UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2024

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from__________ to___________

Commission file number 001-38884

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania	25-1440803
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1500 Nitterhouse Drive, Chambersburg, PA	17201-0819
(Address of principal executive offices)	(Zip Code)

(717) 264-6116
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Title of class	Symbol	Name of exchange on which registered
Common stock	FRAF	Nasdaq Capital Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ☐

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

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes ☐ No x

There were 4,395,702 outstanding shares of the Registrant’s common stock as of April 30, 2024.

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Part I FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data)	*(unaudited)* **March 31, 2024**	December 31, 2023
Assets		
Cash and due from banks	**$ 21,779**	$ 19,505
Short-term interest-earning deposits in other banks	**160,791**	3,635
Total cash and cash equivalents	**182,570**	23,140
Long-term interest-earning deposits in other banks	**3,989**	6,229
Debt securities available for sale, at fair value	**462,951**	472,503
Equity securities	**386**	427
Restricted stock	**10,295**	2,375
Loans held for sale	**281**	213
Loans	**1,277,595**	1,256,985
Allowance for credit losses	**(16,533)**	(16,052)
Net Loans	**1,261,062**	1,240,933
Premises and equipment, net	**28,897**	28,543
Right of use asset	**4,536**	4,680
Bank owned life insurance	**22,390**	22,758
Goodwill	**9,016**	9,016
Deferred tax asset, net	**11,880**	11,801
Other assets	**13,361**	13,421
Total assets	**$ 2,011,614**	$ 1,836,039
Liabilities		
Deposits		
Noninterest-bearing checking	**$ 291,893**	$ 273,050
Money management, savings, and interest checking	**1,095,510**	1,132,482
Time	**171,909**	132,446
Total deposits	**1,559,312**	1,537,978
Federal Reserve Bank borrowings	**40,000**	90,000
FHLB advances	**240,000**	40,000
Subordinate notes	**19,672**	19,661
Lease liability	**4,678**	4,816
Other liabilities	**13,715**	11,448
Total liabilities	**1,877,377**	1,703,903
Commitments and contingent liabilities		
Shareholders' equity		
Common stock, $1 par value per share,15,000,000 shares authorized with 4,710,972 shares issued and 4,393,873 shares outstanding at March 31, 2024 and 4,710,972 shares issued and 4,371,231 shares outstanding at December 31, 2023	**4,711**	4,711
Capital stock no par value, 5,000,000 shares authorized with no shares issued and outstanding	**—**	—
Additional paid-in capital	**43,459**	43,646
Retained earnings	**135,955**	133,993
Accumulated other comprehensive loss	**(41,234)**	(40,940)
Treasury stock, 317,099 shares at March 31, 2024 and 339,741 shares at December 31, 2023, at cost	**(8,654)**	(9,274)
Total shareholders' equity	**134,237**	132,136
Total liabilities and shareholders' equity	**$ 2,011,614**	$ 1,836,039

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

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended March 31, 2024	2023
Interest income		
Loans, including fees	**$ 17,222**	$ 12,336
Interest and dividends on investments:		
Taxable interest	**3,913**	3,451
Tax exempt interest	**275**	365
Dividend income	**45**	8
Interest-earning deposits in other banks	**2,354**	423
Total interest income	**23,809**	16,583
Interest expense		
Deposits	**6,504**	3,429
Federal Reserve Bank borrowings	**961**	51
FHLB advances	**2,527**	—
Subordinate notes	**264**	266
Total interest expense	**10,256**	3,746
Net interest income	**13,553**	12,837
Provision for credit losses - loans	**490**	467
Provision for credit losses - unfunded commitments	**(38)**	62
Total provision for credit losses	**452**	529
Net interest income after credit loss expense	**13,101**	12,308
Noninterest income		
Wealth management fees	**2,026**	1,834
Loan service charges	**206**	302
Gain on sale of loans	**58**	73
Deposit service charges and fees	**613**	583
Other service charges and fees	**488**	432
Debit card income	**536**	502
Increase in cash surrender value of life insurance	**112**	108
Net losses on sales of debt securities	**—**	(602)
Change in fair value of equity securities	**(41)**	(24)
Other	**190**	17
Total noninterest income	**4,188**	3,225
Noninterest Expense		
Salaries and employee benefits	**7,727**	6,936
Net occupancy	**1,182**	1,110
Marketing and advertising	**519**	519
Legal and professional	**516**	552
Data processing	**1,423**	1,060
Pennsylvania bank shares tax	**125**	223
FDIC Insurance	**322**	182
ATM/debit card processing	**323**	294
Telecommunications	**111**	100
Nonservice pension	**(29)**	(29)
Other	**1,085**	1,072
Total noninterest expense	**13,304**	12,019
Income before federal income taxes	**3,985**	3,514
Federal income tax expense	**624**	222
Net income	**$ 3,361**	$ 3,292
Per share		
Basic earnings per share	**$ 0.77**	$ 0.75
Diluted earnings per share	**$ 0.77**	$ 0.75

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

Consolidated Statements of Comprehensive Income

	For the Three Months Ended March 31,	
(Dollars in thousands) (unaudited)	**2024**	2023
Net Income	**$ 3,361**	$ 3,292
Debt Securities:		
Unrealized (losses) gains arising during the period	**(373)**	8,626
Reclassification adjustment for losses included in net income (1)	**—**	602
Net unrealized (losses) gains	**(373)**	9,228
Tax effect	**79**	(1,937)
Net of tax amount	**(294)**	7,291
Total other comprehensive (loss) gain	**(294)**	7,291
Total Comprehensive Income	**$ 3,067**	$ 10,583

(1) Reclassified to net losses on sales of debt securities

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

Consolidated Statements of Changes in Shareholders' Equity
For the three months ended March 31, 2024 and 2023

(Dollars in thousands, except per share data) (unaudited)	Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at January 1, 2024	**4,371,231**	**$ 4,711**	**$ 43,646**	**$ 133,993**	**$ (40,940)**	**$ (9,274)**	**$ 132,136**
Net income		**—**	**—**	**3,361**	**—**	**—**	**3,361**
Other comprehensive loss		**—**	**—**	**—**	**(294)**	**—**	**(294)**
Cash dividends declared, $0.32 per share		**—**	**—**	**(1,399)**	**—**	**—**	**(1,399)**
Acquisition of treasury stock	**(1,518)**	**—**	**—**	**—**	**—**	**(39)**	**(39)**
Treasury shares issued under dividend reinvestment plan	**12,288**	**—**	**(6)**	**—**	**—**	**335**	**329**
Stock Compensation Plans:							
Treasury shares issued	**11,872**	**—**	**(311)**	**—**	**—**	**324**	**13**
Compensation expense		**—**	**130**	**—**	**—**	**—**	**130**
Balance at March 31, 2024	**4,393,873**	**$ 4,711**	**$ 43,459**	**$ 135,955**	**$ (41,234)**	**$ (8,654)**	**$ 134,237**
Balance at January 1, 2023	4,390,397	$ 4,711	$ 43,535	$ 125,892	$ (51,287)	$ (8,654)	$ 114,197
Cumulative change in accounting principle, net of tax		—	—	98	—	—	98
Net income		—	—	3,292	—	—	3,292
Other comprehensive income		—	—	—	7,291	—	7,291
Cash dividends declared, $0.32 per share		—	—	(1,405)	—	—	(1,405)
Acquisition of treasury stock	(10,108)	—	—	—	—	(316)	(316)
Treasury shares issued under dividend reinvestment plan	8,484	—	48	—	—	229	277
Stock Compensation Plans:							
Treasury shares issued	13,902	—	(362)	—	—	376	14
Compensation expense		—	135	—	—	—	135
Balance at March 31, 2023	4,402,675	$ 4,711	$ 43,356	$ 127,877	$ (43,996)	$ (8,365)	$ 123,583

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

Consolidated Statements of Cash Flows

(Dollars in thousands) (unaudited)	Three Months Ended March 31, 2024	2023
Cash flows from operating activities		
Net income	**$ 3,361**	$ 3,292
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**538**	479
Net amortization of loans and investment securities	**914**	842
Amortization of subordinate debt issuance costs	**11**	12
Provision for credit losses	**452**	529
Change in fair value of equity securities	**41**	24
Realized losses on sales of debt securities	**—**	602
Loans originated for sale	**(3,439)**	(5,007)
Proceeds from sale of loans	**3,429**	5,363
Gain on sale of loans held for sale	**(58)**	(73)
Increase in cash surrender value of life insurance	**(112)**	(108)
Gain from claims on life insurance policies	**(78)**	—
Change in fair value of derivative	**(1)**	1
Stock based compensation	**130**	135
Decrease (increase) in other assets	**762**	(168)
Increase in other liabilities	**1,354**	1,794
Net cash provided by operating activities	**7,304**	7,717
Cash flows from investing activities		
Net decrease in long-term interest-earning deposits in other banks	**2,240**	4,498
Proceeds from sales and calls of investment securities available for sale	**—**	32,855
Proceeds from maturities and pay-downs of securities available for sale	**11,997**	8,452
Purchase of investment securities available for sale	**(3,510)**	(4,325)
Increase in restricted stock	**(7,920)**	—
Net increase in loans	**(20,617)**	(26,654)
Proceeds from surrender of life insurance policies	**559**	—
Capital expenditures	**(861)**	(111)
Net cash (used in) provided by investing activities	**(18,112)**	14,715
Cash flows from financing activities		
Net decrease in demand deposits, interest-bearing checking, and savings accounts	**(18,129)**	(65,523)
Net increase in time deposits	**39,463**	16,185
Increase in long-term borrowings	**200,000**	—
Net (decrease) increase in short-term borrowings	**(50,000)**	50,000
Dividends paid	**(1,399)**	(1,405)
Purchase of Treasury shares	**(39)**	(316)
Cash received from option exercises	**13**	14
Treasury shares issued under dividend reinvestment plan	**329**	277
Net cash provided by (used in) financing activities	**170,238**	(768)
Increase in cash and cash equivalents	**159,430**	21,664
Cash and cash equivalents at the beginning of the period	**23,140**	64,899
Cash and cash equivalents at the end of the period	**$ 182,570**	$ 86,563
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest on deposits and other borrowed funds	**$ 9,902**	$ 3,268

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

Note 1. Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank) and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly owned subsidiary, Franklin Financial Properties Corp. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of the non-bank subsidiary are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of March 31, 2024, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation’s 2023 Annual Report on Form 10-K. The consolidated results of operations for the three month period ended March 31, 2024 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2023 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks and cash items with original maturities less than 90 days.

Earnings per share are computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended March 31,	
(Dollars and shares in thousands, except per share data)	**2024**	2023
Weighted average shares outstanding (basic)	**4,378**	4,395
Impact of common stock equivalents	**8**	22
Weighted average shares outstanding (diluted)	**4,386**	4,417
Anti-dilutive options excluded from calculation	**—**	25
Net income	**$ 3,361**	$ 3,292
Basic earnings per share	**$ 0.77**	$ 0.75
Diluted earnings per share	**$ 0.77**	$ 0.75

Note 2. Recent Accounting Pronouncements

Recently adopted accounting standards

ASU 2023-01, Leases (Topic 842): Common Control Arrangements		
Description		This ASU requires entities to determine whether a related party arrangement between entities under common control is a lease. If the arrangement is determined to be a lease, an entity must classify and account for the lease on the same basis as an arrangement with a related party (on the basis of legally enforceable terms and conditions).
Effective Date		January 1, 2024
Effect on the Consolidated Financial Statements		The Corporation adopted the ASU on January 1, 2024 and it did not have a material effect on the Corporation's financial statements.

ASU 2023-02, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method		
Description		This ASU permits reporting entities to elect to account for their tax equity investments, regardless of the tax credit program from which the income tax credits are received, using the proportional amortization method if certain conditions are met.
Effective Date		January 1, 2024
Effect on the Consolidated Financial Statements		The Corporation adopted the ASU on January 1, 2024 and it did not have a material effect on the Corporation's financial statements.

Recently issued but not yet effective accounting standards

ASU 2023-09, Income Taxes (Topic 740): Improvements to Income Tax Disclosures		
Description		This ASU is intended to improve the transparency of income tax disclosures by requiring consistent categories and greater disaggregation of information in the rate reconciliation table and income taxes paid to be disaggregated by jurisdiction. It also includes certain amendments to improve the effectiveness of income tax disclosures.
Effective Date		January 1, 2025
Effect on the Consolidated Financial Statements		The ASU is not expected to have an impact on the Corporation's financial statements.

ASU 2023-07, Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures		
Description		This ASU is intended to improve reportable segment disclosure requirements primarily through enhanced disclosures about significant segment expenses.
Effective Date		Fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024.
Effect on the Consolidated Financial Statements		The Corporation is currently evaluating the impact the ASU will have on its consolidated financial statements.

ASU 2023-01, Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative		
Description		This ASU incorporates certain U.S. Securities and Exchange Commission (SEC) disclosure requirements into the FASB Accounting Standards Codification. The amendments in the ASU are expected to clarify or improve disclosure and presentation requirements of a variety of Codification Topics, allow users to more easily compare entities subject to the SEC's existing disclosures with those entities that were not previously subject to the requirement, and align the requirements in the Codification with the SEC's regulations.
Effective Date		The effective date for each amendment will be the date on which the SEC's removal of that related disclosure from Regulation S-X or Regulation S-K becomes effective, with early adoption prohibited.
Effect on the Consolidated Financial Statements		The ASU is not expected to have an impact on the Corporation's financial statements.

