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DELTA REPORT

10-Q

FDBC - FIDELITY D & D BANCORP IN

10-Q - SEPTEMBER 30, 2023 COMPARED TO 10-Q - JUNE 30, 2023

The following comparison report has been automatically generated

TOTAL DELTAS	1193
CHANGES	536
DELETIONS	309
ADDITIONS	348

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

FORM 10-Q

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

For the quarterly period ended June 30, 2023 September 30, 2023

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: 001-38229

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION:	IRS EMPLOYER IDENTIFICATION NO:
Pennsylvania	23-3017653

Address of principal executive offices:
Blakely & Drinker St.
Dunmore, Pennsylvania 18512
TELEPHONE: **570-342-8281**

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	**Trading Symbols(s)**	**Name of each exchange on which registered**
Common stock, without par value	FDBC	The NASDAQ Stock Market, LLC

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 subjected to such filing requirements for the past 90 days. ☒ Yes ☐ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☐ Non-accelerated filer ☒ Accelerated filer ☐ Smaller reporting company ☒ Emerging growth company ☐

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

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

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on July 31, 2023 October 31, 2023, the latest practicable date, was 5,687,162 5,696,351 shares.

FIDELITY D & D BANCORP, INC.

Form 10-Q June 30, 2023 September 30, 2023

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PART I – Financial Information

Item 1: Financial Statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Balance Sheets

(Unaudited)

(dollars in thousands)	**June 30, 2023**	December 31, 2022	**September 30, 2023**	December 31, 2022
Assets:				
Cash and due from banks	$ 35,294	$ 3,542	$ 28,431	$ 3,542
Interest-bearing deposits with financial institutions	34,338	25,549	82,040	25,549
Total cash and cash equivalents	69,632	29,091	110,471	29,091
Available-for-sale securities	380,785	420,862	352,835	420,862
Held-to-maturity securities (fair value of $192,084 in 2023; $187,280 in 2022)	223,479	222,744		

Held-to-maturity securities (fair value of $178,012 in 2023; $187,280 in 2022)			223,853	222,744
Restricted investments in bank stock	3,728	5,268	3,800	5,268
Loans and leases, net (allowance for credit losses of $18,350 in 2023; $17,149 in 2022)	1,611,314	1,547,025		
Loans held-for-sale (fair value $1,851 in 2023; $1,660 in 2022)	1,808	1,637		
Loans and leases, net (allowance for credit losses of $18,757 in 2023; $17,149 in 2022)			1,626,451	1,547,025
Loans held-for-sale (fair value $2,354 in 2023; $1,660 in 2022)			2,345	1,637
Foreclosed assets held-for-sale	87	168	87	168
Bank premises and equipment, net	31,329	31,307	32,625	31,307
Leased property under finance leases, net	969	1,089	1,219	1,089
Right-of-use assets	8,411	8,642	8,311	8,642
Cash surrender value of bank owned life insurance	53,892	54,035	54,226	54,035
Accrued interest receivable	8,343	8,487	8,758	8,487
Goodwill	19,628	19,628	19,628	19,628
Core deposit intangible, net	1,353	1,540	1,269	1,540
Other assets	26,474	26,849	30,942	26,849
Total assets	$ 2,441,232	$ 2,378,372	$ 2,476,820	$ 2,378,372
Liabilities:				
Deposits:				
Interest-bearing	$ 1,569,519	$ 1,564,305	$ 1,602,018	$ 1,564,305
Non-interest-bearing	582,473	602,608	549,741	602,608
Total deposits	2,151,992	2,166,913	2,151,759	2,166,913
Accrued interest payable and other liabilities	16,442	17,434	16,864	17,434
Allowance for credit losses on off-balance sheet credit exposures	1,284	49	1,009	49
Finance lease obligation	991	1,110	1,238	1,110
Operating lease liabilities	9,170	9,357	9,079	9,357
Short-term borrowings	76,111	12,940	124,000	12,940
Secured borrowings	7,498	7,619	7,439	7,619
Total liabilities	2,263,488	2,215,422	2,311,388	2,215,422
Shareholders' equity:				
Preferred stock authorized 5,000,000 shares with no par value; none issued	-	-	-	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 5,681,260 at June 30, 2023; and 5,630,794 at December 31, 2022)	116,959	115,611		
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 5,696,351 at September 30, 2023; and 5,630,794 at December 31, 2022)			117,256	115,611
Retained earnings	126,711	119,754	129,976	119,754
Accumulated other comprehensive loss	(65,268)	(71,152)	(81,504)	(71,152)
Treasury stock, at cost (16,473 shares at June 30, 2023 and 32,663 shares at December 31, 2022)	(658)	(1,263)		
Treasury stock, at cost (7,284 shares at September 30, 2023 and 32,663 shares at December 31, 2022)			(296)	(1,263)
Total shareholders' equity	177,744	162,950	165,432	162,950
Total liabilities and shareholders' equity	$ 2,441,232	$ 2,378,372	$ 2,476,820	$ 2,378,372

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Income

(Unaudited)	Three months ended		Six months ended		Three months ended		Nine months ended	
(dollars in thousands except per share data)	**June 30, 2023**	June 30, 2022	**June 30, 2023**	June 30, 2022	**September 30, 2023**	September 30, 2022	**September 30, 2023**	September 30, 2022
Interest income:								

Loans and leases:								
Taxable	$ 18,875	$ 15,043	$ 36,994	$ 29,409	$ 19,766	$ 15,828	$ 56,760	$ 45,237
Nontaxable	828	457	1,727	866	736	492	2,463	1,358
Interest-bearing deposits with financial institutions	121	80	152	113	60	351	212	464
Restricted investments in bank stock	75	33	181	64	59	56	240	120
Investment securities:								
U.S. government agency and corporations	1,475	1,614	2,995	3,123	1,461	1,602	4,456	4,725
States and political subdivisions (nontaxable)	1,160	1,388	2,377	2,769	1,152	1,357	3,529	4,126
States and political subdivisions (taxable)	445	450	891	900	444	449	1,335	1,348
Total interest income	22,979	19,065	45,317	37,244	23,678	20,135	68,995	57,378
Interest expense:								
Deposits	6,607	950	11,225	1,772	8,488	1,550	19,713	3,321
Secured borrowings	118	(31)	229	34	123	75	352	109
Other short-term borrowings	772	1	1,356	1	428	-	1,784	1
Total interest expense	7,497	920	12,810	1,807	9,039	1,625	21,849	3,431
Net interest income	15,482	18,145	32,507	35,437	14,639	18,510	47,146	53,947
Provision for credit losses on loans	675	525	855	1,050	525	525	1,380	1,575
Provision (credit) for credit losses on unfunded loan commitments	(50)	(7)	175	(18)	(275)	(6)	(100)	(24)
Net interest income after provision for credit losses	14,857	17,627	31,477	34,405	14,389	17,991	45,866	52,396
Other income:								
Service charges on deposit accounts	1,001	836	1,922	1,634	1,039	920	2,962	2,554
Interchange fees	1,168	1,114	2,419	2,289	1,169	1,095	3,588	3,385
Service charges on loans	284	317	582	758	244	290	826	1,048
Fees from trust fiduciary activities	718	613	1,413	1,230	783	621	2,197	1,852
Fees from financial services	227	246	450	513	169	198	618	712
Fees and other revenue	734	312	1,352	692	349	281	1,701	972
Earnings on bank-owned life insurance	324	319	645	638	335	327	980	965
Gain (loss) on write-down, sale or disposal of:								
Loans	242	477	406	1,190	315	232	721	1,421
Available-for-sale debt securities	-	-	(1)	-	-	4	(1)	4
Premises and equipment	(163)	22	(165)	(134)	(78)	(57)	(243)	(191)
Total other income	4,535	4,256	9,023	8,810	4,325	3,911	13,349	12,722
Other expenses:								
Salaries and employee benefits	6,430	6,941	12,945	13,655	6,258	6,802	19,203	20,457
Premises and equipment	2,250	1,893	4,377	3,818	2,276	1,855	6,653	5,673
Data processing and communication	699	618	1,376	1,331	765	663	2,141	1,994
Advertising and marketing	478	489	1,371	1,270	461	753	1,831	2,023
Professional services	1,074	826	1,999	1,545	950	838	2,949	2,383
Automated transaction processing	476	440	905	809	434	383	1,339	1,192
Office supplies and postage	197	178	378	357	165	177	543	534
PA shares tax	324	441	291	601	261	441	553	1,043
Loan collection	46	30	59	65	45	115	105	181
Other real estate owned	1	29	2	3	3	6	6	9
FDIC assessment	393	136	561	373	282	152	843	525
Other	1,057	786	2,017	1,645	884	849	2,900	2,494
Total other expenses	13,425	12,807	26,281	25,472	12,784	13,034	39,066	38,508
Income before income taxes	5,967	9,076	14,219	17,743	5,930	8,868	20,149	26,610
Provision for income taxes	605	1,412	1,817	2,556	590	1,179	2,407	3,735
Net income	$ 5,362	$ 7,664	$ 12,402	$ 15,187	$ 5,340	$ 7,689	$ 17,742	$ 22,875
Per share data:								
Net income - basic	$ 0.95	$ 1.35	$ 2.19	$ 2.68	$ 0.94	$ 1.36	$ 3.13	$ 4.05

