings	105,913,799	97,506,072
Accumulated other comprehensive loss	(38,681,206)	(1,551,012)
Total stockholders' equity	**67,748,142**	**96,470,609**
Total liabilities and stockholders' equity	**$ 1,044,793,467**	**$ 1,074,132,922**

See accompanying notes.

Consolidated Statements of Income

	Year Ended December 31 2022	2021
Interest income		
Loans, including fees	$ 32,645,493	$ 33,235,150
Securities		
U.S. Treasury securities	377,911	71,845
U.S. Government agencies	2,613,923	1,845,955
Obligations of states and political subdivisions	1,887,257	2,013,630
Other securities	696,631	575,680
Other interest income	295,864	441,894
	38,517,079	**38,184,154**
Interest expense		
Deposits	3,191,395	3,609,055
Borrowed funds and subordinated debentures	1,334,894	886,025
	4,526,289	4,495,080
Net interest income	**33,990,790**	**33,689,074**
Provision (recovery) for loan losses	(42)	922,000
Net interest income after provision (recovery) for loan losses	**33,990,832**	**32,767,074**
Noninterest income		
Trust fees	2,007,020	1,935,214
Service charges on deposit accounts	924,719	818,677
Other service charges and fees	1,456,224	1,531,901
Net gain on sale of investment securities	49,471	1,699
Net gain on sale of loans	4,875,515	17,057,476
Other	1,242,322	1,654,241
	10,555,271	**22,999,208**
Noninterest expenses		
Salaries and wages	17,303,947	21,676,965
Pensions and other employee benefits	4,280,938	4,640,227
Occupancy expenses, net	6,332,133	6,485,486
Postage and supplies	192,281	241,347
FDIC and general insurance	402,952	418,426
Legal and professional	1,068,657	1,050,588
Loan related expense	1,017,236	2,158,672
Marketing	241,527	402,147
Net cost of operations of other real estate – including write downs and gains/losses on sales	50,032	440,850
Other operating expenses	1,806,226	1,942,188
	32,695,929	**39,456,896**
Income before income tax expense	**11,850,174**	**16,309,386**
Income tax expense	1,850,027	3,209,568
Net income	**$ 10,000,147**	**$ 13,099,818**
Net income per share of common stock	**$ 8.62**	**$ 11.30**

See accompanying notes.

Consolidated Statements of Comprehensive Income (Loss)

	Year ended December 31 2022	2021
Net income	$ 10,000,147	$ 13,099,818
Other comprehensive loss, net of tax		
Unrealized holding losses arising during the period	(37,091,112)	(5,100,994)
Reclassification adjustment for net gains included in net income	(39,082)	(1,342)
Total other comprehensive loss, net of tax	**(37,130,194)**	**(5,102,336)**
Total comprehensive income (loss)	**$(27,130,047)**	**$ 7,997,482**

Consolidated Statements of Changes In Stockholders' Equity

Years Ended December 31, 2022 and 2021

	Common Stock Number of Shares	Assigned Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at January 1, 2021	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**
Net income for 2022			10,000,147		10,000,147
Other comprehensive loss, net of tax				(37,130,194)	(37,130,194)
Shares issued for compensation obligations	398		54,283		54,283
Cash dividends paid ($1.42 per share)			(1,646,703)		(1,646,703)
Balance at December 31, 2022	**1,159,748**	**$ 515,549**	**$105,913,799**	**$ (38,681,206)**	**$ 67,748,142**

See accompanying notes.