Note 3. Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss), net of income tax effects, included in shareholders' equity are as follows:

(Dollars in thousands)	**March 31, 2024**	December 31, 2023
Net unrealized losses on debt securities	**$** (49,789)	$ (49,416)
Tax effect	10,456	10,377
Net of tax amount	**$** (39,333)	$ (39,039)
Accumulated pension adjustment	**$** (2,406)	$ (2,406)
Tax effect	505	505
Net of tax amount	**$** (1,901)	$ (1,901)
Total accumulated other comprehensive (loss)	**$** (41,234)	$ (40,940)

Note 4. Investments

Available for Sale (AFS) Securities

The amortized cost and estimated fair value of AFS securities as of March 31, 2024 and December 31, 2023 are as follows:

(Dollars in thousands) **March 31, 2024**	**Amortized cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair Value**
U.S. Treasury	**$ 83,317**	$ **—**	$ **(10,207)**	$ **73,110**
Municipal	**161,016**	**—**	**(23,560)**	**137,456**
Corporate	**26,341**	**1**	**(2,890)**	**23,452**
Agency mortgage & asset-backed	**137,883**	**161**	**(9,718)**	**128,326**
Non-Agency mortgage & asset-backed	**104,183**	**36**	**(3,612)**	**100,607**
Total	**$ 512,740**	**$ 198**	**$ (49,987)**	**$ 462,951**

(Dollars in thousands) December 31, 2023	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. Treasury	$ 83,494	$ —	$ (9,403)	$ 74,091
Municipal	161,339	—	(22,721)	138,618
Corporate	26,336	—	(3,138)	23,198
Agency mortgage & asset-backed	142,565	90	(10,064)	132,591
Non-Agency mortgage & asset-backed	108,185	48	(4,228)	104,005
Total	$ 521,919	$ 138	$ (49,554)	$ 472,503

At March 31, 2024 and December 31, 2023, the fair value of debt securities pledged to secure public funds and trust deposits totaled $204.4 million and $207.4 million, respectively. The Bank has no investment in a single issuer that exceeds 10% of shareholders’ equity, except for securities issued by the U.S. Treasury and U.S. government sponsored entities.

The amortized cost and estimated fair value of debt securities at March 31, 2024, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities. Securities not due at a single maturity date are presented separately.

(Dollars in thousands)	**Amortized cost**	**Fair value**
Due in one year or less	$ —	$ —
Due after one year through five years	78,032	69,240
Due after five years through ten years	87,037	75,338
Due after ten years	105,605	89,440
	270,674	234,018
Mortgage & asset-backed	242,066	228,933
	$ 512,740	$ 462,951

The composition of the net realized gains (losses) on debt securities for the three months ended are as follows:

	For the Three Months Ended March 31,	
(Dollars in thousands)	**2024**	2023
Proceeds	**$ —**	$ 32,855
Gross gains realized	**$ —**	$ 12
Gross losses realized	**—**	(614)
Net (losses) gains realized	**$ —**	$ (602)
Tax benefit (provision) on net (losses) gains realized	**$ —**	$ 126

Credit Impairment:

The debt securities portfolio contained 550 securities with a fair value of $437.5 million, and $50.0 million in unrealized losses at March 31, 2024, the same unrealized loss at the prior year-end.

AFS securities in an unrealized loss position are evaluated for credit impairment at least quarterly. For these securities, the Bank considers: (1) the extent to which the fair value is less than amortized cost; (2) adverse conditions specifically related to the security, industry or geographic area; (3) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future; (4) failure of the issuer of the security to make scheduled interest or principal payments; and (5) any changes to the rating of the security by a rating agency. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. The Bank does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost. The unrealized losses identified on debt securities and subject to evaluation at March 31, 2024, was determined not to be attributable to credit related factors; therefore, the Bank does not have an allowance for credit loss for these investments.

The following table summarizes debt securities in the AFS portfolio in an unrealized loss position for which an allowance for credit losses has not been recorded, aggregated by investment category, length of time that individual securities have been in continuous unrealized loss position and the number of securities in each category as of March 31, 2024 and December 31, 2023:

	March 31, 2024								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Treasury	$ —	$ —	—	$ 73,110	$ (10,207)	28	$ 73,110	$ (10,207)	28
Municipal	—	—	—	137,456	(23,560)	168	137,456	(23,560)	168
Corporate	—	—	—	22,470	(2,890)	50	22,470	(2,890)	50
Agency mortgage & asset-backed	2,116	(17)	12	111,772	(9,701)	221	113,888	(9,718)	233
Non-Agency mortgage & asset-backed	43,919	(223)	18	46,654	(3,389)	53	90,573	(3,612)	71
Total temporarily impaired	$ 46,035	$ (240)	30	$ 391,462	$ (49,747)	520	$ 437,497	$ (49,987)	550

	December 31, 2023								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Treasury	$ —	$ —	—	$ 74,091	$ (9,403)	28	$ 74,091	$ (9,403)	28
Municipal	—	—	—	138,618	(22,721)	168	138,618	(22,721)	168
Corporate	1,483	(167)	5	21,715	(2,971)	46	23,198	(3,138)	51
Agency mortgage & asset-backed	6,227	(186)	19	118,053	(9,878)	223	124,280	(10,064)	242
Non-Agency mortgage & asset-backed	47,928	(560)	19	50,071	(3,668)	56	97,999	(4,228)	75
Total temporarily impaired	$ 55,638	$ (913)	43	$ 402,548	$ (48,641)	521	$ 458,186	$ (49,554)	564

Equity Securities at Fair Value

The Corporation owns one equity investment with a readily determinable fair value. At March 31, 2024 and December 31, 2023, this investment was reported at fair value of $386 thousand and $427 thousand, respectively, with changes in value reported through income.

Note 5. Loans

The Bank reports its loan portfolio based on the primary collateral of the loan. It further classifies these loans by the primary purpose, either consumer or commercial. The Bank's mortgage loans include long-term loans to individuals and businesses secured by mortgages on the borrower's real property. Construction loans are made to finance the purchase of land and the construction of residential and commercial buildings thereon and are secured by mortgages on real estate. Commercial loans are made to businesses of various sizes for a variety of purposes including construction, property, plant and equipment, and working capital. Commercial loans also include loans to government municipalities. Commercial lending is concentrated in the Bank's primary market, but also includes purchased loan participations. Consumer loans are comprised of installment, home equity and unsecured personal lines of credit.

Each class of loans involves a different kind of risk. However, risk factors such as changes in interest rates, general economic conditions and changes in collateral values are common across all classes. The risk of each loan class is presented below.

Residential Real Estate 1-4 family

The largest risk in residential real estate loans to retail customers is the borrower's inability to repay the loan due to the loss of the primary source of income. The Bank attempts to mitigate this risk through prudent underwriting standards including employment history, current financial condition and credit history. These loans are generally owner occupied and serve as the borrower's primary residence. The Bank usually holds a first lien position on these properties but may hold a second lien position in some home equity loans or lines of credit. Commercial purpose loans, secured by residential real estate, are usually dependent upon repayment from the rental income or other business purposes. These loans are generally non-owner occupied. In addition to the real estate collateral, these loans may have personal guarantees or UCC filings on other business assets. If a payment default occurs on a 1-4 family residential real estate loan, the collateral serves as a source of repayment, but may be subject to a change in value due to economic conditions.

Residential Real Estate Construction

This class includes loans to individuals for construction of a primary residence and to contractors and developers to improve real estate and construct residential properties. Construction loans to individuals generally bear the same risk as 1-4 family residential loans. Additional risks may include cost overruns, delays in construction or contractor problems.

Loans to contractors and developers are primarily dependent on the sale of improved lots or finished homes for repayment. Risks associated with these loans include the borrower's character and capacity to complete a development, the effect of economic conditions on the valuation of lots or homes, cost overruns, delays in construction or contractor problems. In addition to real estate collateral, these loans may have personal guarantees or UCC filings on other business assets, depending on the financial strength and experience of the developer. Real estate construction loans are monitored on a regular basis by either an independent third party or the responsible loan officer, depending on the size and complexity of the project. This monitoring process includes, at a minimum, the submission of invoices or AIA documents detailing the cost incurred by the borrower, on-site inspections, and an authorizing signature for disbursement of funds.

Commercial Real Estate

Commercial real estate loans may be secured by various types of commercial property including retail space, office buildings, warehouses, hotels and motels, manufacturing facilities and, agricultural land.

Commercial real estate loans present a higher level of risk than residential real estate loans. Repayment of these loans is normally dependent on cash flow generated by the operation of a business that utilizes the real estate. The successful operation of the business, and therefore repayment ability, may be affected by general economic conditions outside of the control of the operator. On most commercial real estate loans ongoing monitoring of cash flow and other financial performance indictors is completed annually through financial statement analysis. In addition, the value of the collateral may be negatively affected by economic conditions and may be insufficient to repay the loan in the event of default. In the event of foreclosure, commercial real estate may be more difficult to liquidate than residential real estate.

Commercial

Commercial loans are made for various business purposes to finance equipment, inventory, accounts receivables, and operating liquidity. These loans are generally secured by business assets or equipment, non-real estate collateral and/or personal guarantees.

Commercial loans present a higher level of credit risk than other loans because repayment ability is usually dependent on cash-flow from a business operation that can be affected by general economic conditions. On most commercial loans ongoing monitoring of cash flow and other financial performance indicators occur at least annually through financial statement analysis. In the event of a default, collateral for these loans may be more difficult to liquidate, and the valuation of the collateral may decline more quickly than loans secured by other types of collateral.

Loans to governmental municipalities are also included in the Commercial class. These loans generally have less risk than Commercial & Industrial (C&I) loans due to the taxing authority of the municipality and its ability to assess fees on services.

This class also includes loans made as part of the Paycheck Protection Program (PPP). The PPP is a small business loan program, administered by the Small Business Administration (SBA). The PPP loans are 100 percent guaranteed by the SBA and have a maturity of two years or five years with a fixed interest rate of 1.00% for the life of the loan. Because the PPP loans are 100% guaranteed by the SBA, they present no credit risk to the Bank once the SBA guarantee is fulfilled. However, if the SBA does not grant loan forgiveness, the PPP loan would present the same risk factors as any other commercial loan.

Consumer

These loans are made for a variety of reasons to consumers and include term loans and personal lines-of credit. The loans may be secured or unsecured. Repayment is primarily dependent on the income of the borrower and to a lesser extent the sale of collateral. The underwriting of these loans is based on the consumer's ability and willingness to repay and is determined by the borrower's employment history, current financial condition and credit history. Collateral for these loans, if any, usually depreciates quickly and therefore, may not be adequate to repay the loan if it is repossessed. Therefore, the overall health of the economy, including unemployment rates and wages, will have an effect on the credit quality in this loan class.

A summary of loans outstanding, by class, at the end of the reporting periods is as follows:

(Dollars in thousands)	**March 31, 2024**	December 31, 2023
Residential Real Estate 1-4 Family		
Consumer first liens	**$ 145,519**	$ 142,017
Commercial first lien	**63,475**	63,271
Total first liens	**208,994**	205,288
Consumer junior liens and lines of credit	**68,046**	68,752
Commercial junior liens and lines of credit	**4,163**	3,809
Total junior liens and lines of credit	**72,209**	72,561
Total residential real estate 1-4 family	**281,203**	277,849
Residential real estate - construction		
Consumer	**16,293**	13,837
Commercial	**12,593**	12,063
Total residential real estate construction	**28,886**	25,900
Commercial real estate	**721,320**	703,767
Commercial	**239,603**	242,654
Total commercial	**960,923**	946,421
Consumer	**6,583**	6,815
	1,277,595	1,256,985
Less: Allowance for credit losses	**(16,533)**	(16,052)
Net Loans	**$ 1,261,062**	$ 1,240,933
Included in the loan balances are the following:		
Net unamortized deferred loan costs	**$ 1,757**	$ 1,615
Loans pledged as collateral for borrowings and commitments from:		
FHLB	**$ 726,686**	$ 699,527
Federal Reserve Bank	**78,678**	83,482
	$ 805,364	$ 783,009
Paycheck Protection Program (included in commercial loans)	**$ 31**	$ 57

Note 6. Loan Quality and Allowance for Credit Losses

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, and current economic trends, among other factors. Management utilizes a risk rating scale ranging from 1-Prime to 9-Loss to evaluate loan quality. This risk rating scale is used primarily for commercial purpose loans. Consumer purpose loans are identified as either performing or nonperforming based on the payment status of the loans. Nonperforming consumer loans are loans that are nonaccrual or 90 days or more past due and still accruing. The Bank uses the following definitions for risk ratings:

Pass (1-5): are considered pass credits with lower or average risk and are not otherwise classified.

OAEM (6): Loans classified as OAEM have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the borrower’s credit position at some future date.

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

Doubtful (8): Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not included in the pool evaluation. When management determines that foreclosure is probable or when the borrower is experiencing financial difficulty at the reporting date and repayment is expected to be provided substantially through the sale of the collateral, the expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for any discounts and selling costs as appropriate.

Management monitors loan performance on a monthly basis and performs a quarterly evaluation of the adequacy of the Allowance for Credit Loss for loans (ACL). The Bank begins enhanced monitoring of all loans rated 6–OAEM or worse and obtains a new appraisal or asset valuation for any loans placed on nonaccrual and rated 7 - Substandard or worse. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on factors, including, but not limited to: the economy, deferred maintenance, industry, type of property/equipment, age of the appraisal, etc. and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. When determining the ACL, certain factors involved in the evaluation are inherently subjective and require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows. Management monitors the adequacy of the ACL on an ongoing basis and reports its adequacy quarterly to the Enterprise Risk Management Committee of the Board of Directors. Management believes the ACL at March 31, 2024 is adequate.