Net income - diluted	$ 0.94	$ 1.35	$ 2.18	$ 2.67	$ 0.93	$ 1.36	$ 3.11	$ 4.03
Dividends	$ 0.36	$ 0.33	$ 0.72	$ 0.66	$ 0.36	$ 0.33	$ 1.08	$ 0.99

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income	Three months ended		Six months ended		Three months ended		Nine months ended	
(Unaudited)	June 30,		June 30,		September 30,		September 30,	
(dollars in thousands)	**2023**	2022	**2023**	2022	**2023**	2022	**2023**	2022
Net income	$ 5,362	$ 7,664	$ 12,402	$ 15,187	$ 5,340	$ 7,689	$ 17,742	$ 22,875
Other comprehensive gain (loss), before tax:								
Unrealized holding gain (loss) on available-for-sale debt securities	(3,517)	7	6,307	(54,013)				
Reclassification adjustment for net losses realized in income		-	1	-				
Unrealized holding loss on available-for-sale debt securities					(21,129)	(27,590)	(14,823)	(81,603)
Reclassification adjustment for net losses (gains) realized in income					-	(4)	1	(4)
Reclassification of unrealized loss on securities transferred from available-for-sale to held-to-maturity	-	(23,882)	-	(23,882)	-	-	-	(23,882)
Amortization of unrealized loss on held-to-maturity securities	568	555	1,140	555	577	565	1,718	1,120
Net unrealized gain (loss)	(2,949)	(23,320)	7,448	(77,340)				
Net unrealized loss					(20,552)	(27,029)	(13,104)	(104,369)
Tax effect	619	4,897	(1,564)	16,241	4,316	5,676	2,752	21,917
Unrealized gain (loss), net of tax	(2,330)	(18,423)	5,884	(61,099)				
Other comprehensive income (loss), net of tax	(2,330)	(18,423)	5,884	(61,099)				
Unrealized loss, net of tax					(16,236)	(21,353)	(10,352)	(82,452)
Other comprehensive loss, net of tax					(16,236)	(21,353)	(10,352)	(82,452)
Total comprehensive income (loss), net of tax	$ 3,032	$ (10,759)	$ 18,286	$ (45,912)	$ (10,896)	$ (13,664)	$ 7,390	$ (59,577)

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

For the Six Months Ended June 30, 2023 and 2022												
For the Nine Months Ended September 30, 2023 and 2022												
(Unaudited)	Capital stock		Retained	Accumulated other comprehensive	Treasury		Capital stock		Retained	Accumulated other comprehensive	Treasury	
(dollars in thousands)	Shares	Amount	earnings	income (loss)	Stock	Total	Shares	Amount	earnings	income (loss)	Stock	Total
Balance, December 31, 2021	5,645,687	$ 114,108	$ 97,442	$ 179	$ -	$ 211,729	5,645,687	$ 114,108	$ 97,442	$ 179	$ -	$ 211,729
Net income			15,187			15,187			22,875			22,875
Other comprehensive loss				(61,099)		(61,099)				(82,452)		(82,452)

	Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Treasury Stock	Total	Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Treasury Stock	Total
Issuance of common stock through Employee Stock Purchase Plan	4,891	252				252	4,891	252				252
Forfeited restricted dividend reinvestment shares	(48)				-	-	(106)				-	-
Issuance of common stock from vested restricted share grants through stock compensation plans	11,541	-				-	11,699	-				-
Stock-based compensation expense		719				719		977				977
Common stock repurchased	(10,294)				(388)	(388)	(31,839)				(1,235)	(1,235)
Cash dividends declared			(3,781)			(3,781)			(5,659)			(5,659)
Balance, June 30, 2022	5,651,777	$ 115,079	$ 108,848	$ (60,920)	$ (388)	$ 162,619						
Balance, September 30, 2022							5,630,332	$ 115,337	$ 114,658	$ (82,273)	$ (1,235)	$ 146,487
Balance, December 31, 2022	5,630,794	$ 115,611	$ 119,754	$ (71,152)	$ (1,263)	$ 162,950	5,630,794	$ 115,611	$ 119,754	$ (71,152)	$ (1,263)	$ 162,950
Cumulative-effect adjustment for adoption of ASU 2016-13 (Footnote 1)			(1,326)			(1,326)			(1,326)			(1,326)
Net income			12,402			12,402			17,742			17,742
Other comprehensive income				5,884		5,884				(10,352)		(10,352)
Issuance of common stock through Employee Stock Purchase Plan	7,294	302				302	7,294	302				302
Re-issuance of common stock through Dividend Reinvestment Plan	17,576	135			673	808	26,765	193			1,035	1,228
Issuance of common stock from vested restricted share grants through stock compensation plans	24,283	-				-	24,442	-				-
Issuance of common stock through exercise of SSARs	2,699	-				-	8,442	-				-
Stock-based compensation expense		963				963		1,321				1,321
Repurchase of shares to cover withholdings	(1,386)	**(52)**			(68)	(120)	(1,386)	**(171)**			(68)	(239)
Cash dividends declared			(4,119)			(4,119)			(6,194)			(6,194)
Balance, June 30, 2023	5,681,260	$ 116,959	$ 126,711	$ (65,268)	$ (658)	$ 177,744						
Balance, September 30, 2023							5,696,351	$ 117,256	$ 129,976	$ (81,504)	$ (296)	$ 165,432

For the Three Months Ended June 30, 2023 and 2022												
For the Three Months Ended September 30, 2023 and 2022												
(Unaudited)				Accumulated other						Accumulated other		
	Capital stock		Retained	comprehensive	Treasury		Capital stock		Retained	comprehensive	Treasury	
(dollars in thousands)	Shares	Amount	earnings	income (loss)	Stock	Total	Shares	Amount	earnings	income (loss)	Stock	Total
Balance, March 31, 2022	5,659,068	$ 114,666	$ 103,074	$ (42,497)	$ -	$ 175,243						

Balance, June 30, 2022							5,651,777	$ 115,079	$ 108,848	$ (60,920)	$ (388)	$ 162,619
Net income			7,664			7,664			7,689			7,689
Other comprehensive loss				(18,423)		(18,423)				(21,353)		(21,353)
Forfeited restricted dividend reinvestment shares	(48)				-	-	(58)				-	-
Issuance of common stock from vested restricted share grants through stock compensation plans	3,051	-				-	158	-				-
Stock-based compensation expense		413				413		258				258
Common stock repurchased	(10,294)	-			(388)	(388)	(21,545)	-			(847)	(847)
Cash dividends declared			(1,890)			(1,890)			(1,879)			(1,879)
Balance, June 30, 2022	5,651,777	$ 115,079	$ 108,848	$ (60,920)	$ (388)	$ 162,619						
Balance, September 30, 2022							5,630,332	$ 115,337	$ 114,658	$ (82,273)	$ (1,235)	$ 146,487
Balance, March 31, 2023	5,665,255	$ 116,437	$ 123,416	$ (62,938)	$ (1,028)	$ 175,887						
Balance, June 30, 2023							5,681,260	$ 116,959	$ 126,711	$ (65,268)	$ (658)	$ 177,744
Net income			5,362			5,362			5,340			5,340
Other comprehensive loss				(2,330)		(2,330)				(16,236)		(16,236)
Re-issuance of common stock through Dividend Reinvestment Plan	9,472	56			370	426	9,189	57			362	419
Issuance of common stock from vested restricted share grants through stock compensation plans	3,834	-				-	159	-				-
Issuance of common stock through exercise of SSARs	2,699	-				-	5,743	-				-
Stock-based compensation expense		518				518		358				358
Repurchase of shares to cover withholdings	-	**(52)**				(52)	-	(118)			-	(118)
Cash dividends declared			(2,067)			(2,067)			(2,075)			(2,075)
Balance, June 30, 2023	5,681,260	$ 116,959	$ 126,711	$ (65,268)	$ (658)	$ 177,744						
Balance, September 30, 2023							5,696,351	$ 117,256	$ 129,976	$ (81,504)	$ (296)	$ 165,432

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

(Unaudited)	Six months ended June 30,		Nine months ended September 30,	
(dollars in thousands)	**2023**	2022	**2023**	2022
Cash flows from operating activities:				
Net income	$ 12,402	$ 15,187	$ 17,742	$ 22,875
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation, amortization and accretion	2,552	2,495	4,251	3,692
Provision for credit losses on loans	855	1,050	1,380	1,575