Consolidated Statements of Cash Flows

	Year Ended December 31 2022	2021
Cash flows from operating activities:		
Net income	$ 10,000,147	$ 13,099,818
Adjustments to reconcile net income from operating activities:		
Depreciation and amortization of right-of-use assets	1,672,069	1,568,260
Amortization of core deposit intangibles	156,143	156,143
Accretion of time deposit purchased	–	(98,833)
Accretion of loans purchased	(944,470)	(1,230,974)
Net amortization of investment securities	657,078	964,318
Deferred taxes (benefit)	341,000	(56,000)
Fair value increase at transfer of other real estate owned	–	(10,739)
Valuation write-downs of other real estate owned	–	21,510
Net gain on sale of other real estate owned	(14,156)	(58,522)
Loss on disposal of premises and equipment	–	398,977
Realized net investment security gains	(49,471)	(1,699)
Repayment of lease liabilities	(746,668)	(677,996)
Gain on sale of loans	(4,875,515)	(17,057,476)
Proceeds from sale of mortgage loans held for sale	178,868,116	455,573,903
Origination of mortgage loans held for sale	(168,403,354)	(425,206,711)
Provision (recovery) for loan losses	(42)	922,000
Net change in:		
Accrued interest receivable and other assets	179,309	(87,997)
Accrued interest payable and other liabilities	(1,616,560)	1,301,349
Net cash from operating activities	15,223,626	29,519,331
Cash flows from investing activities		
Decrease in interest-bearing time deposits in other financial institutions	1,250,253	3,750,247
Activity in investment securities available for sale:		
Purchases	(38,587,822)	(170,707,994)
Maturities, prepayments, calls, and sales	33,488,404	59,035,586
Transactions of Federal Reserve and Federal Home Loan Bank stock	1,819,150	(116,750)
Loan originations and payments, net	(87,028,328)	(20,957,182)
Proceeds from sales of other real estate owned	8,400	254,465
Additions to bank premises and equipment, net	(3,472,913)	(967,908)
Net cash from investing activities	(92,522,856)	(129,709,536)
Cash flows from financing activities		
Net change in demand, NOW, money market, and savings deposits	(64,459,907)	122,718,722
Net change in time deposits	1,833,188	(40,954,067)
Proceeds from borrowings and subordinated debentures	221,645,000	15,000,000
Repayments on borrowings	(155,870,000)	–
Principal payments on notes payable	(1,449,352)	(8,339,943)
Stock issued for compensation obligations	54,283	–
Cash dividends	(1,646,703)	(1,553,530)
Net cash from financing activities	106,509	86,871,182
Net change in cash and cash equivalents	(77,192,721)	(13,319,023)
Cash and cash equivalents at beginning of year	89,408,621	102,727,644
Cash and cash equivalents at end of year	**$ 12,215,900**	**$ 89,408,621**

See accompanying notes.

Consolidated Statements of Cash Flows (continued)

	Year ended December 31 2022	2021
Supplemental cash flow information		
Transfer of loans to other real estate loans	$ –	$ 149,514
Loans originated from sale of other real estate owned	32,356	37,000
Lease liabilities arising from obtaining right-of-use assets	47,311	437,679
Income taxes paid	1,854,056	3,524,568
Interest paid	4,124,882	4,622,488

Notes To Consolidated Financial Statements • December 31, 2022

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.

The Corporation acquired 100% of North Star Financial Holdings, Inc. (North Star), a Michigan corporation, on February 4, 2020 at which time Main Street Bank, a state-chartered bank previously owned by North Star, became a subsidiary of the Corporation. Operations and technology systems of Main Street Bank were merged into Superior National Bank effective February 19, 2021. The merger was approved by the Office of the Comptroller of Currency (OCC), the Bank's primary regulator, on November 12, 2020.

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 2024 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, 2022 and 2021, the application of valuation techniques applied to similar assets and liabilities has been consistent.

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 loss. 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.

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 loss. 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.

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

Federal Home Loan Bank Stock (continued)

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.

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.

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

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.

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:

<u>General Component</u>

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;

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

Allowance for Loan Losses (continued)

General Component (continued)

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.

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

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

Allowance for Loan Losses (continued)

Specific Component (continued)

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.

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 $918,460 and $884,345 and includes accretion related to the recognition of a service provider credit for future expenses of $147,142 at December 31, 2022 and 2021, 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

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

Goodwill (continued)

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 $19.9 million, thereby establishing the goodwill value as of February 4, 2020. The goodwill value was subsequently decreased by $0.3 million due to a credit associated with a net operating loss carry back processed in December 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 2022 or 2021.

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 2022 and in 2021. These intangible assets are tested for impairment annually. There was no impairment recorded in 2022 or in 2021.