The following table presents loans by year of origination and internally assigned risk ratings:

(Dollars in thousands)	Term Loans						Revolving Loans	Revolving Loans	
	Amortized Cost Basis by Origination Year						Amortized	Converted	
As of March 31, 2024	**2024**	2023	2022	2021	2020	Prior	Cost Basis	to Term	Total
Residential real estate 1-4 family:									
Commercial:									
Risk rating:									
Pass (1-5)	$ 2,305	$ 9,845	$ 8,813	$ 10,904	$ 9,427	$ 24,002	$ 2,342	$ —	$ 67,638
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	—	—	—	—	—	—	—	—
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total Commercial	2,305	9,845	8,813	10,904	9,427	24,002	2,342	—	67,638
Consumer:									
Performing	6,362	51,787	33,432	15,262	9,846	32,007	43,723	21,146	213,565
Nonperforming	—	—	—	—	—	—	—	—	—
Total Consumer	6,362	51,787	33,432	15,262	9,846	32,007	43,723	21,146	213,565
Total	$ 8,667	$ 61,632	$ 42,245	$ 26,166	$ 19,273	$ 56,009	$ 46,065	$ 21,146	$ 281,203
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Residential real estate construction:									
Commercial:									
Risk rating:									
Pass (1-5)	$ 252	$ 8,301	$ 2,356	$ 949	$ 196	$ 539	$ —	$ —	$ 12,593
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	—	—	—	—	—	—	—	—
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total Commercial	252	8,301	2,356	949	196	539	—	—	12,593
Consumer:									
Performing	688	15,605	—	—	—	—	—	—	16,293
Nonperforming	—	—	—	—	—	—	—	—	—
Total Consumer	688	15,605	—	—	—	—	—	—	16,293
Total	$ 940	$ 23,906	$ 2,356	$ 949	$ 196	$ 539	$ —	$ —	$ 28,886
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Commercial real estate:									
Risk rating:									
Pass (1-5)	$ 17,044	$ 193,141	$ 110,031	$ 98,514	$ 33,814	$ 239,161	$ 12,727	$ —	$ 704,432
OAEM (6)	—	2,941	1,341	1,000	6,762	2,157	124	—	14,325
Substandard (7)	—	—	—	—	—	2,513	50	—	2,563
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total	$ 17,044	$ 196,082	$ 111,372	$ 99,514	$ 40,576	$ 243,831	$ 12,901	$ —	$ 721,320
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ (2)	$ —	$ —	$ (2)
Commercial:									
Risk rating:									
Pass (1-5)	$ 2,214	$ 33,580	$ 32,580	$ 44,547	$ 21,959	$ 66,286	$ 37,933	$ —	$ 239,099
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	—	307	—	1	—	196	—	504
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total	$ 2,214	$ 33,580	$ 32,887	$ 44,547	$ 21,960	$ 66,286	$ 38,129	$ —	$ 239,603
Current period gross charge-offs	$ (4)	$ —	$ —	$ —	$ —	$ —	$ (62)	$ —	$ (66)
Consumer:									
Performing	648	1,544	588	1,911	113	64	1,710	—	6,578
Nonperforming	—	—	—	—	—	—	5	—	5
Total	$ 648	$ 1,544	$ 588	$ 1,911	$ 113	$ 64	$ 1,715	$ —	$ 6,583
Current period gross charge-offs	$ (12)	$ —	$ (2)	$ —	$ (6)	$ (1)	$ (7)	$ —	$ (28)

(Dollars in thousands)

As of December 31, 2023	Term Loans Amortized Cost Basis by Origination Year 2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Residential real estate 1-4 family:									
Commercial:									
Risk rating:									
Pass (1-5)	$ 9,867	$ 9,088	$ 11,038	$ 9,691	$ 2,433	$ 22,906	$ 2,057	$ —	$ 67,080
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	—	—	—	—	—	—	—	—
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total Commercial	9,867	9,088	11,038	9,691	2,433	22,906	2,057	—	67,080
Consumer:									
Performing	53,128	34,136	15,625	10,245	5,222	28,423	43,968	20,022	210,769
Nonperforming	—	—	—	—	—	—	—	—	—
Total Consumer	53,128	34,136	15,625	10,245	5,222	28,423	43,968	20,022	210,769
Total	$ 62,995	$ 43,224	$ 26,663	$ 19,936	$ 7,655	$ 51,329	$ 46,025	$ 20,022	$ 277,849
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Residential real estate construction:									
Commercial:									
Risk rating:									
Pass (1-5)	$ 6,845	$ 2,209	$ 1,289	$ 214	$ —	$ 1,506	$ —	$ —	$ 12,063
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	—	—	—	—	—	—	—	—
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total Commercial	6,845	2,209	1,289	214	—	1,506	—	—	12,063
Consumer:									
Performing	13,837	—	—	—	—	—	—	—	13,837
Nonperforming	—	—	—	—	—	—	—	—	—
Total Consumer	13,837	—	—	—	—	—	—	—	13,837
Total	$ 20,682	$ 2,209	$ 1,289	$ 214	$ —	$ 1,506	$ —	$ —	$ 25,900
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Commercial real estate:									
Risk rating:									
Pass (1-5)	$ 180,052	$ 110,886	$ 98,540	$ 34,307	$ 38,603	$ 214,179	$ 10,567	$ —	$ 687,134
OAEM (6)	2,955	1,350	1,000	6,823	—	2,182	139	—	14,449
Substandard (7)	—	—	—	—	—	2,134	50	—	2,184
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total	$ 183,007	$ 112,236	$ 99,540	$ 41,130	$ 38,603	$ 218,495	$ 10,756	$ —	$ 703,767
Current period gross charge-offs	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Commercial:									
Risk rating:									
Pass (1-5)	$ 34,851	$ 33,983	$ 45,754	$ 22,847	$ 3,579	$ 64,542	$ 36,508	$ —	$ 242,064
OAEM (6)	—	—	—	—	—	—	—	—	—
Substandard (7)	—	317	—	—	—	—	273	—	590
Doubtful (8)	—	—	—	—	—	—	—	—	—
Total	$ 34,851	$ 34,300	$ 45,754	$ 22,847	$ 3,579	$ 64,542	$ 36,781	$ —	$ 242,654
Current period gross charge-offs	$ (125)	$ —	$ (130)	$ —	$ —	$ —	$ (50)	$ —	$ (305)
Consumer:									
Performing	1,863	669	1,985	148	80	5	2,060	—	6,810
Nonperforming	—	—	—	—	—	—	5	—	5
Total	$ 1,863	$ 669	$ 1,985	$ 148	$ 80	$ 5	$ 2,065	$ —	$ 6,815
Current period gross charge-offs	$ (63)	$ —	$ (10)	$ (2)	$ (6)	$ —	$ (36)	$ —	$ (117)

The following table presents the amortized cost basis of loans on nonaccrual status and loans past due over 90 days and still accruing as of March 31, 2024:

(Dollars in thousands)	March 31, 2024 Nonaccrual and Loans Past Due Over 90 Days+			December 31, 2023 Nonaccrual and Loans Past Due Over 90 Days+		
March 31, 2024	Nonaccrual Without ACL	Nonaccrual With ACL	Loans Past Due Over 90 Days Still Accruing	Nonaccrual Without ACL	Nonaccrual With ACL	Loans Past Due Over 90 Days Still Accruing
Residential Real Estate 1-4 Family						
First liens	$ —	$ —	$ —	$ —	$ —	$ —
Junior liens and lines of credit	—	—	—	—	—	—
Total	—	—	—	—	—	—
Residential real estate - construction	—	—	—	—	—	—
Commercial real estate	407	—	—	—	—	—
Commercial	83	—	—	147	—	—
Consumer	—	—	5	—	—	5
Total	$ 490	$ —	$ 5	$ 147	$ —	$ 5

At March 31, 2024 the company had $407 thousand of commercial real estate loans and $1 thousand of commercial loans that were considered to be collateral dependent. A loan is considered to be collateral dependent when the borrower is experiencing financial difficulty, and the repayment is expected to be provided substantially through the operation or sale of collateral. These loans were secured by farmland and business assets, respectively. No loans were considered collateral dependent at December 31, 2023.

At March 31, 2024 and December 31, 2023, the Bank had $0 of residential properties in the process of foreclosure.

The following table presents the aging of payments of the loan portfolio:

(Dollars in thousands)	Loans Past Due					
March 31, 2024	30-59 Days	60-89 Days	90 Days+	Total Past Due	Current	Total Loans
Residential Real Estate 1-4 Family						
First liens	$ 410	$ 7	$ —	$ 417	$ 208,577	$ 208,994
Junior liens and lines of credit	514	30	—	544	71,665	72,209
Total	924	37	—	961	280,242	281,203
Residential real estate - construction	—	—	—	—	28,886	28,886
Commercial real estate	922	82	407	1,411	719,909	721,320
Commercial	162	375	83	620	238,983	239,603
Consumer	14	11	5	30	6,553	6,583
Total	$ 2,022	$ 505	$ 495	$ 3,022	$ 1,274,573	$ 1,277,595

December 31, 2023	30-59 Days	60-89 Days	90 Days+	Total Past Due	Current	Total Loans
Residential Real Estate 1-4 Family						
First liens	$ 62	$ 394	$ —	$ 456	$ 204,832	$ 205,288
Junior liens and lines of credit	239	228	—	467	72,094	72,561
Total	301	622	—	923	276,926	277,849
Residential real estate - construction	—	—	—	—	25,900	25,900
Commercial real estate	3,232	—	—	3,232	700,535	703,767
Commercial	542	112	147	801	241,853	242,654
Consumer	21	12	5	38	6,777	6,815
Total	$ 4,096	$ 746	$ 152	$ 4,994	$ 1,251,991	$ 1,256,985

The following table presents, by class, the activity in the Allowance for Credit Losses (ACL) for the periods shown:

(Dollars in thousands)	Residential Real Estate 1-4 Family First Liens	Residential Real Estate 1-4 Family Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
ACL at December 31, 2023	**$ 1,296**	**$ 419**	**$ 296**	**$ 10,657**	**$ 3,290**	**$ 94**	**$ —**	**$ 16,052**
Charge-offs	**—**	**—**	**—**	**(2)**	**(66)**	**(28)**	**—**	**(96)**
Recoveries	**—**	**—**	**4**	**—**	**60**	**23**	**—**	**87**
Provision	**12**	**(4)**	**37**	**402**	**40**	**3**	**—**	**490**
ACL at March 31, 2024	**$ 1,308**	**$ 415**	**$ 337**	**$ 11,057**	**$ 3,324**	**$ 92**	**$ —**	**$ 16,533**
ACL at June 30, 2023	$ 465	$ 245	$ 289	$ 8,096	$ 5,076	$ 119	$ 725	$ 15,015
ACL at December 31, 2022	$ 459	$ 234	$ 343	$ 7,493	$ 4,846	$ 133	$ 667	$ 14,175
Impact of adopting ASU 2016-13	1,096	493	(95)	584	(1,907)	(40)	(667)	(536)
Charge-offs	—	—	—	—	(86)	(34)	—	(120)
Recoveries	2	—	39	—	67	15	—	123
Provision	67	(37)	(97)	159	355	20	—	467
ACL at March 31, 2023	$ 1,624	$ 690	$ 190	$ 8,236	$ 3,275	$ 94	$ —	$ 14,109

On January 1, 2023, The Bank adopted ASU 2022-02, "Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures" ("ASU 2022-02"), which eliminated the accounting guidance for troubled debt restructurings ("TDRs") while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. Modifications to borrowers experiencing financial difficulty may include interest rate reductions, principal or interest forgiveness, forbearances, term extensions, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral.

As of March 31, 2024 and December 31, 2023 there were no modifications made to borrowers experiencing financial difficulty.

Note 7. Leases

The Corporation leases various assets in the course of its operations that are subject to recognition on the balance sheet. The Corporation considers all of its leases to be operating leases and it has no finance leases. The leased assets may include equipment, and buildings and land (collectively real estate). The equipment leases are shorter-term than the real estate leases, and generally have a fixed payment over a defined term without renewal options. Certain equipment leases have purchase options and it was determined the option was not reasonably certain to be exercised. The real estate leases are longer-term and may contain renewal options after the initial term, but none of the real estate leases contain a purchase option. The renewal options on real estate leases were reviewed and if it was determined the option was reasonably certain to be renewed, the option term was considered in the determination of the lease liability. There is only one real estate lease with a variable payment based on an index included in the lease liability. None of the leases contain any restrictive covenants and there are no significant leases that have not yet commenced. The discount rate used to determine the lease liability is based on the Bank's fully secured borrowing rate from the Federal Home Loan Bank for a term similar to the lease term. Operating lease expense is included in net occupancy expense in the consolidated statements of income.

Lease costs:

The components of total lease cost were as follows:

(Dollars in thousands)	Three Months Ended March 31, **2024**	Three Months Ended March 31, 2023
Operating lease cost	**$ 194**	$ 211
Short-term lease cost	**1**	4
Variable lease cost	**37**	36
Total lease cost	**$ 232**	$ 251

Supplemental Lease Information:

(Dollars in thousands)	Three Months Ended March 31, 2024	2023
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	**$ 189**	$ 206
Weighted-average remaining lease term (years)	**11.7**	11.8
Weighted-average discount rate	**3.42%**	3.38%

Lease Obligations:

Future undiscounted lease payments for operating leases with initial terms of one year or more as of March 31, 2024, are as follows:

(Dollars in thousands)	
2024	**$ 543**
2025	**666**
2026	**564**
2027	**421**
2028	**393**
2029 and beyond	**3,205**
Undiscounted cash flow	**5,792**
Imputed Interest	**(1,114)**
Total lease liability	**$ 4,678**

Note 8. Other Real Estate Owned

The Bank had no other real estate owned at March 31, 2024 and December 31, 2023.

Note 9. Derivatives

The Corporation is exposed to certain risks arising from both its business operations and economic conditions. The Corporation principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Corporation manages economic risks, including interest rate, liquidity, and credit risk, primarily by managing the amount, sources, and duration of its assets and liabilities.

The Corporation's existing credit derivatives result from participations in interest rate swaps provided by external lenders as part of loan participation arrangements. Derivatives not designated as hedges are not speculative and result from a service the Corporation provides to certain lenders which participate in loans.

The table below presents the fair value of the Corporation's derivative financial instruments as well as their classification on the Balance Sheet.

Fair Value of Derivative Instruments

Derivative Liabilities

(Dollars in thousands)	**March 31, 2024** Notional amount	Balance Sheet Location	Fair Value	December 31, 2023 Notional amount	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments						
Other Contracts	**$ 6,217**	Other Liabilities	**$ 1**	$ 6,268	Other Liabilities	$ 2
Total derivatives not designated as hedging instruments			**$ 1**			$ 2

The table below presents the effect of the Corporation's derivative financial instruments that are not designated as hedging instruments on the Income Statement.