Provision (credit) for credit losses on unfunded loan commitments	175	(18)	(100)	(24)
Deferred income tax (benefit) expense	(224)	1,300	(489)	2,012
Stock-based compensation expense	963	719	1,321	977
Excess tax benefit from exercise of SSARs	31	-	104	-
Proceeds from sale of loans held-for-sale	23,285	52,800	38,105	68,556
Originations of loans held-for-sale	(23,540)	(42,581)	(38,801)	(56,575)
Earnings from bank-owned life insurance	(645)	(638)	(980)	(965)
Gain from bank-owned life insurance claim	(142)	-	(142)	-
Net gain from sales of loans	(406)	(1,190)	(721)	(1,421)
Net loss from sales of investment securities	1	-		
Net loss (gain) from sales of investment securities			1	(4)
Net gain from sale and write-down of foreclosed assets held-for-sale	-	(23)	-	(24)
Net loss from write-down and disposal of bank premises and equipment	165	134	243	191
Operating lease payments	44	57	53	79
Change in:				
Accrued interest receivable	145	(384)	(271)	(255)
Other assets	400	(1,430)	250	(2,166)
Accrued interest payable and other liabilities	(992)	323	(571)	1,757
Net cash provided by operating activities	15,069	27,801	21,375	40,280
Cash flows from investing activities:				
Available-for-sale securities:				
Proceeds from sales	31,208	-	31,208	1,691
Proceeds from maturities, calls and principal pay-downs	13,356	23,561	19,392	32,733
Purchases	-	(39,183)	-	(39,183)
Decrease (increase) in restricted investments in bank stock	1,540	(416)	1,468	(433)
Net increase in loans and leases	(66,711)	(40,733)	(83,220)	(73,412)
Principal portion of lease payments received under direct finance leases	2,803	2,859	4,106	4,423
Purchases of bank premises and equipment	(2,579)	(3,875)	(4,576)	(4,614)
Proceeds from death benefits received on bank-owned life insurance	931	-	931	-
Proceeds from sale of bank premises and equipment	22	466	22	1,095
Proceeds from sale of foreclosed assets held-for-sale	-	780	-	806
Net cash used in investing activities	(19,430)	(56,541)	(30,669)	(76,894)
Cash flows from financing activities:				
Net (decrease) increase in deposits	(14,903)	47,776	(15,130)	83,394
Net increase (decrease) in other borrowings	63,052	(2,755)	110,883	(2,800)
Repayment of finance lease obligation	(118)	(116)	(176)	(173)
Purchase of treasury stock	-	(388)	-	(1,235)
Proceeds from employee stock purchase plan participants	302	252	302	252
Repurchase of shares to cover withholdings	(121)	-	(239)	-
Dividends paid, net of dividends reinvested	(3,310)	(3,781)	(4,966)	(5,659)
Net cash provided by financing activities	44,902	40,988	90,674	73,779
Net increase in cash and cash equivalents	40,541	12,248	81,380	37,165
Cash and cash equivalents, beginning	29,091	96,877	29,091	96,877
Cash and cash equivalents, ending	$ 69,632	$ 109,125	$ 110,471	$ 134,042

See notes to unaudited consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows (continued)

(Unaudited)	Six months ended June 30,		Nine months ended September 30,	
(dollars in thousands)	**2023**	2022	**2023**	2022
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$ 11,881	$ 1,838	$ 20,067	$ 3,423
Income tax	1,700	900	2,550	1,550
Supplemental Disclosures of Non-cash Investing Activities:				
Net change in unrealized gains (losses) on available-for-sale securities	6,308	(54,013)		
Net change in unrealized losses on available-for-sale securities			(14,821)	(81,607)
Transfers of securities from available-for-sale to held-to-maturity	-	245,536	-	245,536
Unrealized losses on securities transferred from available-for-sale to held-to-maturity	-	(23,882)	-	(22,762)
Cumulative-effect adjustment for adoption of ASU 2016-13	(1,326)	-	(1,326)	-
Amortization of unrealized losses on securities transferred from available-for-sale to held-to-maturity	1,140	555	1,718	1,120
Transfers from/(to) loans to/(from) foreclosed assets held-for-sale	(82)	450	(82)	450
Transfers from/(to) loans to/(from) loans held-for-sale, net	(205)	(17,129)	(205)	(18,052)
Transfers from premises and equipment to other assets held-for-sale	739	1,184	739	1,184
Right-of-use asset	-	24	303	141
Lease liability	-	24	303	141

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements
(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity D & D Bancorp, Inc. (the Company) is a bank holding company and the parent of The Fidelity Deposit and Discount Bank (the Bank). The Bank is a commercial bank and trust company chartered under the laws of the Commonwealth of Pennsylvania and a wholly-owned subsidiary of the Company. Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna, Northampton and Luzerne Counties and Wealth Management offices in Schuylkill and Lebanon Counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

For additional information and disclosures required under U.S. GAAP, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2022.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with U.S. GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company's assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of June September 30, 2023 and December 31, 2022 and the related consolidated statements of income, consolidated statements of comprehensive income and consolidated statements of changes in shareholders' equity for the three and six nine months ended June September 30, 2023 and 2022 and consolidated statements of cash flows for the six nine months ended June September 30, 2023 and 2022 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature. Certain reclassifications have been made to the 2022 financial statements to conform to the 2023 presentation.

In preparing these consolidated financial statements, the Company evaluated the events and transactions that occurred after June September 30, 2023 through the date these consolidated financial statements were issued.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2022, and the notes included therein, included within the Company's Annual Report filed on Form 10-K.

Critical accounting policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for credit losses. Management believes that the allowance for credit losses at June September 30, 2023 is adequate and reasonable to cover expected losses. Given the subjective nature of identifying and estimating loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance amount. While management uses available information to recognize losses on loans, changes in current economic conditions and reasonable and supportable forecasts may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. All of the Company's debt securities are classified as available-for-sale (AFS) or held-to-maturity (HTM). AFS debt securities are carried at fair value on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (AOCI). Debt securities, for which the Company has the positive intent and ability to hold to maturity, are reported at cost. On occasion, the Company may transfer securities from AFS to HTM at fair value on the date of transfer.

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells residential mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these circumstances, pricing may be obtained from other entities and the residential mortgage loans are transferred at the lower of cost or market value and simultaneously sold. For other loans transferred to HFS, pricing may be obtained from other entities or modeled and the other loans are transferred at the lower of cost or market value and then sold. As of June September 30, 2023 and December 31, 2022, loans classified as HFS consisted of residential mortgage loans.

Financing of automobiles, provided to customers under lease arrangements of varying terms, are accounted for as direct finance leases. Interest income on automobile direct finance leasing is determined using the interest method to arrive at a level effective yield over the life of the lease. The lease residual and the lease receivable, net of unearned lease income, are recorded within loans and leases on the balance sheet.

Foreclosed assets held-for-sale includes other real estate acquired through foreclosure (ORE) and may, from time-to-time, include repossessed assets such as automobiles. ORE is carried at the lower of cost (principal balance at date of foreclosure) or fair value less estimated cost to sell. Any write-downs at the date of foreclosure are charged to the allowance for credit losses. Expenses incurred to maintain ORE properties, subsequent write downs to the asset's fair value, any rental income received and gains or losses on disposal are included as components of other real estate owned expense in the consolidated statements of income.

The Company accounts for business combinations under the purchase method of accounting. The application of this method of accounting requires the use of significant estimates and assumptions in the determination of the fair value of assets acquired and liabilities assumed in order to properly allocate purchase price consideration between assets that are amortized, accreted or depreciated from those that are recorded as goodwill. Estimates of the fair values of assets acquired and liabilities assumed are based upon assumptions that management believes to be reasonable.

Goodwill is recorded on the consolidated balance sheets as the excess of liabilities assumed over identifiable assets acquired on the acquisition date. Goodwill is recorded at its net carrying value which represents estimated fair value. Goodwill is tested for impairment on at least an annual basis. There was no goodwill impairment as of June September 30, 2023 and December 31, 2022. Other acquired intangible assets that have finite lives, such as core deposit intangibles, are amortized over their estimated useful lives and subject to periodic impairment testing.

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. The Company accounts for certain participation interests in commercial loans receivable (loan participation agreements) sold as a sale of financial assets pursuant to ASC 860, Transfers and Servicing. Loan participation agreements that meet the sale criteria under ASC 860 are derecognized from the Consolidated Balance Sheets at the time of transfer. If the transfer of loans does not meet the sale criteria or participating interest criteria under ASC 860, the transfer is accounted for as a secured borrowing and the loan is not de-recognized and a participating liability is recorded in the Consolidated Balance Sheets.