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)

Stock-Based Incentive Compensation

Compensation cost for equity-based awards is measured on the grant date based on the fair value of the award at that time. Fair value of restricted stock awards is based upon the market price of common stock on the grant date.

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 2022 and 2021. Since inception of the Plan, the Corporation has repurchased 16,743 shares of common stock. The Corporation repurchased no shares of common stock in 2022 and 2021. In January 2023, 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 1,159,682 shares as of December 31, 2022 and 1,159,350 shares as of December 31, 2021.

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.

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

Advertising

The Bank expenses advertising costs as incurred.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income and other comprehensive loss. Other comprehensive 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 loss also includes a reclassification adjustment for net gains included in net income.

Restrictions on Cash

Cash on hand or on deposit with the Federal Reserve Bank was not required at December 31, 2022 or 2021, 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. This change to the reserve requirement does not have a defined timeframe and may be revised by the Federal Reserve in the future.

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.

New Accounting Standard That Has Not Yet Been Adopted

Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* as amended, was issued to replace the incurred loss model for loans and other financial assets with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. Such assets will be presented at the net amount expected to be collected over their remaining contractual lives. Estimated credit losses will be based on relevant information about historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts. CECL also applies to off-balance sheet credit exposures (loan commitments, standby letters of credit, financial guarantees, and other similar instruments). Estimated credit losses related to off-balance sheet credit exposures will be reported as a liability on the consolidated financial statements. In addition, the amendments in Topic 326 require credit losses on available-for-sale debt securities to be presented as a valuation allowance rather than as a direct write-down. This new accounting standard is effective for

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

New Accounting Standard That Has Not Yet Been Adopted (continued)

consolidated financial statements issued for interim and annual periods beginning after December 15, 2022. The Corporation adopted this new accounting standard as of January 1, 2023. For assets within the scope of CECL, a cumulative effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period after adoption.

Subsequent Events

Subsequent events were evaluated for potential recognition or disclosure through February 22, 2023 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:

2022	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Government and federal agencies	$ 145,550,886	$ -	$ (19,926,486)	$ 125,624,400
Corporate debt	34,930,866	-	(5,038,304)	29,892,562
Mortgage-backed securities	59,509,530	-	(10,693,866)	48,815,664
State and local governments	99,860,727	838	(13,305,734)	86,555,831
	$ 339,852,009	**$ 838**	**$(48,964,390)**	**$ 290,888,457**

2021	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. Government and 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**

The amortized cost and fair values of investment securities available for sale by contractual maturity at December 31, 2022, 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	$ 14,387,876	$ 14,124,170
Due after one year through five years	88,378,619	81,865,249
Due after five years through ten years	128,877,849	108,515,746
Due after ten years	48,698,135	37,567,628
Mortgage-backed securities	59,509,530	48,815,664
	$ 339,852,009	**$ 290,888,457**

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
2022	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Government and federal agencies	$ 28,021,923	$ 1,532,305	$ 97,602,477	$ 18,394,181	$ 125,624,400	$ 19,926,486
Corporate debt	7,761,111	208,346	20,631,451	4,829,958	28,392,562	5,038,304
Mortgage-backed securities	9,815,770	887,977	38,999,894	9,805,889	48,815,664	10,693.866
State and local governments	33,082,167	1,900,770	49,603,411	11,404,964	82,685,578	13,305,734
	$ 78,680,971	**$ 4,529,398**	**$206,837,233**	**$ 44,434,992**	**$285,518,204**	**$48,964,390**

	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**

On December 31, 2022, 144 debt securities had unrealized losses with aggregate depreciation of approximately 14.4% from the Bank's amortized cost basis. 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. On December 31, 2022 and 2021, there were no securities which qualified as OTTI.

2. Investment Securities (continued)

Proceeds from sales and maturities of investment securities available for sale during 2022 were $33,488,404. Net gains on those sales and maturities totaled $49,471.

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.

Investment securities with a book value of $30,256,856 at December 31, 2022, and investment securities with a book value of $30,525,765 at December 31, 2021, were pledged as collateral to secure borrowings, public deposits, and for other purposes required by law.