Effect of Derivatives as Hedging Instruments on the Income Statement

Derivatives Not Designated as Hedging Instruments under Subtopic 815-20	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivatives	
(Dollars in thousands)		Three Months Ended	
		March 31, 2024	March 31, 2023
Other Contracts	Other income	$ **1**	$ (1)

As of March 31, 2024, the fair value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $1 thousand.

Note 10. Pension

The components of pension expense for the periods presented are as follows:

	Three Months Ended March 31,	
(Dollars in thousands)	**2024**	2023
Components of net periodic cost:		
Service cost	$ **51**	$ 54
Interest cost	**188**	202
Expected return on plan assets	**(217)**	(231)
Recognized net actuarial loss	**—**	—
Total pension expense	$ **22**	$ 25

The service cost component of pension expense is recorded in the salaries and employee benefits line and all other cost components are recorded in the nonservice pension line of the Consolidated Statements of Income.

Note 11. Fair Value Measurements and Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end. The Corporation uses the exit price notion to measure the fair value of financial instruments.

FASB ASC Topic 820, "Financial Instruments", requires disclosure of the fair value of financial assets and liabilities, including those financial assets and liabilities that are not measured and reported at fair value on a recurring and nonrecurring basis. The Corporation does not report any nonfinancial assets at fair value. FASB ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC Topic 820 are as follows:

Level 1: Valuation is based on unadjusted, quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. There may be substantial differences in the assumptions used for securities within the same level. For example, prices for U.S. Agency securities have fewer assumptions and are closer to level 1 valuations than the private label mortgage-backed securities that require more assumptions and are closer to level 3 valuations.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Corporation’s assumptions regarding what market participants would assume when pricing a financial instrument.

An asset’s or liability’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following information regarding the fair value of the Corporation’s financial instruments should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation’s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation’s disclosures and those of other companies may not be meaningful.

The following methods and assumptions were used to estimate the fair values of the Corporation’s financial instruments measured at fair value on a recurring and nonrecurring basis.

<u>Equity Securities</u>: Equity securities are valued using quoted market prices from nationally recognized markets (Level 1). Equity securities are measured at fair value on a recurring basis.

<u>Investment securities</u>: Fair values of investment securities available-for-sale were primarily measured using information from a third-party pricing service. This service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. Level 2 investment securities are primarily comprised of debt securities issued by states and municipalities, corporations, mortgage-backed securities issued by government agencies, and government-sponsored enterprises. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. Investment securities are measured at fair value on a recurring basis.

<u>Collateral Dependent Loans</u>: The fair value of collateral dependent loans with specific allocations of the allowance for credit losses is generally based on recent real estate appraisals conducted by an independent, licensed appraiser, less cost to sell. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach (Level 2). If the appraiser makes an adjustment to account for differences between the comparable sales and income data available for similar loans, or if management adjusts the appraised value, then the fair value is considered Level 3. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Collateral dependent loans are evaluated on a quarterly basis for additional impairment and adjusted in accordance with the allowance policy. No partial charge-offs on these loans were taken in the first quarter of 2024. Collateral dependent loans are measured at fair value on a nonrecurring basis.

Recurring Fair Value Measurements

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at March 31, 2024 and December 31, 2023 are as follows:

(Dollars in thousands)	**Fair Value at March 31, 2024**			
Asset Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities, at fair value	**$ 386**	**$ —**	**$ —**	**$ 386**
Available for sale:				
U.S. Treasury	**73,110**	**—**	**—**	**73,110**
Municipal	**—**	**137,456**	**—**	**137,456**
Corporate	**—**	**23,452**	**—**	**23,452**
Agency mortgage & asset-backed	**—**	**128,326**	**—**	**128,326**
Non-Agency mortgage & asset-backed	**—**	**100,607**	**—**	**100,607**
Total assets	**$ 73,496**	**$ 389,841**	**$ —**	**$ 463,337**

(Dollars in thousands)	Fair Value at December 31, 2023			
Asset Description	Level 1	Level 2	Level 3	Total
Equity securities, at fair value	$ 427	$ —	$ —	$ 427
Available for sale:				
U.S. Treasury	74,091	—	—	74,091
Municipal	—	138,618	—	138,618
Corporate	—	23,198	—	23,198
Agency mortgage and asset-backed	—	132,591	—	132,591
Non-Agency mortgage and asset-backed	—	104,005	—	104,005
Total assets	$ 74,518	$ 398,412	$ —	$ 472,930

The fair value of derivative liabilities measured at fair value was $1 thousand at March 31, 2024, $2 thousand at December 31, 2023 and was considered immaterial.

Nonrecurring Fair Value Measurements

The Corporation did not record any assets or liabilities at fair value for which measurement of the fair value was made on a nonrecurring basis at March 31, 2024 and December 31, 2023. For financial assets and liabilities measured at fair value on a recurring basis, there were no transfers of financial assets or liabilities between Level 1 and Level 2 during the period ending March 31, 2024 and December 31, 2023.

The carrying amounts and estimated fair value of financial instruments not carried at fair value are as follows:

	March 31, 2024				
(Dollars in thousands)	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets, carried at cost:					
Cash and cash equivalents	**$ 182,570**	**$ 182,570**	**$ 182,570**	**$ —**	**$ —**
Long-term interest-earning deposits in other banks	**3,989**	**3,989**	**3,989**	**—**	**—**
Loans held for sale	**281**	**281**	**—**	**281**	**—**
Net loans	**1,261,062**	**1,221,414**	**—**	**—**	**1,221,414**
Accrued interest receivable	**7,400**	**7,400**	**—**	**—**	**7,400**
Financial liabilities:					
Deposits	**$ 1,559,312**	**$ 1,558,310**	**$ —**	**$ 1,558,310**	**$ —**
Federal Reserve Bank borrowings	**40,000**	**39,886**		**39,886**	
FHLB advances	**240,000**	**240,040**	**—**	**240,040**	**—**
Subordinate notes	**19,672**	**17,191**	**—**	**17,191**	**—**
Accrued interest payable	**4,211**	**4,211**	**—**	**4,211**	**—**

	December 31, 2023				
(Dollars in thousands)	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial assets, carried at cost:					
Cash and cash equivalents	$ 23,140	$ 23,140	$ 23,140	$ —	$ —
Long-term interest-earning deposits in other banks	6,229	6,229	6,229	—	—
Loans held for sale	213	213	—	213	—
Net loans	1,240,933	1,207,403	—	—	1,207,403
Accrued interest receivable	7,506	7,506	—	—	7,506
Financial liabilities:					
Deposits	$ 1,537,978	$ 1,537,480	$ —	$ 1,537,480	$ —
Federal Reserve Bank Borrowings	90,000	89,783		89,783	
FHLB Advances	40,000	40,110		40,110	
Subordinate notes	19,661	18,303	—	18,303	—
Accrued interest payable	3,856	3,856	—	3,856	—

Note 12. Deposits

(Dollars in thousands)	**March 31, 2024**	December 31, 2023
Noninterest-bearing checking	**$ 291,893**	$ 273,050
Interest-bearing checking	**402,978**	454,517
Money management	**589,149**	572,058
Savings	**103,383**	105,907
Total interest-bearing checking and savings	**1,095,510**	1,132,482
Time deposits	**171,909**	132,446
Total deposits	**$ 1,559,312**	$ 1,537,978
Overdrawn deposit accounts reclassified as loans	**$ 195**	$ 160

Time deposits greater than $250,000 at March 31, 2024 and December 31, 2023 were $47.3 million and $44.4 million, respectively.

Note 13. Borrowings

At March 31, 2024, the Bank had $40.0 million borrowed from the Federal Reserve's Bank Term Funding Program (BTFP) with a rate of 4.81% due January 10, 2025, compared to $90.0 million at December 31, 2023. At March 31, 2024, the fair value of debt securities pledged for the BTFP was $76.4 million.

At March 31, 2024, the Bank had $240.0 million in total borrowings from the Federal Home Loan Bank of Pittsburgh (FHLB), compared to $40.0 million at December 31, 2023. The borrowings are comprised of $40.0 million in short-term borrowings with a blended rate of 5.80%, due during the third quarter of 2024, and $200.0 million in long-term borrowings with a rate of 4.32%, due January 12, 2027.

At March 31, 2024, the Corporation had $20.0 million of unsecured subordinated debt notes payable, $15.0 million which mature on September 1, 2030 and $5.0 million which mature on September 1, 2035. The notes are recorded on the consolidated balance sheet net of remaining debt issuance costs totaling $328 thousand at March 31, 2024, which is being amortized on a pro-rata basis, based on the maturity date of the notes, on an effective interest method. The subordinated notes totaling $15.0 million have a fixed interest rate of 5.00% through September 1, 2025, then convert to a variable rate of 90-day Secured Overnight Financing Rate (SOFR) plus 4.93% for the applicable interest periods through maturity. The subordinated notes totaling $5.0 million have a fixed interest rate of 5.25% through September 1, 2030, then convert to a variable rate of 90-day SOFR plus 4.92% for the applicable interest periods through maturity. The Corporation may, at its option, redeem the notes, in whole or in part, at any time 5-years prior to the maturity. The notes are structured to qualify as Tier 2 Capital for the Corporation and there are no debt covenants on the notes.

Note 14. Capital Ratios

Capital adequacy for the Bank is currently defined by regulatory agencies through the use of several minimum required ratios. The capital ratios to be considered "well capitalized" are: (1) Common Equity Tier 1 (CET1) of 6.5%, (2) Tier 1 Leverage of 5%, (3) Tier 1 Risk-Based Capital of 8%, and (4) Total Risk-Based Capital of 10%. In addition, a capital conservation buffer of 2.5% is applicable to all of the capital ratios except for the Tier 1 Leverage ratio. The capital conservation buffer is equal to the lowest value of the three applicable capital ratios less the regulatory minimum for each respective capital measurement. The Bank's capital conservation buffer at March 31, 2024 was 5.77% compared to the regulatory buffer of 2.5%. Compliance with the capital conservation buffer is required in order to avoid limitations to certain capital distributions and is in addition to the minimum required capital requirements. As of March 31, 2024, the Bank was "well capitalized."

In 2019, the Community Bank Leverage Ratio (CBLR) was approved by federal banking agencies as an optional capital measure available to Qualifying Community Banking Organizations (QCBO). If a bank qualifies as a QCBO and maintains a CBLR of 9% or greater, the bank would be considered "well-capitalized" for regulatory capital purposes and exempt from complying with the risk-based capital rule described above. The CBLR rule took effect January 1, 2020 and banks could opt-in through an election in the first quarter 2020 regulatory filing. The Bank met the criteria of a QCBO but did not opt-in to the CBLR.

The consolidated asset limit on small bank holding companies is $3.0 billion and a company with assets under that limit is not subject to the consolidated capital rules but may file reports that include capital amounts and ratios. The Corporation has elected to file those reports.

The following table summarizes the regulatory capital requirements and results as of March 31, 2024 and December 31, 2023 for the Corporation and the Bank:

(Dollars in thousands)	March 31, 2024	December 31, 2023	Regulatory Ratios: Adequately Capitalized Minimum	Regulatory Ratios: Well Capitalized Minimum
Common Equity Tier 1 Risk-based Capital Ratio (1)				
Franklin Financial Services Corporation	**11.91%**	11.82%	N/A	N/A
Farmers & Merchants Trust Company	**12.52%**	12.38%	4.50%	6.50%
Tier 1 Risk-based Capital Ratio (2)				
Franklin Financial Services Corporation	**11.91%**	11.82%	N/A	N/A
Farmers & Merchants Trust Company	**12.52%**	12.38%	6.00%	8.00%
Total Risk-based Capital Ratio (3)				
Franklin Financial Services Corporation	**14.53%**	14.45%	N/A	N/A
Farmers & Merchants Trust Company	**13.77%**	13.63%	8.00%	10.00%
Tier 1 Leverage Ratio (4)				
Franklin Financial Services Corporation	**8.32%**	9.01%	N/A	N/A
Farmers & Merchants Trust Company	**8.74%**	9.44%	4.00%	5.00%

(1) Common equity Tier 1 capital / total risk-weighted assets
(2) Tier 1 capital / total risk-weighted assets
(3) Total risk-based capital / total risk-weighted assets
(4) Tier 1 capital / average quarterly assets

Note 15. Revenue Recognition

All of the Corporation’s revenue from contracts with customers within the scope of ASC 606 is recognized in non-interest income as presented in its consolidated statements of income. Revenue generating activities that fall within the scope of ASC 606 are described as follows:

Wealth Management Fees – these represent fees from wealth management (assets under management), fees from the management and settlement of estates and commissions from the sale of investment and insurance products. Asset management fees are generally assessed based on a tiered fee schedule, based on the value of assets under management, and are recognized monthly when the service obligation is completed. Fees for estate management services are based on the estimated fair value of the estate. These fees are generally recognized monthly over an 18-month period that Management has determined to represent the average time to fulfill the performance obligations of the contract. Management has the discretion to adjust this time period as needed based upon the nature and complexity of an individual estate. Commissions from the sale of investment and insurance products are recognized upon the completion of the transaction.

The following table presents Wealth Management Fees for the three months ended March 31, 2024 and 2023:

(Dollars in thousands)	For the Three Months Ended March 31,	
Wealth Management Fees	**2024**	2023
Asset Management Fees	**$ 1,833**	$ 1,637
Estate Management Fees	**87**	92
Commissions	**106**	105
Total	**$ 2,026**	$ 1,834

Loan Service Charges – these represent fees on loans for services or charges that occur after the loan has been booked, for example, late payment fees. These also include fees for mortgages settled for third-party mortgage companies. All of these fees are transactional in nature and are recognized upon completion of the transaction which represents the performance obligation.

Deposit Service Charges and Fees – these represent fees from deposit customers for transaction based, account maintenance, and overdraft services. Transaction based fees include, but are not limited to, stop payment fees and overdraft fees. These fees are recognized at the time of the transaction when the performance obligation has been fulfilled. Account maintenance fees and account analysis fees are earned over the course of a month, representing the period of the performance obligation, and are recognized monthly.