The Company holds separate supplemental executive retirement (SERP) agreements for certain officers and an amount is credited to each participant's SERP account monthly while they are actively employed by the bank until retirement. A deferred tax asset is provided for the non-deductible SERP expense. The Company also entered into separate split dollar life insurance arrangements with four executives providing post-retirement benefits and accrues monthly expense for this benefit. The split dollar life insurance expense is not deductible for tax purposes. Monthly expenses for the SERP and post-retirement split dollar life benefit are recorded as components of salaries and employee benefit expense on the consolidated statements of income.

For purposes of the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions.

2. New accounting pronouncements

On January 1, 2023, the Company adopted ASU 2016-13 and all of the subsequent amendments using the modified-retrospective approach and recorded a cumulative-effect adjustment to retained earnings. The change in this accounting guidance could require the Company to record loan losses more rapidly. The Company has engaged the services of a qualified third-party service provider to assist management in estimating credit allowances under this standard. Starting in the 3rd quarter of 2022, the Company ran its CECL model parallel to the current allowance for loan losses calculation to gain a better understanding of the effects of the change. During the fourth quarter of 2022, a third-party service provider ran a model validation with no substantial findings. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The Company recorded a net decrease to retained earnings of $1.3 million as of January 1, 2023 for the cumulative effect of adopting ASC 326. The transition adjustment includes a $0.5 million decrease for the allowance for credit losses on loans (ACL) and a $0.8 million decrease for the reserve for unfunded commitments, net of deferred tax. The Company has also run a quarterly CECL analysis on its held-to-maturity investment securities starting in 2023 and the estimated CECL reserve is immaterial. While the CECL model does not apply to available-for-sale securities, the ASU does require companies to record an allowance when recognizing credit losses for available-for-sale securities with unrealized losses, rather than reduce the amortized cost of the securities by direct write-offs. The guidance will require companies to recognize improvements to estimated credit losses immediately in earnings rather than in interest income over time.

The Company adopted the provisions of ASC 326 related to financial assets purchased with credit deterioration (PCD) that were previously classified as purchased credit impaired (PCI) and accounted for under ASC 310-30 using the prospective transition approach. In accordance with the standard, management did not reassess whether PCI assets met the criteria of PCD assets as of the date of adoption. On January 1, 2023, the amortized cost basis of the PCD assets were adjusted to reflect the addition of $0.1 million of the ACL.

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2016-13, *Financial Instruments – Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments (CECL)*. The amendments in this update require financial assets measured at amortized cost basis to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. Previously, when credit losses were measured under GAAP, an entity only considered past events and current conditions when measuring the incurred loss. The amendments in this update broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgement in determining the relevant information and estimation methods that are appropriate under the circumstances. The amendments in this update also require that credit losses on available-for-sale debt securities be presented as an allowance for credit losses rather than a writedown.

In November 2018, the FASB issued ASU 2018-19, *Codification Improvements to Topic 326*, which clarifies that receivables arising from operating leases are not within the scope of Topic 326. In December 2018, regulators issued a final rule related to regulatory capital *(Regulatory Capital Rule: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rule and Conforming Amendments to Other Regulations)* which is intended to provide regulatory capital relief for entities transitioning to CECL. In April 2019, the FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging and Topic 825, Financial Instruments*. As it relates to CECL, this guidance amends certain provisions contained in ASU 2016-13, particularly in regards to the inclusion of accrued interest in the definition of amortized cost, as well as clarifying that extension and renewal options that are not unconditionally cancelable by the entity that are included in the original or modified contract should be considered in the entity's determination of expected credit losses.

In March 2022, the FASB issued ASU 2022-02, *Financial Instruments-Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures*. The amendments in this update eliminate the accounting guidance for TDRs by creditors in Subtopic 310-40, *Receivables-Troubled Debt Restructurings by Creditors*, while enhancing disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty. The amendments in this update also require that an entity disclose current-period gross writeoffs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, *Financial Instruments-Credit Losses-Measured at Amortized Cost*. The amendments in this update were effective for the Company upon adoption of ASU 2016-13. The amendments in this update should be applied prospectively, except as provided in the next sentence. For the transition method related to the recognition and measurement of TDRs, the Company has the option to apply a modified retrospective transition method, resulting in a cumulative-effect adjustment to retained earnings in the period of adoption. The Company adopted ASU 2022-02 on January 1, 2023 and the adoption required additional quantitative and qualitative disclosures. There was not any significant effect on the Company's financial statements.

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848) – Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The amendments in this update provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The amendments in this update are elective and apply to all entities that have contracts that reference LIBOR or another reference rate expected to be discontinued. The guidance includes a general principle that permits an entity to consider contract modifications due to reference rate reform to be an event that does not require contract remeasurement at the modification date or reassessment of a previous accounting determination. An optional expedient simplifies accounting for contract modifications to loans receivable and debt, by prospectively adjusting the effective interest rate. The amendments in ASU 2020-04 are effective as of March 12, 2020 through December 31, 2022.

In December 2022, the FASB issued ASU 2022-06, *Reference Rate Reform (Topic 848) - Deferral of the Sunset Date of Topic 848*. The amendments in this update defer the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The Company expects to apply the amendments prospectively for applicable loan and other contracts within the effective period of ASU 2022-06. As of June September 30, 2023, the Company no longer had any loans with rates tied to LIBOR.

In October 2023, the FASB issued ASU 2023-06,*Disclosure Improvements*. The amendments in this update are the result of the FASB's decision to incorporate into the Codification certain disclosures referred by the SEC that overlap with, but require incremental information to, generally accepted accounting principles (GAAP). The amendments in this update represent changes to clarify or improve disclosure and presentation requirements of a variety of topics in the Codification. For entities subject to the SEC's existing requirements, 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. The amendments in this update should be applied prospectively. The adoption is not expected to have a material impact on the consolidated financial statements but could change certain disclosures in SEC filings.

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3. Accumulated other comprehensive income

The following tables illustrate the changes in accumulated other comprehensive income by component and the details about the components of accumulated other comprehensive income as of and for the periods indicated:

As of and for the six months ended June 30, 2023				
As of and for the nine months ended September 30, 2023			**As of and for the nine months ended September 30, 2023**	
	Unrealized gains (losses) on available-for-sale	Securities transferred to	Unrealized gains (losses) on available-for-sale	Securities transferred to

(dollars in thousands)	debt securities	held-to-maturity	Total	debt securities	held-to-maturity	Total
Beginning balance	$ (53,624)	$ (17,528)	$ (71,152)	$ (53,624)	$ (17,528)	$ (71,152)
Other comprehensive income before reclassifications, net of tax	4,982	901	5,883			
Other comprehensive (loss) income before reclassifications, net of tax				(11,710)	1,357	(10,353)
Amounts reclassified from accumulated other comprehensive income, net of tax	1	-	1	1	-	1
Net current-period other comprehensive loss	4,983	901	5,884	(11,709)	1,357	(10,352)
Ending balance	$ (48,641)	$ (16,627)	$ (65,268)	$ (65,333)	$ (16,171)	$ (81,504)

As of and for the three months ended June 30, 2023

As of and for the three months ended September 30, 2023

				As of and for the three months ended September 30, 2023		
(dollars in thousands)	Unrealized gains (losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total	Unrealized gains (losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total
Beginning balance	$ (45,862)	$ (17,076)	$ (62,938)	$ (48,641)	$ (16,627)	$ (65,268)
Other comprehensive loss before reclassifications, net of tax	(2,779)	449	(2,330)			
Other comprehensive (loss) income before reclassifications, net of tax				(16,692)	456	(16,236)
Amounts reclassified from accumulated other comprehensive income, net of tax	-	-	-	-	-	-
Net current-period other comprehensive loss	(2,779)	449	(2,330)	(16,692)	456	(16,236)
Ending balance	$ (48,641)	$ (16,627)	$ (65,268)	$ (65,333)	$ (16,171)	$ (81,504)

As of and for the six months ended June 30, 2022

As of and for the nine months ended September 30, 2022

(dollars in thousands)	Unrealized gains (losses) on available-for-sale securities	Securities transferred to held-to-maturity	Total	Unrealized gains (losses) on available-for-sale securities	Securities transferred to held-to-maturity	Total
Beginning balance	$ 179	$ -	$ 179	$ 179	$ -	$ 179
Other comprehensive loss before reclassifications, net of tax	(42,670)	(18,429)	(61,099)	(64,466)	(17,983)	(82,449)
Amounts reclassified from accumulated other comprehensive income, net of tax	-	-	-	(3)	-	(3)
Net current-period other comprehensive loss	(42,670)	(18,429)	(61,099)	(64,469)	(17,983)	(82,452)
Ending balance	$ (42,491)	$ (18,429)	$ (60,920)	$ (64,290)	$ (17,983)	$ (82,273)