3. Loans and Allowance for Loan Losses

Loan segments at December 31 were as follows:

	2022	2021
Commercial	$ 111,474,068	$ 117,446,382
Commercial real estate	279,429,536	260,957,772
Residential real estate	241,785,961	173,417,397
Consumer installment	56,554,444	49,967,733
	689,244,009	601,789,284
Allowance for loan losses	(9,129,791)	(9,680,262)
Net loans	**$ 680,114,218**	**$ 592,109,022**

Changes in the allowance for loan losses by loan segment for the year ended December 31, 2022 were as follows:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
Balance at beginning of year	$ 1,456,128	$ 4,401,435	$ 2,019,597	$ 607,042	$ 1,196,060	$ 9,680,262
Provision (recovery) charged to operations	166,126	282,773	239,172	122,943	(811,056)	(42)
Loans charged off	(450,453)	–	(45,275)	(205,251)	–	(700,979)
Recoveries	35,517	49,528	9,096	56,409	–	150,550
Balance at end of year	**$ 1,207,318**	**$ 4,733,736**	**$2,222,590**	**$ 581,143**	**$ 385,004**	**$9,129,791**

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, 2022:

	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	$ 35,127	$ 163,030	$ 254,231	$ –	$ –	$ 452,388
Collectively evaluated for impairment	1,090,910	4,258,990	1,955,099	581,143	–	7,886,142
Acquired with deteriorated credit quality	81,281	311,716	13,260	–	–	406,257
Unallocated to specific loan segments	–	–	–	–	385,004	385,004
Ending allowance balance	**$ 1,207,318**	**$ 4,733,736**	**$ 2,222,590**	**$ 581,143**	**$ 385,004**	**$ 9,129,791**
Loans:						
Individually evaluated for impairment	$ 788,874	$ 2,602,639	$ 3,706,860	$ 220,669	$ –	$ 7,319,042
Collectively evaluated for impairment	110,526,986	275,602,231	238,053,396	56,333,775	–	680,516,388
Acquired with deteriorated credit quality	158,208	1,224,666	25,705	–	–	1,408,579
Ending loan balance	**$111,474,068**	**$279,429,536**	**$241,785,961**	**$56,554,444**	**$ –**	**$689,244,009**

3. Loans and Allowance for Loan Losses (continued)

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**

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**

3. Loans and Allowance for Loan Losses (continued)

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer Installment	Unallocated	Total
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**

The following table presents impaired loans individually evaluated for impairment by loan segment at December 31, 2022. 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	$ 685,392	$ 606,236	$ –	$ 766,190	$ 54,229
Commercial real estate	1,764,151	1,741,244	–	1,757,953	129,826
Residential real estate	2,008,729	1,933,121	–	2,021,771	109,593
Consumer installment	365,286	220,669	–	205,621	19,364
Total impaired loans without a valuation allowance	**$ 4,823,558**	**$ 4,501,270**	**$ –**	**$ 4,751,535**	**$ 313,012**
Impaired loans with a valuation allowance:					
Commercial	$ 182,638	$ 182,638	$ 35,127	$ 191,969	$ 9,870
Commercial real estate	947,376	861,395	163,030	908,854	64,014
Residential real estate	1,783,703	1,773,739	254,231	1,807,915	94,102
Total impaired loans with a valuation allowance	**$ 2,913,717**	**$ 2,817,772**	**$ 452,388**	**$ 2,908,738**	**$ 167,986**
Total impaired loans	**$ 7,737,275**	**$ 7,319,042**	**$ 452,388**	**$ 7,660,273**	**$ 480,998**

3. Loans and Allowance for Loan Losses (continued)

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**

The following table presents TDRs that occurred during 2022 by loan segment:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Valuation Allowance
Commercial	5	$ 272,789	$ 272,789	$ 64,436
Residential real estate	1	34,539	34,539	13,260
Consumer installment	1	8,251	8,251	–

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 $4,070,700 with a total valuation allowance of $158,457 as of December 31, 2022.