Debit Card Income – this represents interchange fees from cardholder transactions conducted through the card payment network. Cardholders use the debit card to conduct point-of-sale transactions that produce interchange fees. The fees are transaction based and the fee is recognized with the processing of the transaction. These fees are reported net of cardholder rewards.

Other Service Charges and Fees – these are comprised primarily of merchant card fees, credit card fees, ATM surcharges and interchange fees and wire transfer fees. Merchant card fees represent fees the Bank earns from a third party for enrolling a customer in the processor's program. Credit card fees represent a fee earned by the Bank for a successful referral to a card-issuing company. ATM surcharges and interchange fees are the result of Bank customers conducting ATM transactions that generate fee income and are processed through multiple card networks. All of these fees are transaction based and are recognized at the time of the transaction.

Gains/Losses on the Sale of Other Real Estate – these are recognized when control of the property transfers to the buyer.

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into longer-term revenue contracts with customers, and therefore, does not experience significant contract balances.

Contract Acquisition Costs

The Corporation expenses all contract acquisition costs as costs are incurred.

Note 16. Commitments and Contingencies

In the normal course of business, the Bank is a party to financial instruments that are not reflected in the accompanying financial statements and are commonly referred to as off-balance-sheet instruments. These financial instruments are entered into primarily to meet the financing needs of the Bank's customers and include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss in the event of nonperformance by other parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contract or notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for on-balance-sheet instruments.

The Bank had the following outstanding commitments for the periods presented:

(Dollars in thousands)		March 31, 2024		December 31, 2023
Financial instruments whose contract amounts represent credit risk				
Commercial commitments to extend credit	**$**	**316,224**	$	325,982
Consumer commitments to extend credit (secured)		**115,715**		112,157
Consumer commitments to extend credit (unsecured)		**6,295**		5,964
	$	**438,234**	$	444,103
Standby letters of credit	**$**	**21,047**	$	19,851
ACL - Unfunded Commitments (1)	**$**	**1,984**	$	2,022

(1) Reported in Other Liabilities on the Consolidated Balance Sheet

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses with the exception of home equity lines and personal lines of credit and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on Management's credit evaluation of the counterparty. Collateral for most commercial commitments varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties. Collateral for secured consumer commitments consists of liens on residential real estate.

Standby letters of credit are instruments issued by the Bank, which guarantee the beneficiary payment by the Bank in the event of default by the Bank's customer in the nonperformance of an obligation or service. Most standby letters of credit are extended for one-year periods. Generally, the credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral supporting those commitments for which collateral is deemed necessary primarily in the form of certificates of deposit and liens on real estate. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees.

Most of the Bank's business activity is with customers located within its primary market and does not involve any significant concentrations of credit to any one entity or industry.

Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation.

The Corporation establishes accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable, and the amount of the loss can be reasonably estimated. When the Corporation is able to do so, it also determines estimates of possible losses, whether in excess of any accrued liability or where there is no accrued liability.

These assessments are based on the analysis of currently available information and are subject to significant judgment and a variety of assumptions and uncertainties. As new information is obtained, the Corporation may change its assessments and, as a result, take or adjust the amounts of its accruals and change its estimates of possible losses or ranges of possible losses. Due to the inherent subjectivity of the assessments and the unpredictability of outcomes of legal proceedings, any amounts that may be accrued or included in estimates of possible losses or ranges of possible losses may not represent the actual loss to the Corporation from any legal proceeding. Its exposure and ultimate losses may be higher, possibly significantly higher, than amounts it may accrue or amounts it may estimate.

In management’s opinion, the Corporation does not anticipate, at the present time, that the ultimate aggregate liability, if any, arising out of all litigation to which the Corporation is a party at this time will have a material adverse effect on its financial position. The Corporation cannot now determine, however, whether or not any claim asserted against it will have a material adverse effect on its results of operations in any future reporting period, which will depend on, among other things, the amount of loss resulting from the claim and the amount of income otherwise reported for the reporting period. Thus, at March 31, 2024, the Corporation is unable to provide an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss with respect to such other matters and, accordingly, have not yet established any specific accrual for such other matters.

Note 17. Reclassification

Certain prior period amounts may have been reclassified to conform to the current year presentation. Such reclassifications did not affect prior year net income or shareholders’ equity.

Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition

Management’s Discussion and Analysis of Results of Operations and Financial Condition
For the Three Months Ended March 31, 2024 and 2023

Forward Looking Statements

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management’s current views as to likely future developments, and use words such as “may,” “will,” “expect,” “believe,” “estimate,” “anticipate,” or similar terms. Because forward-looking statements involve certain risks, uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, changes in the rates of inflation and the effects of inflation, changes in interest rates, ongoing disruption in the financial services industry caused by the bank failures and continuing uncertainty of various banks, changes in the Corporation’s cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, changes in technology, the intensification of competition within the Corporation’s market area, and other similar factors.

We caution readers not to place undue reliance on these forward-looking statements. They only reflect management’s analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances.

Critical Accounting Policies

Management has identified critical accounting policies for the Corporation. These policies are particularly sensitive, requiring significant judgements, estimates and assumptions to be made by Management.

There were no changes to the critical accounting policies disclosed in the 2023 Annual Report on Form 10-K in regards to application or related judgments and estimates used as of March 31, 2024. Please refer to Item 7 of the Corporation’s 2023 Annual Report on Form 10-K for a more detailed disclosure of the critical accounting policies.

Results of Operations

Summary

Franklin Financial Services Corporation, reported its first quarter 2024 financial results as of or for the quarter ended March 31, 2024.

A summary of operating results follows:

- Net income for the first quarter of 2024 was $3.4 million compared to $3.5 million for the fourth quarter of 2023 (a decrease of 3.2%) and $3.3 million for the first quarter of 2023 (an increase of 2.1%). Diluted earnings per share were $0.77, $0.79, and $0.75, for the respective periods.
- For the first quarter of 2024, the provision for credit losses was $452 thousand compared to $529 thousand for the first quarter of 2023.
- Total assets were $2.011 billion, exceeding $2.0 billion for the first time on a quarterly report.
- Total net loans increased 1.6% from December 31, 2023.
- Total deposits increased 1.4% from the end of 2023. At March 31, 2024, borrowings from the Federal Reserve and Federal Home Loan Bank of Pittsburgh (FHLB) totaled $280.0 million.
- Return on Average Assets (ROA) was 0.67%, Return on Average Equity (ROE) was 10.21% and the Net Interest Margin (NIM) was 2.88%, compared to an ROA of 0.80%, ROE of 11.33% and NIM of 3.41% for the same period in 2023.
- On April 11, 2024, the Board of Directors declared a $0.32 per share regular quarterly cash dividend for the second quarter of 2024 to be paid on May 22, 2024 to shareholders of record at the close of business on May 2, 2024.

Key performance ratios as of, or for the three months ended March 31, 2024 and 2023 and the year ended December 31, 2023 are listed below:

(Dollars in thousands, except per share)	**March 31, 2024**	March 31, 2023	December 31, 2023
Balance Sheet Highlights			
Total assets	**$ 2,011,614**	$ 1,711,285	$ 1,836,039
Debt securities available for sale	**462,951**	458,154	472,503
Loans, net	**1,261,062**	1,063,337	1,240,933
Deposits	**1,559,312**	1,502,110	1,537,978
Other borrowings	**280,000**	50,000	130,000
Shareholders' equity	**134,237**	123,583	132,136
Summary of Operations			
Interest income	**$ 23,809**	$ 16,583	$ 76,762
Interest expense	**10,256**	3,746	23,125
Net interest income	**13,553**	12,837	53,637
Provision for credit losses - loans	**490**	467	2,589
Provision for credit losses - unfunded commitments	**(38)**	62	135
Total provision for credit losses	**452**	529	2,724
Net interest income after provision for loan losses	**13,101**	12,308	50,913
Noninterest income	**4,188**	3,225	14,851
Noninterest expense	**13,304**	12,019	50,011
Income before income taxes	**3,985**	3,514	15,753
Federal income tax expense	**624**	222	2,155
Net income	**$ 3,361**	$ 3,292	$ 13,598
Performance Measurements			
Return on average assets*	**0.67%**	0.80%	0.78%
Return on average equity*	**10.21%**	11.33%	11.39%
Return on average tangible equity (1)*	**10.92%**	12.11%	12.32%
Efficiency ratio (1)	**73.76%**	70.70%	70.75%
Net interest margin*	**2.88%**	3.41%	3.31%
Shareholders' Value (per common share)			
Diluted earnings per share	**$ 0.77**	$ 0.75	$ 3.10
Basic earnings per share	**0.77**	0.75	3.11
Regular cash dividends declared	**0.32**	0.32	1.28
Book value	**30.55**	28.07	30.23
Tangible book value (1)	**28.50**	26.02	28.17
Market value	**26.20**	29.64	31.55
Market value/book value ratio	**85.76%**	105.59%	104.37%
Market value/tangible book value ratio	**91.94%**	113.91%	112.01%
Price/earnings multiple*	**8.51**	9.88	10.18
Current quarter dividend yield	**4.89%**	4.32%	4.06%
Dividend payout ratio year-to-date	**41.62%**	42.68%	41.15%
Safety and Soundness			
Average equity/average assets	**6.58%**	7.09%	6.82%
Risk-based capital ratio (Total)	**14.53%**	17.21%	14.45%
Leverage ratio (Tier 1)	**8.32%**	9.58%	9.01%
Common equity ratio (Tier 1)	**11.91%**	14.24%	11.82%
Nonperforming loans / gross loans	**0.04%**	0.02%	0.01%
Nonperforming assets/total assets	**0.02%**	0.01%	0.01%
Allowance for credit losses as a % of loans	**1.29%**	1.31%	1.28%
Net loans (charged-off) recovered / average loans*	**0.00%**	0.00%	-0.02%
Assets under Management			
Trust assets under management (fair value)	**$ 1,107,611**	$ 942,025	$ 1,094,747
Held at third-party brokers (fair value)	**151,465**	124,483	135,423

**Year-to-date annualized*

(1) See the section titled "GAAP versus Non-GAAP Presentation" that follows.

GAAP versus non-GAAP Presentations – The Corporation supplements its traditional GAAP measurements with certain non-GAAP measurements to evaluate its performance and to eliminate the effect of intangible assets. By eliminating intangible assets (Goodwill), the Corporation believes it presents a measurement that is comparable to companies that have no intangible assets or to companies that have eliminated intangible assets in similar calculations. However, not all companies may use the same calculation method for each measurement. The non-GAAP measurements are not intended to be used as a substitute for the related GAAP measurements. Non-GAAP financial measures should be viewed in addition to, and not as an alternative for, our reported results prepared in accordance with GAAP. In the event of such a disclosure or release, the Securities and Exchange Commission's Regulation G requires: (i) the presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP and (ii) a reconciliation of the differences between the non-GAAP financial measure presented and the most directly comparable financial measure calculated and presented in accordance with GAAP. The following table shows the calculation of the non-GAAP measurements as of, or for the three months ended March 31, 2024 and 2023 and the year ended December 31, 2023.

(Dollars in thousands, except per share)

	March 31, 2024	December 31, 2023	March 31, 2023
Return on Tangible Equity (non-GAAP)			
Net income	$ **3,361**	$ 13,598	$ 3,292
Average shareholders' equity	**132,081**	119,408	117,785
Less average intangible assets	**(9,016)**	(9,016)	(9,016)
Average tangible equity (non-GAAP)	**123,065**	110,392	108,769
Return on average tangible equity (non-GAAP)*	**10.92%**	12.32%	12.11%
Tangible Book Value (per share) (non-GAAP)			
Shareholders' equity	$ **134,237**	$ 132,136	$ 123,583
Less intangible assets	**(9,016)**	(9,016)	(9,016)
Tangible book value (non-GAAP)	**125,221**	123,120	114,567
Shares outstanding (in thousands)	**4,394**	4,371	4,403
Tangible book value per share (non-GAAP)	$ **28.50**	$ 28.17	$ 26.02
Efficiency Ratio			
Noninterest expense	$ **13,304**	$ 50,011	$ 12,019
Net interest income	**13,553**	53,637	12,837
Plus tax equivalent adjustment to net interest income	**254**	1,094	311
Plus noninterest income, net of securities transactions	**4,229**	15,954	3,851
Total revenue	**18,036**	70,685	16,999
Efficiency ratio (Noninterest expense/total revenue)	**73.76%**	70.75%	70.70%

* Year-to-date annualized

Net Interest Income

The largest source of the Corporation's earnings is net interest income, which is defined as the difference between income on interest-earning assets and the expense of interest-bearing liabilities supporting those assets. Principal categories of interest-earning assets are loans and securities, while deposits, short-term borrowings and long-term debt are the principal categories of interest-bearing liabilities. Demand deposits enhance net interest income because they are noninterest-bearing deposits. For the purpose of this discussion, balance sheet items refer to the average balance for the year and net interest income is adjusted to a fully taxable-equivalent basis. This tax-equivalent adjustment facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Corporation's 21% Federal statutory rate.

Comparison of the three months ended March 31, 2024 to the three months ended March 31, 2023:

Tax equivalent net interest income increased $659 thousand to $13.8 million in the first quarter of 2024 compared to $13.1 million for the same period in 2023. Tax-equivalent net interest income increased $433 thousand from balance sheet volume changes and $226 thousand from interest rate changes.

The following table presents average balances, tax-equivalent (T/E) interest income, and yields earned or rates paid on the assets or liabilities. Loans are classified by type of collateral and residential loans include commercial purpose loans and nonaccrual loans are included in the average loan balance used to calculate the yield. All nontaxable interest income has been adjusted to a tax-equivalent basis using a tax rate of 21%.