As of and for the three months ended June 30, 2022

As of and for the three months ended September 30, 2022

				As of and for the three months ended September 30, 2022		
	Unrealized gains			Unrealized gains		

(dollars in thousands)	(losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total	(losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total
Beginning balance	$ (42,497)	$ -	$ (42,497)	$ (42,491)	$ (18,429)	$ (60,920)
Other comprehensive income (loss) before reclassifications, net of tax	6	(18,429)	(18,423)	(21,796)	446	(21,350)
Amounts reclassified from accumulated other comprehensive income, net of tax	-	-	-	(3)	-	(3)
Net current-period other comprehensive income (loss)	6	(18,429)	(18,423)	(21,799)	446	(21,353)
Ending balance	$ (42,491)	$ (18,429)	$ (60,920)	$ (64,290)	$ (17,983)	$ (82,273)

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Details about accumulated other comprehensive income components (dollars in thousands)	Amount reclassified from accumulated other comprehensive income				Affected line item in the statement where net income is presented
	For the three months ended June 30,		For the six months ended June 30,		
	2023	2022	**2023**	2022	
Unrealized gains (losses) on AFS debt securities	$ -	$ -	$ (1)	$ -	Gain (loss) on sale of investment securities
Income tax effect	-	-	-	-	Provision for income taxes
Total reclassifications for the period	$ -	$ -	$ (1)	$ -	Net income

Details about accumulated other comprehensive income components (dollars in thousands)	Amount reclassified from accumulated other comprehensive income				Affected line item in the statement where net income is presented
	For the three months ended September 30,		For the nine months ended September 30,		
	2023	2022	**2023**	2022	
Unrealized gains (losses) on AFS debt securities	$ -	$ -	$ (1)	$ -	Gain (loss) on sale of investment securities
Income tax effect	-	-	-	-	Provision for income taxes
Total reclassifications for the period	$ -	$ -	$ (1)	$ -	Net income

4. Investment securities

Agency – Government-sponsored enterprise (GSE) and Mortgage-backed securities (MBS) - GSE residential

Agency – GSE and MBS – GSE residential securities consist of short- to long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), FNMA, FHLB and Government National Mortgage Association (GNMA). These securities have interest rates that are fixed, have varying short to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions (municipal)

The municipal securities are general obligation and revenue bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

The Company did not record any allowance for credit losses on its available-for-sale or held-to-maturity securities. The amortized cost and fair value of investment securities at June September 30, 2023 and December 31, 2022 are summarized as follows:

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2023								
September 30, 2023								
Held-to-maturity securities:								
Agency - GSE	$ 80,838	$ -	$ (8,915)	$ 71,923	$ 81,107	$ -	$ (11,755)	$ 69,352
Obligations of states and political subdivisions	142,641	-	(22,480)	120,161	142,746	-	(34,086)	108,660
Total held-to-maturity securities	$ 223,479	$ -	$ (31,395)	$ 192,084	$ 223,853	$ -	$ (45,841)	$ 178,012
Available-for-sale debt securities:								
Agency - GSE	$ 31,131	$ -	$ (4,185)	$ 26,946	$ 31,155	$ -	$ (4,696)	$ 26,459
Obligations of states and political subdivisions	173,828	1	(21,842)	151,987	173,281	-	(33,734)	139,547
MBS - GSE residential	237,397	-	(35,545)	201,852	231,099	-	(44,270)	186,829
Total available-for-sale debt securities	$ 442,356	$ 1	$ (61,572)	$ 380,785	$ 435,535	$ -	$ (82,700)	$ 352,835

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2022				
Held-to-maturity securities:				
Agency - GSE	$ 80,306	$ -	$ (9,243)	$ 71,063
Obligations of states and political subdivisions	142,438	-	(26,221)	116,217
Total held-to-maturity securities	$ 222,744	$ -	$ (35,464)	$ 187,280
Available-for-sale debt securities:				
Agency - GSE	$ 36,076	$ -	$ (4,543)	$ 31,533
Obligations of states and political subdivisions	197,935	501	(26,542)	171,894
MBS - GSE residential	254,730	-	(37,295)	217,435
Total available-for-sale debt securities	$ 488,741	$ 501	$ (68,380)	$ 420,862

The amortized cost and fair value of debt securities at June September 30, 2023 by contractual maturity are summarized below:

(dollars in thousands)	Amortized cost	Fair value	Amortized cost	Fair value
Held-to-maturity securities:				
Due in one year or less	$ -	$ -	$ -	$ -
Due after one year through five years	18,777	17,246	22,575	20,286
Due after five years through ten years	71,172	62,607	74,050	61,870
Due after ten years	133,530	112,231	127,228	95,856
Total held-to-maturity securities	$ 223,479	$ 192,084	$ 223,853	$ 178,012

Available-for-sale securities:				
Debt securities:				
Due in one year or less	$ 751	$ 752	$ 751	$ 749
Due after one year through five years	21,252	18,951	26,100	23,014
Due after five years through ten years	36,879	30,903	34,385	27,976
Due after ten years	146,077	128,327	143,148	114,267
MBS - GSE residential	237,397	201,852	231,099	186,829
Total available-for-sale debt securities	$ 442,356	$ 380,785	$ 435,483	$ 352,835

There was a $52 thousand increase to the carrying value of municipal AFS securities resulting from the interest rate swap that was not included in the maturity table above.

Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without call or prepayment penalty. Agency – GSE and municipal securities are included based on their original stated maturity. MBS – GSE residential, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total. Most of the securities have fixed rates or have predetermined scheduled rate changes and many have call features that allow the issuer to call the security at par before its stated maturity without penalty.

Securities pledged at June September 30, 2023 had a carrying amount of $382.0 million $415.9 million and were pledged to secure public deposits and trust client deposits.

The following table presents the fair value and gross unrealized losses of debt securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of June September 30, 2023 and December 31, 2022:

	Less than 12 months		More than 12 months		Total		Less than 12 months		More than 12 months		Total	
(dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
June 30, 2023												
September 30, 2023												
Agency - GSE	$ -	$ -	$ 98,869	$ (13,100)	$ 98,869	$ (13,100)	$ -	$ -	$ 95,811	$ (16,451)	$ 95,811	$ (16,451)
Obligations of states and political subdivisions	4,137	(252)	267,258	(44,070)	271,395	(44,322)	1,788	(162)	246,419	(67,606)	248,207	(67,768)
MBS - GSE residential	3,605	(193)	198,247	(35,352)	201,852	(35,545)	-	-	186,829	(44,218)	186,829	(44,218)
Total	$ 7,742	$ (445)	$ 564,374	$ (92,522)	$ 572,116	$ (92,967)	$ 1,788	$ (162)	$ 529,059	$ (128,275)	$ 530,847	$ (128,437)
Number of securities	18		419		437		4		433		437	
December 31, 2022												
Agency - GSE	$ 9,285	$ (377)	$ 93,312	$ (13,409)	$ 102,597	$ (13,786)	$ 9,285	$ (377)	$ 93,312	$ (13,409)	$ 102,597	$ (13,786)
Obligations of states and political subdivisions	170,484	(26,928)	112,353	(25,835)	282,837	(52,763)	170,484	(26,928)	112,353	(25,835)	282,837	(52,763)
MBS - GSE residential	61,803	(6,018)	155,632	(31,277)	217,435	(37,295)	61,803	(6,018)	155,632	(31,277)	217,435	(37,295)
Total	$ 241,572	$ (33,323)	$ 361,297	$ (70,521)	$ 602,869	$ (103,844)	$ 241,572	$ (33,323)	$ 361,297	$ (70,521)	$ 602,869	$ (103,844)
Number of securities	272		213		485		272		213		485	

There was a $104 thousand increase to the carrying value of AFS securities resulting from the interest rate swap that increased the unrealized loss position at September 30, 2023 that was not included in the table above.

The Company had 437 debt securities in an unrealized loss position at June September 30, 2023, including 46 agency-GSE securities, 136 135 MBS – GSE residential securities and 255 256 municipal securities. The severity of these unrealized losses based on their underlying cost basis was as follows at June September 30, 2023: 11.70% 14.65% for agency - GSE, 14.97% 19.14% for total MBS-GSE residential; and 14.04% 21.45% for municipals. Management has no intent to sell any securities in an unrealized loss position as of June 30, 2023.

The Company reassessed classification of certain investments and effective April 1, 2022, the Company transferred agency and municipal investment securities with a book value of $245.5 million from available-for-sale to held-to-maturity. The securities were transferred at their amortized cost basis, net of any remaining unrealized gain or loss reported in accumulated other comprehensive income. The market value of the securities on the date of the transfer was $221.7 million, after netting unrealized losses totaling $18.9 million. The $18.9 million, net of deferred taxes, will be accreted into other comprehensive income over the life of the bonds. The allowance for credit losses on these securities was evaluated under the accounting policy for HTM debt securities.