The following table presents TDRs by loan segment that had a payment default in 2022 within 12 months following modification:

	Number of Loans	Amount in Default
Commercial	1	$ 170,543
Consumer installment	1	8,251

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

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	1	$1,175,286
Consumer installment	1	1,977

3. Loans and Allowance for Loan Losses (continued)

During 2022 and 2021, 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 $0.5 million in PPP loans outstanding as of December 31, 2022, and $9.6 million outstanding as of December 31, 2021. These loans are fully guaranteed by the Small Business Administration (SBA). During the first two years of the pandemic, 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 $0.4 million for 2022 and $1.8 million for 2021 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. There were no COVID-19 deferrals in 2022.

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

	2022		2021	
	Past Due 90 days or more still accruing	**Nonaccrual**	**Past Due 90 Days or More Still Accruing**	**Nonaccrual**
Commercial	$ –	$ 692,776	$ –	$ 1,973,458
Commercial real estate	–	1,246,538	–	168,891
Residential real estate	–	638,492	–	357,699
Consumer installment	–	73,764	–	6,578
	$ –	**$ 2,651,570**	**$ –**	**$ 2,506,626**

3. Loans and Allowance for Loan Losses (continued)

The following table presents the aging of all loans by segment at December 31, 2022:

	Past Due 30-89 Days	Past Due 90 Days or More	Total Past Due	Current	Loan Total Balance
Commercial	$ 434,621	$ –	$ 434,621	$ 111,039,447	$ 111,474,068
Commercial real estate	651,796	–	651,796	278,777,740	279,429,536
Residential real estate	1,135,608	–	1,135,608	240,650,353	241,785,961
Consumer installment	113,552	–	113,552	56,440,892	56,554,444
	$ 2,335,577	**$ –**	**$ 2,335,577**	**$ 686,908,432**	**$ 689,244,009**

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**

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)

Credit Quality Information (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, 2022 were as follows:

	Commercial	Commercial Real Estate
Pass (Grades 1-4B)	$ 108,662,653	$ 274,915,771
Other/Special mention	1,987,550	2,261,442
Substandard	823,865	2,252,323
Total	**$111,474,068**	**$279,429,536**

3. Loans and Allowance for Loan Losses (continued)

Credit Quality Information (continued)

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**

The following table presents the balance of residential real estate and consumer installment loans based on payment activity as of December 31, 2022:

	Residential Real Estate	Consumer Installment
Performing	$ 239,642,414	$ 56,392,031
Nonperforming	2,143,547	162,413
Total	**$ 241,785,961**	**$ 56,554,444**

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**

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:

	2022	2021
Commercial	$ 158,208	$ 236,156
Commercial real estate	1,224,666	1,294,944
Consumer installment	25,705	28,539
Outstanding balance	1,408,579	1,559,639
Less allowance	406,257	95,446
Carrying amount, net of allowance	**$ 1,002,322**	**$ 1,464,193**

	2022	2021
Accretable yield or income expected to be collected, is as follows:		
Balance at beginning of year	$ 33,351	$ 82,142
Accretion of income	(66,570)	(348,874)
Reclassifications from nonaccretable differences	128,741	305,437
Disposals	(1,154)	(5,354)
End of year	**$ 94,368**	**$ 33,351**

4. Other Real Estate Owned

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

	2022	2021
Beginning balance	$ 26,600	$ 120,800
Loans transferred to real estate owned	–	149,514
Fair value increases at transfer		10,739
Direct writedowns	–	(21,510)
Sales of real estate owned	(26,600)	(232,943)
End of year	**$ -**	**$ 26,600**

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 $0 at December 31, 2022, and approximately $30,000 at December 31, 2021. 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 $30,000 at December 31, 2022, and $200,000 at December 31, 2021.

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

	2022	2021
Net gain on sales	$ (14,156)	$ (58,522)
Operating expenses, net of rental income	64,188	78,885
	$ 50,032	**$ 20,363**

5. Bank Premises and Equipment

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

	2022	2021
Land and improvements	$ 2,964,674	$ 1,236,175
Buildings and improvements	9,987,697	8,467,716
Equipment (including software)	6,143,096	5,886,045
Leasehold improvements	572,344	569,565
	19,667,811	16,159,501
Accumulated depreciation/amortization	(10,141,614)	(9,187,757)
Bank premises and equipment, net	**$ 9,526,197**	**$ 6,971,744**

6. Time Deposits

The aggregate amount of time deposit accounts meeting or exceeding $250,000 was $110,173,236 at December 31, 2022, and $102,511,165 at December 31, 2021.