	For the Three Months Ended March 31,					
	2024			2023		
(Dollars in thousands)	**Average balance**	**Income or expense**	**Average yield/rate**	Average balance	Income or expense	Average yield/rate
Interest-earning assets:						
Interest-earning deposits in other banks	**$ 176,259**	**$ 2,354**	**5.36%**	$ 43,684	$ 423	3.92%
Investment securities:						
Taxable	**425,474**	**3,958**	**3.73%**	407,326	3,459	3.44%
Tax exempt	**51,397**	**337**	**2.63%**	63,309	461	2.95%
Investments	**476,871**	**4,295**	**3.61%**	470,635	3,920	3.38%
Loans:						
Residential real estate 1-4 family:						
First liens	**206,763**	**2,527**	**4.90%**	150,276	1,614	4.36%
Junior liens and lines of credit	**72,451**	**1,066**	**5.90%**	72,930	925	5.14%
Residential real estate - construction	**27,196**	**476**	**7.02%**	24,408	307	5.09%
Commercial real estate	**712,855**	**10,015**	**5.64%**	563,219	6,931	4.99%
Commercial	**240,527**	**3,186**	**5.31%**	233,246	2,651	4.61%
Consumer	**6,889**	**144**	**8.38%**	6,111	123	8.15%
Loans	**1,266,681**	**17,414**	**5.51%**	1,050,190	12,551	4.85%
Total interest-earning assets	**1,919,811**	**$ 24,063**	**5.03%**	1,564,509	$ 16,894	4.38%
Other assets	**88,970**			96,643		
Total assets	**$ 2,008,781**			$ 1,661,152		
Interest-bearing liabilities:						
Deposits:						
Interest-bearing checking	**$ 421,302**	**$ 596**	**0.57%**	$ 470,061	$ 410	0.35%
Money Management	**584,033**	**4,212**	**2.89%**	557,551	2,739	1.99%
Savings	**104,338**	**40**	**0.15%**	126,898	48	0.15%
Time	**158,490**	**1,656**	**4.19%**	62,212	232	1.52%
Total interest-bearing deposits	**1,268,163**	**6,504**	**2.06%**	1,216,722	3,429	1.14%
Subordinated notes	**19,665**	**264**	**5.37%**	19,626	266	5.42%
Overnight borrowings	**2,166**	**31**	**5.74%**	—	—	-
Federal Reserve Bank borrowings	**84,505**	**961**	**4.56%**	4,667	51	4.40%
FHLB advances	**215,824**	**2,496**	**4.64%**	—	—	-
Total interest-bearing liabilities	**1,590,323**	**10,256**	**2.59%**	1,241,015	3,746	1.22%
Noninterest-bearing deposits	**269,307**			288,004		
Other liabilities	**17,070**			14,348		
Shareholders' equity	**132,081**			117,785		
Total liabilities and shareholders' equity	**$ 2,008,781**			$ 1,661,152		
T/E net interest income/Net interest margin		**13,807**	**2.88%**		13,148	3.41%
Tax equivalent adjustment		**(254)**			(311)	
Net interest income		**$ 13,553**			$ 12,837	
Net Interest Spread			**2.44%**			3.16%
Cost of Funds			**2.21%**			0.99%
Cost of Deposits			**1.70%**			0.92%

Provision for Credit Losses

For the first quarter of 2024, the provision for credit losses was $452 thousand allocated between the provision for loans of $490 thousand and a reversal in the provision for unfunded commitments of $38 thousand. The provision for credit loss expense for the first quarter of 2023 was $529 thousand allocated between the provision for loans of $467 thousand and provision for unfunded commitments of $62 thousand. The ACL ratio for loans was 1.29% at March 31, 2024 compared to 1.28% at December 31, 2023. The ACL for unfunded commitments was $2.0 million at March 31, 2024 and December 31, 2023. For more information refer to the Loan Quality and Allowance for Credit Losses discussion in the Financial Condition section.

Noninterest Income

For the first quarter of 2024, noninterest income increased $963 thousand from the same period in 2023. Wealth Management fees increased, primarily because of growth in assets under management. Deposit fees, other service charges and debit card income increased but were offset by a decrease in loan fees as commercial service charges decreased and the volume of mortgages sold decreased. The increase in other income was due in part to life insurance claims of $86 thousand and a state sales tax refund of $38 thousand. There were no debt securities sales in 2024 compared to a loss of $602 thousand from sales in 2023.

The following table presents a comparison of noninterest expense for the three months ended March 31, 2024 and 2023:

	For the Three Months Ended March 31,		Change	
(Dollars in thousands)	**2024**	2023	Amount	%
Noninterest Income				
Wealth management fees	**$ 2,026**	$ 1,834	$ 192	10.5
Loan service charges	**206**	302	(96)	(31.8)
Gain on sale of loans	**58**	73	(15)	(20.5)
Deposit service charges and fees	**613**	583	30	5.1
Other service charges and fees	**488**	432	56	13.0
Debit card income	**536**	502	34	6.8
Increase in cash surrender value of life insurance	**112**	108	4	3.7
Net losses on sales of debt securities	**—**	(602)	602	NA
Change in fair value of equity securities	**(41)**	(24)	(17)	70.8
Other	**190**	17	173	1,017.6
Total noninterest income	**$ 4,188**	$ 3,225	$ 963	29.9

Noninterest Expense

Noninterest expense for the first quarter of 2024 increased $1.3 million compared to the same period in 2023. Salaries and benefits increased $791 thousand primarily in salaries due to a highly competitive labor market and wage increases. Data processing costs increased due to software expenses. FDIC insurance increased due to growth in the balance sheet.

The following table presents a comparison of noninterest expense for the three months ended March 31, 2024 and 2023:

(Dollars in thousands)	For the Three Months Ended March 31,		Change	
Noninterest Expense	**2024**	2023	Amount	%
Salaries and benefits	**$ 7,727**	$ 6,936	$ 791	11.4
Net occupancy	**1,182**	1,110	72	6.5
Marketing and advertising	**519**	519	—	—
Legal and professional	**516**	552	(36)	(6.5)
Data processing	**1,423**	1,060	363	34.2
Pennsylvania bank shares tax	**125**	223	(98)	(43.9)
FDIC insurance	**322**	182	140	76.9
ATM/debit card processing	**323**	294	29	9.9
Telecommunications	**111**	100	11	11.0
Nonservice pension	**(29)**	(29)	—	—
Other	**1,085**	1,072	13	1.2
Total noninterest expense	**$ 13,304**	**$** 12,019	**$** 1,285	10.7

Provision for Income Taxes

For the first quarter of 2024, the Corporation recorded a Federal income tax expense of $624 thousand compared to $222 thousand for the same quarter in 2023. The effective tax rate for the first quarter of 2024 was 15.7% compared to 6.3% for the same period in 2023. The 2023 rate reflects the benefit of $280 thousand in tax credits recorded in the first quarter of 2023. Without the tax credits, the 2023 rate would have been 14.3%. The federal statutory tax rate is 21% for 2024 and 2023.

Financial Condition

Cash and Cash Equivalents:

Cash and cash equivalents totaled $182.6 million at March 31, 2024, an increase of $159.5 million from the prior year-end balance of $23.1 million, as a result of the $200.0 million FHLB advance that has not yet been fully invested. Short-term interest-earning deposits are held primarily at the Federal Reserve ($160.4 million).

Investment Securities:

AFS Securities: At March 31, 2024, the AFS securities portfolio had an amortized cost of $512.7 million, a decrease of $9.2 million from the prior year-end, and had a fair value of $463.0 million, a decrease of $9.6 million from the prior year-end. The AFS portfolio had a net unrealized loss of $49.8 million at March 31, 2024 compared to a net unrealized loss of $49.4 million at the prior year-end. The AFS portfolio averaged $476.9 million with a tax-equivalized yield of 3.61% for the three months ended March 31, 2024. This compares to an average of $470.6 million and a tax-equivalized yield of 3.38% for the same period in 2023. The weighted average life of the AFS portfolio is 4.8 years and the effective duration (which measures the change in fair value for a 1% change in interest rates) is 4.27%.

The AFS portfolio held $83.3 million, or 16% of the total portfolio, of securities issued by the U.S. Treasury and another $137.9 million, or 28% of the total portfolio, of mortgage and asset-backed securities issued by a U.S. Government Agency or a government sponsored entity and securitized by pools of residential mortgages and other loan assets.

Municipal bond holdings in the AFS portfolio were $161.0 million, or 29% of the total portfolio. The municipal bond holdings are well diversified geographically (154 issuers) and are comprised primarily of general obligation bonds (69%). Many municipal bonds have credit enhancements in the form of private bond insurance or other credit support. The largest geographic municipal bond exposures are in the states of Texas (15%), California (13%), Pennsylvania (12%), and Michigan (10%). The average rating of the municipal holdings from Moody's is AA. No securities in the portfolio are rated below investment grade.

Within the municipal portfolio, the Bank held four Build America Bonds with an aggregate book value of $4.5 million and an aggregate par value of $4.0 million as of March 31, 2024. These bonds were issued and purchased at a premium and included a call provision under an extraordinary redemption clause. This call provision was exercised on one bond in the first quarter resulting in accelerated amortization of $143 thousand. Subsequent to quarter-end, a second bond was called with accelerated amortization of $118 thousand. The Bank expects the remaining bonds to be called under this extraordinary redemption clause and if this occurs the remaining premium to amortize as of March 31, 2024 is $238 thousand.

The corporate bond holdings in the AFS portfolio were $26.3 million, or 5% of the total portfolio, comprised predominantly of 46 fixed rate community bank issued subordinated notes totaling $22.1 million. All of the subordinated notes are unrated. The Bank monitors the credit of the issuers of the subordinated notes on a quarterly basis. The remaining corporate bond holdings consist of five trust preferred securities and are investment grade rated.

The non-agency mortgage and asset-backed securities portfolio was $104.2 million, or 22% of the total portfolio, at March 31, 2024, a decrease of $4.0 million from the prior year-end. The majority of these securities, $84.7 million, are investment grade rated while the remaining $22.1 million of securities in this portfolio are unrated. Many of the securities in this portfolio have credit enhancements in the form of subordination and overcollateralization.

Unrealized losses in the AFS securities portfolio were $50.0 million at March 31, 2024 compared to $50.0 million at December 31, 2023. The Bank believes it will be able to collect all interest and principal due, and the decline in fair value below amortized cost is due to changing interest rates and not due to credit related factors; therefore, the Bank has no allowance for credit loss for these investments. The Bank does not have the intent to sell and does not believe it will more likely than not be required to sell, any of these securities prior to a recovery of their fair value to amortized cost.

Restricted Stock at Cost: The Bank held $10.3 million of restricted stock at March 31, 2024. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low-cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

See Note 4 of the accompanying financial statements for additional information on Investment Securities.

Loans:

Residential real estate: This category is comprised of consumer purpose loans secured by residential real estate and to a lesser extent, commercial purpose loans secured by residential real estate. The consumer purpose category represents traditional residential mortgage loans and home equity products (primarily junior liens and lines of credit). Commercial purpose loans in this category represent loans made for various business needs but are secured with residential real estate. In addition to the real estate collateral, it is possible that additional security is provided by personal guarantees or UCC filings. These loans are underwritten as commercial loans and are not originated to be sold.

Total residential real estate loans increased by $3.4 million over year-end 2023, primarily in consumer first lien loans. For the first three months of 2024, the Bank originated $11.7 million in mortgages compared to $14.4 million for the same period in 2023, including $3.4 million for sale through the secondary market. The Bank does not originate or hold any loans that would be considered sub-prime or Alt-A and does not generally originate mortgages outside of its primary market area.

Residential real estate construction: This category contains loans for the vertical construction of 1-4 family residential properties. The largest component of this category represents loans to residential real estate developers ($12.6 million), while loans for individuals to construct personal residences totaled $16.3 million at March 31, 2024. The Bank's exposure to residential construction loans is concentrated primarily in south central Pennsylvania. Real estate construction loans, including residential real estate and land development loans, occasionally provide an interest reserve in order to assist the developer during the development stage when minimal cash flow is generated. All real estate construction loans are underwritten in the same manner, regardless of the use of an interest reserve.

Commercial real estate (CRE): This category includes commercial, industrial, farm and agricultural loans and land development loans, where real estate serves as the primary collateral for the loans. Total commercial real estate loans increased to $721.3 million from $703.8 million at the end of 2023. Included in commercial real estate are approximately $546 million of nonowner occupied loans located primarily in the Bank's market area of south-central Pennsylvania.

The following table presents the largest sectors by collateral in the commercial real estate category:

(Dollars in thousands)

Commercial Real Estate (CRE) Sectors	March 31, 2024	% of CRE
Apartment buildings	$ 127,740	18%
Office buildings	87,709	12%
Hotels & motels	87,091	12%
Shopping centers	76,714	11%
Development land	63,036	9%

Also included in CRE are real estate construction loans totaling $148.2 million. At March 31, 2024, the Bank had $35.2 million in real estate construction loans funded with an interest reserve and capitalized $568 thousand of interest in the first quarter of 2024 from these reserves on active projects for commercial construction. Real estate construction loans are monitored on a regular basis by either an independent third-party inspector or the assigned loan officer depending on loan amount or complexity of the project. This monitoring process includes at a minimum, the submission of invoices and American Institute of Architects (AIA) documents (depending on the complexity of the project) detailing costs incurred by the borrower, on-site inspections, and a signature by the assigned loan officer for disbursement of funds.

Commercial: This category includes commercial, industrial, farm, agricultural, and municipal loans. Commercial loans decreased $3.1 million to $239.6 million at March 31, 2024, compared to $242.7 million at the end of 2023. At March 31, 2024, the Bank had approximately $112.3 million in tax-free loans.

The following table presents the largest sectors by industry in the commercial category:

(Dollars in thousands)

Commercial	March 31, 2024	% of Commercial
Public administration	$ 44,379	19%
Utilities	41,763	17%
Real estate, rental & leasing	24,939	10%
Retail trade	18,907	8%
Manufacturing	17,776	7%

Participations: The Bank may supplement its own commercial loan production by purchasing loan participations. These participations are primarily located in south-central Pennsylvania. At March 31, 2024, the outstanding commercial participations were $99.7 million, or 9.6%, of commercial purpose loans and 7.8% of total gross loans compared to $97.8 million at December 31, 2023, or 9.5%, of commercial purpose loans and 7.8% of total gross loans. The Bank's total exposure (including outstanding balances and unfunded commitments) to purchased participations is $134.1 million, compared to $135.4 million at December 31, 2023. The commercial loan participations are comprised of $26.4 million of Commercial loans and $73.3 million of CRE loans, reported in the respective loan class.