Unrealized losses on available-for-sale securities have not been recognized into income because management believes the cause of the unrealized losses is related to changes in interest rates and is not directly related to credit quality. Quarterly, management conducts a formal review of investment securities to assess whether the fair value of a debt security is less than its amortized cost as of the balance sheet date. An allowance for credit losses has not been recognized on these securities in an unrealized loss position because: (1) the entity does not intend to sell the security; (2) more likely than not the entity will not be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is sufficient to recover the entire amortized cost. The issuer(s) continues to make timely principal and interest payments on the bonds. The fair value is expected to recover as the bond(s) approach maturity.

The Company has U.S. agency bonds and municipal securities classified as held-to-maturity. Management estimated no credit loss reserve will be necessary for agency bonds HTM given the strong credit history of GSE and other U.S. agency issued bonds and the involvement of the U.S. government. For municipal securities HTM, the Company utilized a third-party model to analyze whether a credit loss reserve is needed for these bonds. The amount of credit loss reserve calculated using this model was immaterial to the Company's financial statements, therefore no reserve was recorded, but the Company will continue to evaluate these securities on a quarterly basis.

The Company’s other than temporary impairment (OTTI)/credit impairment losses on debt securities evaluation process also follows the guidance set forth in topics related to debt securities. The guidance set forth in the pronouncements require the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts’ evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value which may be to maturity and other factors when evaluating for the existence of OTTI. credit losses on debt securities. The guidance requires that if OTTI exists, credit losses exist, a contra-asset is recorded for the OTTI on both HTM and AFS securities, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

For all debt securities, as of June September 30, 2023, the Company applied the criteria provided in the recognition and presentation guidance related to OTTI. credit losses on debt securities. That is, management has no intent to sell the securities and nor any conditions were identified by management that, more likely than not, would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI credit losses in the Company’s security portfolio. In addition, management believes the change in fair value is attributable to changes in interest rates.

5. Loans and leases

The classifications of loans and leases at June September 30, 2023 and December 31, 2022 are summarized as follows:

(dollars in thousands)	June 30, 2023	December 31, 2022	September 30, 2023	December 31, 2022
Commercial and industrial:				
Commercial	$ 135,164	$ 141,122	$ 145,185	$ 141,122
Municipal	77,018	72,996	82,058	72,996
Commercial real estate:				
Non-owner occupied	314,838	318,296	311,306	318,296
Owner occupied	294,718	284,677	291,573	284,677
Construction	39,057	24,005	42,773	24,005
Consumer:				

Home equity installment	58,623	59,118	57,856	59,118
Home equity line of credit	52,501	52,568	51,409	52,568
Auto loans - Recourse	11,924	12,929	11,358	12,929
Auto loans - Non-recourse	121,230	114,909	117,266	114,909
Direct finance leases	34,691	33,223	33,902	33,223
Other	13,882	11,709	14,158	11,709
Residential:				
Real estate	429,816	398,136	445,016	398,136
Construction	48,087	42,232	43,337	42,232
Total	1,631,549	1,565,920	1,647,197	1,565,920
Less:				
Allowance for credit losses on loans	(18,350)	(17,149)	(18,757)	(17,149)
Unearned lease revenue	(1,885)	(1,746)	(1,989)	(1,746)
Loans and leases, net	$ 1,611,314	$ 1,547,025	$ 1,626,451	$ 1,547,025

Total unamortized net costs and premiums included in loan totals were as follows:

(dollars in thousands)	**June 30, 2023**	December 31, 2022	**September 30, 2023**	December 31, 2022
Net unamortized fair value mark discount on acquired loans	$ (7,369)	$ (9,064)	$ (6,915)	$ (9,064)
Net unamortized deferred loan origination costs	4,919	4,630	4,926	4,630
Total	$ (2,450)	$ (4,434)	$ (1,989)	$ (4,434)

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Based on the adoption of ASU 2016-13, the Company updated the segmentation of its loan and lease portfolio to ensure that the risk characteristics within these segments were as similar as possible with financial asset type and collateral type as the primary factors used in this evaluation. Consequently, management decided to create a new segment called "Municipal," which are loans and leases to states and political subdivisions in the U.S. based on the unique risk characteristics of this segment as expected credit losses are minimal. Additionally, the previous segment of "Auto Loans", which included direct auto loans, indirect non-recourse auto loans, and indirect recourse auto loans, was broken out between "Auto Loans-Recourse" and "Auto Loans-Non-recourse" as substantially all the recourse portfolio is to a high credit quality dealer with the guaranty of the dealership and high net worth principal. Direct auto loans were included in the "Consumer Other" segment. Additionally, during 2023, the Company analyzed its commercial portfolio to ensure these loans were in the appropriate segment based on their purpose and collateral. Based on this analysis, a total of $25.4 million of commercial and industrial loans were reclassified to other loan segments including: $5.0 million to municipal, $1.4 million to commercial real estate non-owner occupied, $13.9 million to commercial real estate owner occupied, and $5.1 million to commercial real estate construction. The classifications of loans and leases at December 31, 2022 were modified retroactively to enhance comparability between periods.

The Company excludes accrued interest receivable from the amortized cost basis of loans disclosed throughout this footnote. As of June September 30, 2023 and December 31, 2022, accrued interest receivable for loans totaled $4.6 million $5.5 million and $4.5 million, respectively, and is included in accrued interest receivable line in the consolidated balance sheets and is excluded from the estimate of credit losses.

Direct finance leases include the lease receivable and the guaranteed lease residual. Unearned lease revenue represents the difference between the lessor's investment in the property and the gross investment in the lease. Unearned revenue is accrued over the life of the lease using the effective interest method.

The Company services real estate loans for investors in the secondary mortgage market which are not included in the accompanying consolidated balance sheets. The approximate unpaid principal balance of mortgages serviced for others amounted to $469.9 $473.0 million as of June September 30, 2023 and $465.7 million as of December 31, 2022. Mortgage servicing rights amounted to $1.5 million and $1.6 million as of June September 30, 2023 and December 31, 2022, respectively.

Management is responsible for conducting the Company's credit risk evaluation process, which includes credit risk grading of individual commercial and industrial and commercial real estate loans. Commercial and industrial and commercial real estate loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information, and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The Company utilizes an external independent loan review firm that reviews and validates the credit risk program on at least an annual basis. Results of these reviews are presented to management and the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

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Non-accrual loans

Non-accrual loans and loans past due over 89 days still accruing, segregated by class, at June September 30, 2023 and December 31, 2022, were as follows:

(dollars in thousands)	Nonaccrual With No Allowance for Credit Loss	Nonaccrual With Allowance for Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing	Nonaccrual With No Allowance for Credit Loss	Nonaccrual With Allowance for Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing
At June 30, 2023								
At September 30, 2023								
Commercial and industrial:								
Commercial	$ 619	$ 17	$ 636	$ -	$ 40	$ 16	$ 56	$ -
Municipal	-	-	-	-	-	-	-	-
Commercial real estate:								
Non-owner occupied	168	-	168	-	168	-	168	-
Owner occupied	1,841	296	2,137	-	1,859	210	2,069	-
Consumer:								
Home equity installment	54	48	102	-	72	-	72	-
Home equity line of credit	90	-	90	-	90	199	289	-
Auto loans - Recourse	9	-	9	-	8	-	8	12
Auto loans - Non-recourse	39	45	84	-	27	32	59	-
Direct finance leases	-	-	-	47	-	-	-	15
Other	1	-	1	-	-	-	-	-
Residential:								
Real estate	83	183	266	-	284	-	284	248
Total	$ 2,904	$ 589	$ 3,493	$ 47	$ 2,548	$ 457	$ 3,005	$ 275

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(dollars in thousands)	Nonaccrual With No Allowance for Credit Loss	Nonaccrual With Allowance for Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing
At December 31, 2022				
Commercial and industrial:				
Commercial	$ 580	$ 139	$ 719	$ -
Municipal	-	-	-	-
Commercial real estate:				
Non-owner occupied	168	215	383	-
Owner occupied	716	350	1,066	-
Consumer:				
Home equity installment	-	-	-	-
Home equity line of credit	211	-	211	-
Auto loans - Recourse	135	18	153	-
Auto loans - Non-recourse	-	-	-	16
Direct finance leases	-	-	-	17
Other	-	-	-	-

Residential:				
Real estate	3	-	3	-
Total	$ 1,813	$ 722	$ 2,535	$ 33

The decision to place loans on non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. C&I and CRE loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by real estate and residential mortgage loans are placed on non-accrual status at 90 days past due as to principal and interest and unsecured consumer loans are charged-off when the loan is 90 days or more past due as to principal and interest. The Company considers all non-accrual loans to be impaired loans.