The contractual annual maturities of time deposits at December 31, 2022, were as follows:

2023	$ 130,556,975
2024	18,983,566
2025	21,042,496
2026	4,004,900
2027	11,579,071
	$ 186,167,008

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
2022		
Average interest rate at year end	4.55%	4.75%
Average balance at year end	$ 10,054,521	$ 1,049,683
Average interest rate during the year	3.84%	4.10%
Maximum balance during the year	$ 55,740,000	$ 15,090,000
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 balance during the year	$ 250,000	$ 105,000

Real estate mortgage loans are pledged as part of a blanket collateral agreement with the Federal Home Loan Bank to secure current borrowings and future advance potential. Pledged loans totaled $276.8 million as of December 31, 2022, and $212.2 million as of December 31, 2021.

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 $1,586,195 as of December 31, 2022, and $1,724,377 as of December 31, 2021, and total pension expense was $80,681 for the year ended December 31, 2022, and $78,583 for the year ended December 31, 2021. 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, 2022 and 2021, 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, 2022, SNB has not been required to pay an additional amount to the Plan.

401(k) Plan

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 $18,457 for 2022 and $19,085 for 2021. Contributions for non-bargaining employees totaled $485,316 for 2022 and $491,309 for 2021.

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 $523,965 for 2022 and $546,698 for 2021.

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 $309,191 for 2022 and $190,258 for 2021.

9. Interest Payments and Borrowings

Superior National Bank 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. The outstanding balance of the credit facilities was $10,035,000 as of December 31, 2022, and $0 as of December 31, 2021. Interest paid totaled $43,075 in 2022 and $0 in 2021. 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. The outstanding balance on December 31, 2022 was $55,740,000, with total interest payments of $386,228 in 2022. There were no advances outstanding at December 31, 2021 and no interest paid in 2021.

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 $295,647 in 2022 and $439,318 in 2021. Balances outstanding for the term loan were $6,005,745 and $6,961,386 at December 31, 2022 and 2021, respectively. Balances outstanding for the line-of-credit facility were $1,004,960 and $1,498,671 as of December 31, 2022 and 2021, respectively. The line-of-credit facility has since been renewed for an additional 3-year term with a maturity date of February 01, 2025.

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 $609,944 in 2022 and $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.

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, 2022, 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, 2022, and 2021, 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 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 (CBLR) 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 CBLR 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 CBLR minimum requirement was 8.5% as of December 31, 2021, and 9.0% for calendar year 2022 and beyond. The Bank followed requirements of the CBLR framework in 2020 and 2021.

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. The Bank opted out of the CBLR framework in 2022. Actual and required capital amounts (in thousands) and ratios as of December 31, 2022 are presented in the following table:

10. Regulatory Capital Matters (continued)

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to risk-weighted assets	$ 113,166	16.89%	$ 53,616	8.00%	$ 67,020	10.00%
Tier 1 (Core) Capital to risk-weighted assets	104,779	15.63	40,212	6.00	53,616	8.00
Common Tier 1 (CET1) to risk-weighted assets	104,779	15.63	30,159	4.50	43,563	6.50
Tier 1 (Core) Capital to average total assets	104,779	9.95	42,122	4.00	52,653	5.00

Consolidated capital amounts and ratios are not included in the above table as they are not considered significant due to the Bank's comprising approximately 99% of the consolidated assets of the Corporation.

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
Tier 1 (Core) Capital to average total assets	$ 97,798	9.25%	$ 89,873	8.50%

Banks are restricted, under applicable laws, in the payment of cash dividends. Approval from regulatory authorities was obtained for SNB distribution of dividends to the Corporation approximating $1.9 million in 2022 and $3.2 million in 2021. The requirement to obtain regulatory approval of dividends was eliminated after the June 2022 dividend distribution, after which $2.4 million was distributed as dividends without the prior approval of regulatory authorities. As of December 31, 2022, $4.5 million of retained earnings is unrestricted to pay dividends.