Consumer loans: This category had a balance of $6.6 million at March 31, 2024, compared to $6.8 million at prior year-end and is comprised primarily of installment loans and personal lines of credit.

The following table presents a summary of loans outstanding, by class as of:

(Dollars in thousands)	March 31, 2024	December 31, 2023	Change Amount	Change %
Residential Real Estate 1-4 Family				
Consumer first liens	**$ 145,519**	$ 142,017	$ 3,502	2.5
Commercial first lien	**63,475**	63,271	204	0.3
Total first liens	**208,994**	205,288	3,706	1.8
Consumer junior liens and lines of credit	**68,046**	68,752	(706)	(1.0)
Commercial junior liens and lines of credit	**4,163**	3,809	354	9.3
Total junior liens and lines of credit	**72,209**	72,561	(352)	(0.5)
Total residential real estate 1-4 family	**281,203**	277,849	3,354	1.2
Residential real estate - construction				
Consumer	**16,293**	13,837	2,456	17.7
Commercial	**12,593**	12,063	530	4.4
Total residential real estate construction	**28,886**	25,900	2,986	11.5
Commercial real estate	**721,320**	703,767	17,553	2.5
Commercial	**239,603**	242,654	(3,051)	(1.3)
Total commercial	**960,923**	946,421	14,502	1.5
Consumer	**6,583**	6,815	(232)	(3.4)
	1,277,595	1,256,985	20,610	1.6
Less: Allowance for credit losses	**(16,533)**	(16,052)	(481)	3.0
Net Loans	**$ 1,261,062**	$ 1,240,933	$ 20,129	1.6

Loan Quality:

Management monitors loan performance on a monthly basis and performs a quarterly evaluation of the adequacy of the Allowance for Credit Loss for loans (ACL). The Bank begins enhanced monitoring of all loans rated 6–OAEM or worse and obtains a new appraisal or asset valuation for any loans placed on nonaccrual and rated 7 - Substandard or worse. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on factors, including, but not limited to: the economy, deferred maintenance, industry, type of property/equipment, age of the appraisal, etc. and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. When determining the ACL, certain factors involved in the evaluation are inherently subjective and require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows. Management monitors the adequacy of the ACL on an ongoing basis and reports its adequacy quarterly to the Board Enterprise Risk Management Committee of the Board of Directors. Management believes the ACL at March 31, 2024 is adequate.

Watch list loans exhibit financial weaknesses that increase the potential risk of default or loss to the Bank. However, inclusion on the watch list, does not by itself, mean a loss is certain. The watch list totaled $17.4 million at March 31, 2024 compared to $17.2 million at December 31, 2023. The watch list includes both performing and nonperforming loans. Included in the watchlist total are $490 thousand of nonaccrual loans. The credit composition of the watch list (loans rated 6, 7, or 8), by primary collateral is shown in Note 6 of the accompanying financial statements.

Delinquent loans are a result of borrowers' cash flow and/or alternative sources of cash being insufficient to repay loans. The Bank's likelihood of collateral liquidation to repay the loans becomes more probable the further behind a borrower falls, particularly when loans reach 90 days or more past due. Management monitors the performance status of loans by the use of an aging report. The aging report can provide an early indicator of loans that may become severely delinquent and possibly result in a loss to the Bank. See Note 6 in the accompanying financial statements for a table that presents the aging of payments in the loan portfolio.

Nonaccruing loans generally represent Management's determination that the borrower will be unable to repay the loan in accordance with its contractual terms and that collateral liquidation may or may not fully repay both interest and principal. It is the Bank's policy to evaluate the probable collectability of principal and interest due under terms of loan contracts for all loans 90-days or more past due, nonaccrual loans, or individually evaluated loans. Further, it is the Bank's policy to discontinue accruing interest on loans that are not adequately secured and in the process of collection. Upon determination of nonaccrual status, the Bank subtracts any current year accrued and unpaid interest from its income, and any prior year accrued and unpaid interest from the allowance for credit losses. Management continually monitors the status of nonperforming loans, the value of any collateral and potential of risk of loss. Nonaccrual loans are rated no better than 7-Substandard.

The Bank's Loan Management Committee reviews these loans and risk ratings on a quarterly basis in order to proactively identify and manage problem loans. In addition, a committee meets monthly to discuss possible workout strategies for all credits rated 7-Substandard or worse. Management also tracks other commercial loan risk measurements including high loan to value loans, concentrations, participations and policy exceptions and reports these to the Board Enterprise Risk Management Committee of the Board of Directors. The Bank also uses an external loan review consultant to assist with internal loan review with a goal of reviewing up to 80% of commercial loans each year. The FDIC defines certain supervisory loan-to-value lending limits. The Bank's internal loan–to-value limits are all equal to or have a lower loan-to-value limit than the supervisory limits. However, in certain instances, the Bank may make a loan that exceeds the supervisory loan-to-value limit. At March 31, 2024, the Bank had loans of $13.1 million (1.0% of gross loans) that exceeded the supervisory limit, compared to 1.1% at year-end 2023.

Loan quality, as measured by nonaccrual loans, totaled $490 thousand at March 31, 2024 compared to $147 thousand at December 31, 2023 and the nonperforming loan to gross loans ratio was 0.04% at March 31, 2024 compared to 0.01% at December 31, 2023. Loans past due 90-days or more, but still accruing, totaled $5 thousand at March 31, 2024.

In addition to monitoring nonaccrual loans, the Bank also closely monitors loans to borrowers experiencing financial difficulty when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement.

Modifications to borrowers experiencing financial difficulty may include interest rate reductions, principal or interest forgiveness, forbearances, term extensions, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral.

As of March 31, 2024 and December 31, 2023 there were no modifications made to borrowers experiencing financial difficulty

Allowance for Credit Losses:

Allowance for Credit Losses – Loans

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

The ACL for loans is an estimate of the losses expected to be realized over the life of the loan portfolio. The ACL is determined for two distinct categories of loans: 1) loans evaluated individually for expected credit losses (specific reserve), and 2) loans evaluated collectively for expected credit losses (pooled reserve). Management's periodic evaluation of the adequacy of the ACL for loans is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic forecasts and conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' actual or perceived financial and managerial strengths, and other relevant factors. This evaluation is inherently subjective, as it requires material assumptions and estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on loans evaluated individually.

Loans evaluated individually for credit losses are primarily commercial purpose loans that do not share similar characteristics with those loans evaluated in the pool. These loans may exhibit performance characteristics where 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. All commercial purpose loans greater than $250 thousand and rated Substandard (7), Doubtful (8) or on nonaccrual status may be considered for individual evaluation. Impairment is measured on a loan-by-loan basis by one of the following methods: the fair value of the collateral if the loan is collateral dependent, the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's obtainable market price. Commercial purpose loans with a balance less than $250 thousand, and consumer purpose loans are not evaluated individually for a specific reserve but are included in the pooled reserve calculation. Loans that are evaluated for a specific reserve, but not needing a specific reserve are not included in the pooled reserve calculation.

The Corporation has elected to exclude accrued interest receivable from the measurement of the ACL. When a loan is placed on nonaccrual status, any outstanding current accrued interest is reversed against income and prior year accrued interest is deducted from the ACL.

The pooled reserve represents the ACL for pools of homogenous loans, not evaluated individually. The pooled reserve is calculated using a quantitative and qualitative component for the loan pools.

The following inputs are used to calculate the quantitative component for the loan pool:

- Segregating loans into homogeneous pools by the FRB Call Code which is primarily a collateral-based and secondarily a purpose-based segmentation.
- The average remaining life of each pool is calculated using the weighted average remaining maturity method (WARM). The WARM method produces an estimated remaining balance by pool, by year, until maturity.
- A historical credit loss rate is calculated for each pool, using the average historical loss, by FRB Call Code, for a peer group of Pennsylvania community banks over the last eight quarters. The loss rate is calculated over a historical period the Bank believes best represents a period that will be the most similar and relevant to the next four quarters.
- The historical credit loss rate is applied to each WARM bucket through the next four quarter period.
- At the end of the four quarter period, the credit loss rate applied to each WARM bucket reverts to the peer group historical loss rate for the respective pool.
- Collectively these estimated losses represent the quantitative component of the pooled reserve.

The qualitative component for the pool utilizes a risk matrix comprised of eight risk factors and assigns a risk level to each factor. The risk factors give consideration to changes in: lending policy, procedures and practice; economic conditions; nature and volume of loans; experience of lending team; volume of past due loans; quality of the loan review system; concentrations of credit; and other external factors. The risk factors are weighted to reflect Management's estimate of how the factor affects potential losses. The risk levels within each factor are measured in basis points and range from minimal risk to very high risk and are determined independently for commercial loans, residential mortgage loans and consumer loans.

The ACL for pooled loans is the sum of the quantitative and qualitative loss estimates.

Allowance for Credit Losses – Unfunded Commitments

The ACL for unfunded commitments is recorded in other liabilities on the consolidated balance sheet. The ACL represents management's estimate of expected losses from unfunded commitments and is determined by estimating future usage of the commitments, based on historical usage. The estimated loss is calculated in a manner similar to that used for the ACL for loans, previously described. The ACL is increased or decreased through the provision for credit losses.

The following table shows the allocation of the allowance for credit losses and other loan performance ratios, by class, as of March 31, 2024 and December 31, 2023:

(Dollars in thousands)	Residential Real Estate 1-4 Family						
	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Total
2024							
Loans at March 31, 2024	$ 208,994	$ 72,209	$ 28,886	$ 721,320	$ 239,603	$ 6,583	$ 1,277,595
Average Loans through March 31, 2024	206,763	72,451	27,196	712,855	240,527	6,889	1,266,681
Nonaccrual Loans at March 31, 2024	—	—	—	407	83	—	490
Allowance for Credit Loss at March 31, 2024	1,308	415	337	11,057	3,324	92	16,533
YTD Net (Charge-offs)/Recoveries at March 31, 2024	—	—	4	(2)	(6)	(5)	(9)
Loans/Total Gross Loans at March 31, 2024	16%	6%	2%	56%	19%	1%	100%
Nonaccrual Loans/Total Gross Loans at March 31, 2024	0.00%	0.00%	0.00%	0.06%	0.03%	0.00%	0.04%
Allowance for Credit Loss/Gross Loans at March 31, 2024	0.63%	0.57%	1.17%	1.53%	1.39%	1.40%	1.29%
Net (Charge-offs) Recoveries/Average Loans at March 31, 2024*	0.00%	0.00%	0.01%	0.00%	0.00%	-0.07%	0.00%
Allowance for Credit Loss/Nonaccrual Loans at March 31, 2024							3374.08%
2023							
Loans at December 31, 2023	$ 205,288	$ 72,561	$ 25,900	$ 703,767	$ 242,654	$ 6,815	$ 1,256,985
Average Loans for 2023	173,986	72,623	21,124	626,817	243,045	6,285	1,143,880
Nonaccrual Loans at December 31, 2023	—	—	—	—	147	—	147
Allowance for Credit Losses at December 31, 2023	1,296	419	296	10,657	3,290	94	16,052
Net Recoveries/(Charge-offs) for 2023	2	—	49	1	(193)	(35)	(176)
Loans/Total Gross Loans at December 31, 2023	16%	6%	2%	56%	19%	1%	100%
Nonaccrual Loans/Total Gross Loans at December 31, 2023	0.00%	0.00%	0.00%	0.00%	0.06%	0.00%	0.01%
Allowance for Credit Loss/Gross Loans at December 31, 2023	0.63%	0.58%	1.14%	1.51%	1.36%	1.38%	1.28%
Net Recoveries(Charge-offs)/Average Loans for 2023	0.00%	0.00%	0.23%	0.00%	-0.08%	-0.56%	-0.02%
Allowance for Credit Loss/Nonaccrual Loans at December 31, 2023							10919.73%

*Annualized

Deposits:

Total deposits increased $21.3 million during the first three months of 2024 to $1.559 billion. Interest-bearing checking decreased by $51.5 million primarily in municipal deposits and savings decreased by $2.5 million, while the Bank's Money Management increased $17.1 million. Time deposits increased $39.5 million as customers shifted to higher rate products. The Bank has $22.0 million of brokered CDs at March 31, 2024.

As of March 31, 2024, the Bank had deposits of $222.8 million placed in the IntraFi Network deposit program ($105.9 million in interest-bearing checking and $116.9 million in money management) and $18.6 million in reciprocal time deposits in the CDARS program included in time deposits. These programs allow the Bank to offer full FDIC coverage to large depositors, but with the convenience to the customer of only having to deal with one bank. The Bank solicits these deposits from within its market and it believes they present no greater risk than any other local deposit. Only reciprocal deposits that exceed 20% of liabilities are considered brokered deposits. At March 31, 2024, the Bank's reciprocal deposits were 12.9% of total liabilities compared to 14.3% at year-end 2023.

The Bank estimates that approximately 90% of its deposits are FDIC insured or collateralized as of March 31, 2024.

The following table presents a summary of deposits for the periods ended:

(Dollars in thousands)	**March 31, 2024**	December 31, 2023	Change Amount	Change %
Noninterest-bearing checking	**$ 291,893**	$ 273,050	$ 18,843	6.9
Interest-bearing checking	**402,978**	454,517	(51,539)	(11.3)
Money management	**589,149**	572,058	17,091	3.0
Savings	**103,383**	105,907	(2,524)	(2.4)
Total interest-bearing checking and savings	**1,095,510**	1,132,482	(36,972)	(3.3)
Time deposits	**171,909**	132,446	39,463	29.8
Total deposits	**$ 1,559,312**	$ 1,537,978	$ 21,334	1.4
Overdrawn deposit accounts reclassified as loans	**$ 195**	$ 160		

Borrowings:

At March 31, 2024, the Bank had $40.0 million borrowed from the Federal Reserve's Bank Term Funding Program (BTFP) with a rate of 4.81% due January 10, 2025. At March 31, 2024, the fair value of debt securities pledged for the BTFP was $76.4 million.