Loan modifications to borrowers experiencing financial difficulty

Occasionally, the Company modifies loans to borrowers in financial distress by providing lower interest rates below the market rate, temporary interest-only payment periods, term extensions at interest rates lower than the current market rate for new debt with similar risk and/or converting revolving credit lines to term loans. The Company typically does not forgive principal when modifying loans.

In some cases, the Company provides multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as lowering the interest rate, may be granted. For the loans included in the "combination" columns below, multiple types of modifications have been made on the same loan within the current reporting period.

The following table presents the amortized cost basis of loans at June September 30, 2023 that were both experiencing financial difficulty and modified during the six nine months ended June September 30, 2023, by class and type of modification. The percentage of the amortized cost basis of loans that were modified to borrowers in financial distress as compared to the amortized cost basis of each class of financing receivable is also presented below:

	Loans modified for the six months ended:							Loans modified for the nine months ended:					
(dollars in thousands)	June 30, 2023							September 30, 2023					
	Principal Forgiveness	Payment Delay	Term Extension	Interest Rate Reduction	Combination Term Extension and Principal Forgiveness	Combination Term Extension Interest Rate Reduction	Total Class of Financing Receivable	Principal Forgiveness	Payment Delay	Term Extension	Interest Rate Reduction	Combination Term Extension and Principal Forgiveness	C
Commercial and industrial:													
Commercial	$ -	$ 46	$ -	$ -	$ -	$ -	0.03 %	$ -	$ 46	$ -	$ -	$ -	$
Commercial real estate:													
Non-owner occupied	-	-	915	3,191	-	-	1.30 %	-	-	915	3,131	-	
Owner occupied								-	-	128	-	-	
Total	$ -	$ 46	$ 915	$ 3,191	$ -	$ -		$ -	$ 46	$ 1,043	$ 3,131	$ -	$

The Company has not committed to lend additional amounts to the borrowers included in the previous table.

Loans modified to borrowers experiencing financial difficulty are closely monitored to understand the effectiveness of its modification efforts. None of the loans that have been modified in the last 12 months to borrowers experiencing financial difficulty were past due at June September 30, 2023.

The following table presents the financial effect of the loan modifications presented above to borrowers experiencing financial difficulty for the six nine months ended June September 30, 2023:

(dollars in thousands)	June 30, 2023			September 30, 2023		
	Principal Forgiveness	Weighted-Average Interest Rate Reduction	Weighted-Average Term Extension (Months)	Principal Forgiveness	Weighted-Average Interest Rate Reduction	Weighted-Average Term Extension (Months)
Commercial real estate:						
Non-owner occupied	$ -	6.13 %	8.8	$ -	6.13 %	8.8
Owner occupied				-	-	74.0
Total	$ -	6.13 %	8.8	$ -	6.13 %	82.8

There were no loans that had a payment default during the six nine months ended June September 30, 2023 and were modified in the twelve months prior to that default to borrowers experiencing financial difficulty.

Upon the Company's determination that a modified loan (or portion of a loan) has subsequently been deemed uncollectible, the loan (or a portion of the loan) is written off. Therefore, the amortized cost basis of the loan is reduced by the uncollectible amount and the allowance for credit losses is adjusted by the same amount. The allowance for credit losses (ACL) may be increased, adjustments may be made in the allocation of the ACL or partial charge-offs may be taken to further write-down the carrying value of the loan.

Past due loans

Loans are considered past due when the contractual principal and/or interest is not received by the due date. For loans reported 30-59 days past due, certain categories of loans are reported past due as and when the loan is in arrears for two payments or billing cycles. An aging analysis of past due loans, segregated by class of loans, as of the period indicated is as follows (dollars in thousands):

June 30, 2023 / September 30, 2023	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing
Commercial and industrial:														
Commercial	$ 11	-	636	$ 647	$ 134,517	$ 135,164	$ -	$ 32	37	56	$ 125	$ 145,060	$ 145,185	$ -
Municipal	-	-	-	-	77,018	77,018		-	-	-	-	82,058	82,058	
Commercial real estate:														
Non-owner occupied	91	-	168	259	314,579	314,838	-	129	593	168	890	310,416	311,306	-
Owner occupied	104	-	2,137	2,241	292,477	294,718	-	183	104	2,069	2,356	289,217	291,573	-
Construction	-	-	-	-	39,057	39,057	-	-	-	-	-	42,773	42,773	-
Consumer:														
Home equity installment	136	-	102	238	58,385	58,623	-	158	-	72	230	57,626	57,856	-
Home equity line of credit	172	199	90	461	52,040	52,501	-	74	97	289	460	50,949	51,409	-
Auto loans - Recourse	46	4	9	59	11,865	11,924	-	73	18	20	111	11,247	11,358	12
Auto loans - Non-recourse	90	27	84	201	121,029	121,230	-	325	36	59	420	116,846	117,266	-
Direct finance leases	170	33	47	250	32,556	32,806 **(2)**	47	82	38	15	135	31,778	31,913 **(2)**	15
Other	28	5	1	34	13,848	13,882	-	30	4	-	34	14,124	14,158	-
Residential:														
Real estate	32	-	266	298	429,518	429,816	-	31	-	532	563	444,453	445,016	248

Construction	-	-	-	-	48,087	48,087	-	-	-	-	-	43,337	43,337	-
Total	$ 880	$ 268	$ 3,540	$ 4,688	$ 1,624,976	$ 1,629,664	$ 47	$ 1,117	$ 927	$ 3,280	$ 5,324	$ 1,639,884	$ 1,645,208	$ 275

(1) Includes non-accrual loans. (2) Net of unearned lease revenue of $1.9 $2.0 million. (3) Includes net deferred loan costs of $4.9 million.

December 31, 2022	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing
Commercial and industrial							
Commercial	$ -	$ -	$ 719	$ 719	$ 140,403	$ 141,122	$ -
Municipal	-	-	-	-	72,996	72,996	-
Commercial real estate:							
Non-owner occupied	-	-	383	383	317,913	318,296	-
Owner occupied	42	-	1,066	1,108	283,569	284,677	-
Construction	-	-	-	-	24,005	24,005	-
Consumer:							
Home equity installment	239	-	-	239	58,879	59,118	-
Home equity line of credit	110	151	211	472	52,096	52,568	-
Auto loans - Recourse	152	115	11	278	12,651	12,929	-
Auto loans - Non-recourse	411	86	158	655	114,254	114,909	16
Direct finance leases	186	-	17	203	31,274	31,477 (2)	17
Other	12	7	-	19	11,690	11,709	-
Residential:							
Real estate	-	327	3	330	397,806	398,136	-
Construction	-	-	-	-	42,232	42,232	-
Total	$ 1,152	$ 686	$ 2,568	$ 4,406	$ 1,559,768	$ 1,564,174	$ 33

(1) Includes non-accrual loans. (2) Net of unearned lease revenue of $1.7 million. (3) Includes net deferred loan costs of $4.6 million.

Pre-Adoption of ASC 326 - Impaired loans

For periods prior to the adoption of CECL, loans were considered impaired when, based on current information and events, it was probable that the Company would be unable to collect the payments in accordance with the contractual terms of the loan. Factors considered in determining impairment include payment status, collateral value, and the probability of collecting payments when due. The significance of payment delays and/or shortfalls was determined on a case-by-case basis. All circumstances surrounding the loan were considered. Such factors include the length of the delinquency, the underlying reasons and the borrower’s prior payment record. Impairment was measured on these loans on a loan-by-loan basis. Impaired loans included non-accrual loans, TDRs and other loans deemed to be impaired based on the aforementioned factors.

Impaired loans, segregated by class, as of December 31, 2022 prior to the adoption of CECL are detailed below:

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance
December 31, 2022					
Commercial and industrial	$ 942	$ 139	$ 580	$ 719	$ 48
Commercial real estate:					
Non-owner occupied	762	215	547	762	42
Owner occupied	2,347	1,304	716	2,020	70

Consumer:					
Home equity installment	33	-	-	-	-
Home equity line of credit	255	-	211	211	-
Auto loans	213	18	135	153	1
Residential:					
Real estate	50	-	3	3	-
Total	$ 4,602	$ 1,676	$ 2,192	$ 3,868	$ 161

At December 31, 2022, impaired loans totaled $3.9 million consisting of $1.4 million in accruing TDRs and $2.5 million in non-accrual loans. The non-accrual loans included one TDR totaling $0.2 million as of December 31, 2022.

The following table presents the average recorded investments in impaired loans and related amount of interest income recognized during the periods indicated below. The average balances are calculated based on the quarter-end balances of impaired loans. Payments received from non-accruing impaired loans are first applied against the outstanding principal balance, then to the recovery of any charged-off amounts. Any excess is treated as a recovery of interest income. Payments received from accruing impaired loans are applied to principal and interest, as contractually agreed upon.