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 $1,365,000 as of December 31, 2022 and $467,000 as of December 31, 2021, and committed, but as yet not disbursed, loan proceeds and lines of credit of approximately $82,550,000 as of December 31, 2022 and $72,590,000 as of December 31, 2021. The Bank does not anticipate losses in connection with the commitments. Variable interest rates were assigned to $60,313,700 of outstanding commitments and fixed interest rates were assigned to $22,237,000 of outstanding commitments as of December 31, 2022.

12. Income Taxes

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

	2022	2021
Current expense	$ 1,509,000	$ 3,266,000
Deferred expense (benefit)	341,000	(56,000)
	$ 1,850,000	**$ 3,210,000**

As of December 31, 2022, and 2021, the net deferred tax asset recorded is included in other assets. The net deferred tax assets include the following amounts as of December 31:

	2022	2021
Deferred tax assets:		
Nonaccrual interest	$ 55,000	$ 45,000
Deferred compensation	466,000	300,000
Other real estate	-	1,000
Allowance for loan losses	1,917,000	2,033,000
Unrealized losses on investment securities	10,282,000	411,000
Pension withdrawal liability	333,000	362,000
Purchasing accounting adjustments, net	44,000	210,000
Other assets	332,000	417,000
	13,429,000	3,779,000
Deferred tax liabilities:		
Depreciation	588,000	519,000
Discount accretion	85,000	38,000
Other deferred liabilities	33,000	29,000
	706,000	586,000
Net deferred tax assets	**$ 12,723,000**	**$ 3,193,000**

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:

	2022	2021
Tax expense at statutory rate	$ 2,489,000	$ 3,425,000
Tax-exempt interest	(366,000)	(393,000)
Other	(273,000)	178,000
Federal income tax expense	**$ 1,850,000**	**$ 3,210,000**

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 as of December 31, 2021. The $873,000 tax refund was received in 2022. The tax receivable balance was included in other assets in the consolidated balance sheets as of December 31, 2021.

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 2019 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 lines of credit, for the year ended December 31, was as follows:

	2022	2021
Balances at January 1	$ 3,142,942	$ 2,824,080
New loans	203,768	2,166,127
Repayments	(969,363)	(1,847,265)
Balances at December 31	**$ 2,377,347**	**$ 3,142,942**

The amount of deposits of employees, officers, and directors approximated $ 8,549,000 as of December 31, 2022 and $10,188,000 as of December 31, 2021.

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 $24,000 for the year ended December 31, 2022 and $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, 2022. Bank leases have remaining terms ranging from 0.25 years to 4.25 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 $1,455,818 as of December 31, 2022 and $2,162,116 as of December 31, 2021. Lease liabilities are operating leases and totaled $1,468,679 as of December 31, 2022 and $2,168,036 as of December 31, 2021. 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:

		2022		2021
Operating lease cost	$	811,433	$	810,564
Short-term lease cost		58,334		98,935
Total lease cost, net	**$**	**869,767**	**$**	**909,499**

15. Leases (continued)

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

	Lease Costs
2023	$ 497,921
2024	302,578
2025	294,365
2026	267,732
2027 and 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, 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.

Borrowed funds: Fair values for borrowed funds, consisting of federal funds purchased from correspondent banks and FHLB and FRB advances, are based on current rates for like financing. Subordinated debentures are similarly assigned a fair value.

Other: The fair value for off-balance sheet commitments is rendered insignificant.

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:

	2022		2021	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Cash and cash equivalents	$ 12,216,000	$ 12,216,000	$ 89,409,000	$ 89,409,000
Interest-bearing time deposits in other financial institutions	2,600,000	2,600,000	3,851,000	3,851,000
Investment securities available for sale	290,888,000	290,888,000	333,397,000	333,397,000
Federal Reserve and Federal Home Loan Bank stock	2,676,000	2,676,000	4,496,000	4,496,000
Loans held for sale	4,098,000	4,098,000	9,687,000	9,687,000
Loans, less allowance for loan losses	680,114,000	665,351,000	592,109,000	603,362,000
Accrued interest receivable	3,662,000	3,662,000	3,264,000	3,264,000
Liabilities				
Deposits	880,099,000	791,265,000	942,725,000	954,780,000
Borrowed funds	72,786,000	72,775,000	8,460,000	8,460,000
Subordinated debentures	15,000,000	14,998,000	15,000,000	15,000,000
Accrued interest payable	594,000	594,000	192,000	192,000