At March 31, 2024, the Bank had $240.0 million in total borrowings from the Federal Home Loan Bank of Pittsburgh (FHLB). The borrowings are comprised of $40.0 million in short-term borrowings with a blended rate of 5.80%, due during the third quarter of 2024, and $200.0 million in long-term borrowings with a rate of 4.32%, due January 12, 2027.

On August 4, 2020, the Corporation completed the sale of a subordinated debt note offering. The Corporation sold $15.0 million of subordinated debt notes with a maturity date of September 1, 2030. These notes are noncallable for 5 years and carry a fixed interest rate of 5.00% per year for 5 years and then convert to floating rate of SOFR plus 4.93% per year for the remainder of the term. The notes can be redeemed at par beginning 5 years prior to maturity. The Corporation also sold $5.0 million of subordinated debt notes with a maturity date of September 1, 2035. These notes are noncallable for 10 years and carry a fixed interest rate of 5.25% per year for 10 years and then convert to floating rate of SOFR plus 4.92% per year for the remainder of the term. The notes can be redeemed at par beginning 5 years prior to maturity. The notes are structured to qualify as Tier 2 capital for the Corporation and any funds it invests in the Bank qualify as Tier 1 capital at the Bank. The Corporation paid an issuance fee of 2% of the total issue that will be amortized to maturity date of each issue on a pro-rata basis. The proceeds are intended to be used for general corporate purposes.

Shareholders' Equity:

Total shareholders' equity increased $2.1 million to $134.2 million as of March 31, 2024 from December 31, 2023. Retained earnings increased $2.0 million in 2024 and accumulated other comprehensive income (AOCI) decreased $294 thousand as the fair value of the investment portfolio decreased slightly in the first quarter of 2024. The increase in retained earnings was from net earnings of $3.4 million partially offset by cash dividends of $1.4 million. The Corporation's Dividend Reinvestment Plan (DRIP) added $75 thousand in new capital from optional cash contributions and $254 thousand from the reinvestment of quarterly dividends. The Corporation's dividend payout ratio was 41.62% for the first three months of 2024 compared to 42.68% for the first three months of 2023.

As part of its quarterly dividend decision, the Corporation considers, among other factors, current and future income projections, dividend yield, payout ratio, current and future capital ratios, reserves and allocations. For the first quarter of 2024, the Corporation paid a $0.32 per share dividend, compared to $0.32 paid in the first quarter of 2023. On April 11, 2024, the Board of Directors declared a $0.32 per share regular quarterly dividend for the second quarter of 2024, which will be paid on May 22, 2024.

In December 2023, the Board of Directors authorized a repurchase plan for the repurchase of up to 150,000 shares of the Corporation's $1.00 par value common stock at market prices in open market or privately negotiated transactions over a one-year period. No shares have been repurchased under the current plan.

Capital adequacy for the Bank is currently defined by regulatory agencies through the use of several minimum required ratios. The capital ratios to be considered "well capitalized" are: (1) Common Equity Tier 1 (CET1) of 6.5%, (2) Tier 1 Leverage of 5%, (3) Tier 1 Risk-Based Capital of 8%, and (4) Total Risk-Based Capital of 10%. In addition, a capital conservation buffer of 2.5% is applicable to all of the capital ratios except for the Tier 1 Leverage ratio. The capital conservation buffer is equal to the lowest value of the three applicable capital ratios less the regulatory minimum for each respective capital measurement. The Bank's capital conservation buffer at March 31, 2024 was 5.77% compared to the regulatory buffer of 2.5%. Compliance with the capital conservation buffer is required in order to avoid limitations to certain capital distributions and is in addition to the minimum required capital requirements. As of March 31, 2024, the Bank was "well capitalized."

In 2019, the Community Bank Leverage Ratio (CBLR) was approved by federal banking agencies as an optional capital measure available to Qualifying Community Banking Organizations (QCBO). If a bank qualifies as a QCBO and maintains a CBLR of 9% or greater, the bank would be considered "well-capitalized" for regulatory capital purposes and exempt from complying with the risk-based capital rule described above. The CBLR rule took effect January 1, 2020 and banks could opt-in through an election in the first quarter 2020 regulatory filing. The Bank met the criteria of a QCBO but did not opt-in to the CBLR.

The consolidated asset limit on small bank holding companies is $3.0 billion and a company with assets under that limit is not subject to the consolidated capital rules but may file reports that include capital amounts and ratios. The Corporation has elected to file those reports.

The following table summarizes the regulatory capital requirements and results as of March 31, 2024 and December 31, 2023 for the Corporation and the Bank:

			Regulatory Ratios	
(Dollars in thousands)	**March 31, 2024**	December 31, 2023	**Adequately Capitalized Minimum**	**Well Capitalized Minimum**
Common Equity Tier 1 Risk-based Capital Ratio (1)				
Franklin Financial Services Corporation	**11.91%**	11.82%	N/A	N/A
Farmers & Merchants Trust Company	**12.52%**	12.38%	4.50%	6.50%
Tier 1 Risk-based Capital Ratio (2)				
Franklin Financial Services Corporation	**11.91%**	11.82%	N/A	N/A
Farmers & Merchants Trust Company	**12.52%**	12.38%	6.00%	8.00%
Total Risk-based Capital Ratio (3)				
Franklin Financial Services Corporation	**14.53%**	14.45%	N/A	N/A
Farmers & Merchants Trust Company	**13.77%**	13.63%	8.00%	10.00%
Tier 1 Leverage Ratio (4)				
Franklin Financial Services Corporation	**8.32%**	9.01%	N/A	N/A
Farmers & Merchants Trust Company	**8.74%**	9.44%	4.00%	5.00%

(1) Common equity Tier 1 capital / total risk-weighted assets
(2) Tier 1 capital / total risk-weighted assets
(3) Total risk-based capital / total risk-weighted assets
(4) Tier 1 capital / average quarterly assets

Economy

The Corporation's primary market area includes Franklin, Fulton, Cumberland, Huntingdon, and Dauphin County, PA, and Washington County, MD. This area is diverse in demographic and economic composition. County populations range from a low of approximately 15,000 in Fulton County to over 280,000 in Dauphin County. The market area has a diverse economic base and local industries include warehousing, truck and rail shipping centers, light and heavy manufacturers, health care, higher education institutions, farming and agriculture, and a varied service sector. The market area provides easy access to the major metropolitan markets on the east coast via trucking and rail transportation. Because of this, warehousing and distribution companies continue to find the area attractive. The local economy is not overly dependent on any one industry or business and Management believes that the Bank's primary market area continues to be well suited for growth.

Impact of Inflation

The impact of inflation upon financial institutions such as the Corporation differs from its effect upon other commercial enterprises. Unlike many companies, the assets and liabilities of the Corporation are financial in nature. As such, interest rates and changes in interest rates may have a more significant effect on the Corporation's financial results than on other types of industries. Because of this, the Corporation watches the actions of the Federal Reserve Open Market Committee (FOMC) as it makes decisions about interest rate changes and how such changes affect market rates and the Corporation. Although inflation (and inflation expectations) may affect the interest rate environment, it is not possible to measure with any precision the effect of inflation on the Corporation.

Liquidity

The Corporation must meet the financial needs of the customers that it serves, while providing a satisfactory return on the shareholders' investment. In order to accomplish this, the Corporation must maintain sufficient liquidity in order to respond quickly to the changing level of funds required for both loan and deposit activity. The goal of liquidity management is to meet the ongoing cash flow requirements of depositors who want to withdraw funds and of borrowers who request loan disbursements. The Bank regularly reviews its liquidity position by measuring its projected net cash flows (in and out) at a 30 and 90-day interval. The Bank stresses the measurements by assuming a level of deposit out-flows that have not historically been realized. In addition to this forecast, other funding sources are reviewed as a method to provide emergency funding if necessary. The objective of this measurement is to identify the amount of cash that could be raised quickly without the need to liquidate assets. The Bank also stresses its liquidity position utilizing different longer-term scenarios. The varying degrees of stress create pressure on deposit flows in its local market, reduce access to wholesale funding and limit access of funds available through brokered deposit channels. In addition to stressing cash flow, specific liquidity risk indicators are monitored to help identify risk areas. This analysis helps identify and quantify the potential cash surplus/deficit over a variety of time horizons to ensure the Bank has adequate funding resources. Assumptions used for liquidity stress testing are subjective. Should an evolving liquidity situation or business cycle present new data, potential assumption changes will be considered. The Bank believes it can meet all anticipated liquidity demands.

Historically, the Corporation has satisfied its liquidity needs from earnings, repayment of loans and amortizing investment securities, maturing investment securities, loan sales, deposit growth and its ability to access existing lines of credit. All investment securities are classified as available for sale; therefore, securities that are unencumbered ($173.1 million fair value) as collateral for borrowings are an additional source of readily available liquidity, either by selling the security or, more preferably, to provide collateral for additional borrowing. The Bank also has access to other wholesale funding via the brokered CD market.

The FHLB system has always been a major funding source for the Bank. There are no current indicators that lead the Bank to believe the FHLB would discontinue its lending function or restrict the Bank's ability to borrow. If either of these events would occur, it would have a negative effect on the Bank, and it is unlikely that the Bank could replace the level of FHLB funding in a short time. The Bank has established credit at the Federal Reserve Discount Window and at correspondent banks.

The following table shows the Bank's available liquidity at March 31, 2024.

(Dollars in thousands)

Liquidity Source	Capacity		Outstanding		Available	
Federal Home Loan Bank	$	500,736	$	240,000	$	260,736
Federal Reserve Bank Discount Window		53,637		—		53,637
Correspondent Banks		76,000		—		76,000
Total	$	630,373	$	240,000	$	390,373

Off Balance Sheet Commitments

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation.

(Dollars in thousands)	**March 31, 2024**		December 31, 2023	
Financial instruments whose contract amounts represent credit risk				
Commercial commitments to extend credit	**$**	**316,224**	$	325,982
Consumer commitments to extend credit (secured)		**115,715**		112,157
Consumer commitments to extend credit (unsecured)		**6,295**		5,964
	$	**438,234**	$	444,103
Standby letters of credit	**$**	**21,047**	$	19,851
ACL - Unfunded Commitments (1)	**$**	**1,984**	$	2,022

(1) Reported in Other Liabilities on the Consolidated Balance Sheet

The Corporation has entered into various contractual obligations to make future payments. These obligations include time deposits, long-term debt, operating leases, deferred compensation and pension payments. These amounts have not changed materially, except as reported, from those reported in the Corporation's 2023 Annual Report on Form 10-K.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations. The Corporation has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in the Corporation's exposure to market risk during the three months ended March 31, 2024. For more information on market risk refer to the Corporation's 2023 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2024, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no changes in the Corporation's internal control over financial reporting during the quarterly period ended March 31, 2024, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation 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.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation in the ordinary course of business.

In management's opinion, there are no other legal proceedings pending to which the Corporation is a party or to which its property is subject which, if determined adversely to the Corporation, would be material to the Corporation's financial condition or results of operations. No material proceedings are pending or are known to be threatened or contemplated against us by any governmental authorities.

Item 1A. Risk Factors

There were no material changes in the Corporation's risk factors during the three months ended March 31, 2024. For more information, refer to the Corporation's 2023 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In December 2023, the Board of Directors approved an open market repurchase plan to repurchase 150,000 shares of the Corporation's $1.00 par value common stock at market prices in open market or privately negotiated transactions over a one-year period. No shares were repurchased during the first quarter of 2024.

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None of our directors or executive officers adopted or terminated a Rule 10b5-1 trading arrangement or adopted or terminated a non-Rule 10b5-1 trading arrangement (as defined in Item 408(c) of Regulation S-K) during the quarter ended March 31, 2024.

Item 6. Exhibits

Exhibits

3.1	Amended and Restated Articles of Incorporation of the Corporation (Filed as Exhibit 3.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2020 and incorporated herein by reference).
3.2	Bylaws of the Corporation. (Filed on Form 8-K, as Exhibit 99 with the commission on September 2, 2022 and incorporated herein by reference).
31.1	Rule 13a – 14(a)/15d-14(a) Certifications – Principal Executive Officer
31.2	Rule 13a – 14(a)/15d-14(a) Certifications – Principal Financial Officer
32.1	Section 1350 Certifications – Principal Executive Officer
32.2	Section 1350 Certifications – Principal Financial Officer
101	Interactive Data File (XBRL)
104	Cover Page Interactive Data File (the cover page XBRL tags are imbedded in the XBRL document)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Franklin Financial Services Corporation

May 8, 2024	/s/ Timothy G. Henry Timothy G. Henry Chief Executive Officer and President (Principal Executive Officer**)**
May 8, 2024	/s/ Mark R. Hollar Mark R. Hollar Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 31.1

Rule 13a-14(a)/15d-14(a) Certifications

I, Timothy G. Henry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franklin Financial Services Corporation;

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

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

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

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

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

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

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

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

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

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

Date: May 8, 2024

/s/ Timothy G. Henry
Timothy G. Henry
President and Chief Executive Officer

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) Certifications

I, Mark R. Hollar, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Franklin Financial Services Corporation;

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

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

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

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

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

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

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

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

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

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

Date: May 8, 2024

/s/ Mark R. Hollar
Mark R. Hollar
Treasurer and Chief Financial Officer

Exhibit 32.1

Certification Pursuant to 18 U.S.C. Section 1350,

As Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

In connection with the Quarterly Report of Franklin Financial Services Corporation (the “Corporation”) on Form 10-Q, for the period ending March 31, 2024, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Timothy G. Henry, Chief Executive Officer of the Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 that:

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

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Timothy G. Henry

Timothy G. Henry

President and Chief Executive Officer

May 8, 2024

Exhibit 32.2

Certification Pursuant to 18 U.S.C. Sections 1350,

As Adopted Pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

In connection with the Quarterly Report of Franklin Financial Services Corporation (the “Corporation”) on Form 10-Q for the period ending March 31, 2024 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Mark R. Hollar, Chief Financial Officer of the Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002 that:

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

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Mark R. Hollar
Mark R. Hollar
Chief Financial Officer
May 8, 2024