17. Comprehensive Income (Loss)

The Comprehensive Income topic of FASB ASC 220 requires the reporting of comprehensive income (loss) in addition to net income. Comprehensive income (loss) 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 (loss) 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 (Loss) (continued)

	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
2022			
Unrealized losses on securities:			
Unrealized holding losses arising during the period	$ (46,950,775)	$ 9,859,663	$ (37,091,112)
Reclassification adjustment for net gains realized in net income	(49,471)	10,389	(39,082)
Total other comprehensive loss	**$ (47,000,246)**	**$ 9,870,052**	**$(37,130,194)**
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)**

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, 2022	Unobservable Inputs	Range
Impaired loans				
Discounted appraisal value	$	1,216,173	Real estate collateral appraisal marketability discount	10-50%

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%

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)**
2022				
U.S. Government and federal agencies	$ 125,624,400	$ -	$ 125,624,400	$ -
Corporate debt	29,892,562	-	29,892,562	-
Mortgage-backed securities	48,815,664	-	48,815,664	-
State and local governments	86,555,831	-	86,555,831	-
Total securities	**$ 290,888,457**	**$ -**	**$ 290,888,457**	**$ -**
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**	**$ -**

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

	Total	**Level 1**	**Level 2**	**Level 3**
2022				
Impaired loans	$ 1,216,173	$ -	$ -	$ 1,216,173
Total assets	**$ 1,216,173**	**$ -**	**$ -**	**$ 1,216,173**
2021				
Other real estate	$ 26,600	$ -	$ -	$ 26,600
Impaired loans	3,036,674	-	-	3,036,674
Total assets	**$ 3,063,274**	**$ -**	**$ -**	**$ 3,063,274**

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 (OREO). 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 OREO.

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

	2022	2021
Noninterest income		
Trust fees	$ 2,007,020	$ 1,935,214
Service charges on deposit accounts	924,719	818,677
Other service charges and fees:		
Interchange fees	1,375,507	1,306,726
Other fees	80,717	225,175
Net gain on sale of investment securities*	49,471	1,699
Net gain on sale of loans*	4,875,515	17,057,476
Other income:		
Practical Security Solutions, LLC advisory fees	240,951	242,609
Other income*	1,001,371	1,411,632
	$ 10,555,271	**$ 22,999,208**

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 $14,156 and $58,522 for 2022 and 2021, respectively, that are included in noninterest expense. The table above presents the Corporation's sources of noninterest income for the years ended December 31, 2022 and 2021. Items outside of the scope of ASC 606 are noted as such (*). The other fees category includes approximately $45,000 and $51,000 of miscellaneous deposit fees which are within the scope of ASC 606, for 2022 and 2021, 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. Long-Term Incentive Stock Plan

A Long-Term Incentive Stock Plan provides for the issuance of stock-based awards to directors and officers. Total shares issuable under the plan were 200,000 at year-end 2022.

2,155 shares were granted under the plan through restricted stock awards in 2022, of which 398 shares were immediately vested and 1,757 shares will be fully vested by the fourth anniversary of the grant date. No shares were granted in 2021. Compensation expense for restricted stock awards is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The fair value of the stock price is based on a 90-day rolling average of known stock trades as of the month-end prior to the grant date. Restricted stock award shares either vest upon issuance or on a pre-determined vesting schedule.

As of December 31, 2022, there was $239,637 of total unrecognized compensation cost related to nonvested shares granted under the plan. The cost is expected to be recognized over a weighted-average period of 1.2 years. The total fair value of shares vested during the year ended December 31, 2022 was $54,283. There were no shares vested in 2021.

21. Subsequent Event

The Board of Directors approved commitments to further develop two existing branch locations. Facility projects are currently in process with approved development costs valued at approximately $3.6 million. Projects are anticipated to be completed by December 2023.