In the table below, average recorded investment refers to the five quarter average of impaired loans preceding the reporting period.

	For the six months ended June 30, 2022			For the nine months ended September 30, 2022		
(dollars in thousands)	Average recorded investment	Interest income recognized	Cash basis interest income recognized	Average recorded investment	Interest income recognized	Cash basis interest income recognized
Commercial and industrial	$ 329	$ -	$ -	$ 376	$ -	$ -
Commercial real estate:						
Non-owner occupied	1,958	52	-	1,630	57	-
Owner occupied	2,043	53	-	2,175	78	-
Construction	-	-	-	-	-	-
Consumer:						
Home equity installment	11	-	-	5	-	-
Home equity line of credit	133	-	-	130	7	-
Auto loans	108	3	-	141	4	-
Direct finance leases	-	-	-	-	-	-
Other	-	-	-	-	-	-
Residential:						
Real estate	430	39	-	297	39	-
Construction	-	-	-	-	-	-
Total	$ 5,012	$ 147	$ -	$ 4,754	$ 185	$ -

In the table below, average recorded investment refers to the two quarter average of impaired loans preceding the reporting period.

	For the three months ended June 30, 2022			For the three months ended September 30, 2022		
(dollars in thousands)	Average recorded investment	Interest income recognized	Cash basis interest income recognized	Average recorded investment	Interest income recognized	Cash basis interest income recognized

Commercial and industrial	$ 420	$ -	$ -	$ 709	$ -	$ -
Commercial real estate:						
Non-owner occupied	983	6	-	1,108	5	-
Owner occupied	2,270	27	-	2,262	24	-
Construction	-	-	-	-	-	-
Consumer:						
Home equity installment	2	-	-	-	-	-
Home equity line of credit	169	-	-	143	7	-
Auto loans	188	1	-	203	2	-
Direct finance leases	-	-		-	-	
Other	-	-	-	-	-	-
Residential:						
Real estate	89	14	-	40	-	-
Construction	-	-	-	-	-	-
Total	$ 4,121	$ 48	$ -	$ 4,465	$ 38	$ -

Credit Quality Indicators

Commercial and industrial and commercial real estate

The Company utilizes a loan grading system and assigns a credit risk grade to its loans in the C&I and CRE portfolios. The grading system provides a means to measure portfolio quality and aids in the monitoring of the credit quality of the overall loan portfolio. The credit risk grades are arrived at using a risk rating matrix to assign a grade to each of the loans in the C&I and CRE portfolios.

These loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted.

The following is a description of each risk rating category the Company uses to classify each of its C&I and CRE loans:

Pass

Loans in this category have an acceptable level of risk and are graded in a range of one to five. Secured loans generally have good collateral coverage. Current financial statements reflect acceptable balance sheet ratios, sales and earnings trends. Management is competent, and a reasonable succession plan is evident. Payment experience on the loans has been good with minor or no delinquency experience. Loans with a grade of one are of the highest quality in the range. Those graded five are of marginally acceptable quality.

Special Mention

Loans in this category are graded a six and may be protected but are potentially weak. They constitute a credit risk to the Company but have not yet reached the point of adverse classification. Some of the following conditions may exist: little or no collateral coverage; lack of current financial information; delinquency problems; highly leveraged; available financial information reflects poor balance sheet ratios and profit and loss statements reflect uncertain trends; and document exceptions. Cash flow may not be sufficient to support total debt service requirements.

Substandard

Loans in this category are graded a seven and have a well-defined weakness which may jeopardize the ultimate collectability of the debt. The collateral pledged may be lacking in quality or quantity. Financial statements may indicate insufficient cash flow to service the debt; and/or do not reflect a sound net worth. The payment history indicates chronic delinquency problems. Management is weak. There is a distinct possibility that the Company may sustain a loss. All loans on non-accrual are rated substandard. Other loans that are included in the substandard category can be accruing, as well as loans that are current or past due. Loans 90 days or more past due, unless otherwise fully supported, are classified substandard. Also, borrowers that are bankrupt or have loans categorized as modifications experiencing financial difficulty can be graded substandard.

Doubtful

Loans in this category are graded an eight and have a better than 50% possibility of the Company sustaining a loss, but the loss cannot be determined because of specific reasonable factors which may strengthen credit in the near-term. Many of the weaknesses present in a substandard loan exist. Liquidation of collateral, if any, is likely. Any loan graded lower than an eight is considered to be uncollectible and charged-off.

Consumer and residential

The consumer and residential loan segments are regarded as homogeneous loan pools and as such are not risk rated. For these portfolios, the Company utilizes payment activity and history in assessing performance. Non-performing loans are comprised of non-accrual loans and loans past due 90 days or more and accruing. All loans not classified as non-performing are considered performing.

The following tables present loans including $4.9 million and $4.6 million of deferred costs, segregated by class, categorized into the appropriate credit quality indicator category and based on year of origination as of June September 30, 2023 and December 31, 2022, respectively:

Commercial credit exposure
Credit risk profile by creditworthiness category
As of June September 30, 2023

(dollars in thousands)	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total	2023	2022	2021	2020	2019	
Commercial and industrial															
Risk Rating															
Pass	$ 10,316	$ 21,350	25,623	8,841	8,863	13,049	43,383	$ -	$ 131,425	$ 23,909	$ 20,144	24,131	5,541	7,329	
Special Mention	-	695	342	-	-	72	96	-	1,205	-	656	315	-	-	
Substandard	-	171	16	24	67	295	1,961	-	2,534	-	-	16	21	60	
Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total commercial and industrial	$ 10,316	$ 22,216	$ 25,981	$ 8,865	$ 8,930	$ 13,416	$ 45,440	$ -	$ 135,164	$ 23,909	$ 20,800	$ 24,462	$ 5,562	$ 7,389	$
Commercial and industrial: Current period gross write-offs	$ -	$ -	$ 300	$ 20	$ -	$ -	$ -	$ -	$ 320	$ -	$ -	$ 300	$ 20	$ -	$
Commercial and industrial - municipal															
Risk Rating															
Pass	$ 3,310	$ 20,621	$ 19,175	$ 13,498	$ 1,450	$ 18,964	$ -	$ -	$ 77,018	$ 6,568	$ 21,737	$ 20,129	$ 13,427	$ 1,448	$
Special Mention	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Substandard	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total commercial and industrial - municipal	$ 3,310	$ 20,621	$ 19,175	$ 13,498	$ 1,450	$ 18,964	$ -	$ -	$ 77,018	$ 6,568	$ 21,737	$ 20,129	$ 13,427	$ 1,448	$

Commercial and industrial - municipal:															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Commercial real estate - non-owner occupied															
Risk Rating															
Pass	$ 19,532	$ 36,420	$ 78,793	45,289	17,938	94,378	$ 9,040	$ -	$ 301,390	$ 27,578	$ 36,886	$ 72,377	43,449	17,636	
Special Mention	-	65	1,659	324	493	2,220	-	-	4,761	-	-	1,055	314	-	
Substandard	-	-	478	136	86	7,987	-	-	8,687	-	65	1,069	132	572	
Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total commercial real estate - non-owner occupied	$ 19,532	$ 36,485	$ 80,930	$ 45,749	$ 18,517	$ 104,585	$ 9,040	$ -	$ 314,838	$ 27,578	$ 36,951	$ 74,501	$ 43,895	$ 18,208	$ 1
Commercial real estate - non-owner occupied:															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ 32	$ -	$ -	$ 32	$ -	$ -	$ -	$ -	$ -	$
Commercial real estate - owner occupied															
Risk Rating															
Pass	$ 20,866	54,992	49,403	31,605	26,078	87,995	$ 9,985	$ -	$ 280,924	$ 24,145	54,645	47,959	30,854	25,469	
Special Mention	-	237	611	27	-	306	125	-	1,306	-	203	559	-	-	
Substandard	702	-	331	-	-	10,838	617	-	12,488	698	29	379	28	-	
Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total commercial real estate - owner occupied	$ 21,568	$ 55,229	$ 50,345	$ 31,632	$ 26,078	$ 99,139	$ 10,727	$ -	$ 294,718	$ 24,843	$ 54,877	$ 48,897	$ 30,882	$ 25,469	$
Commercial real estate - owner occupied:															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Commercial real estate - construction															
Risk Rating															
Pass	$ 4,064	$ 28,673	$ 861	$ -	$ -	$ 2,335	$ 3,124	$ -	$ 39,057	$ 7,647	$ 29,960	$ 856	$ -	$ -	$
Special Mention	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Substandard	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Doubtful	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total commercial real estate - construction	$ 4,064	$ 28,673	$ 861	$ -	$ -	$ 2,335	$ 3,124	$ -	$ 39,057	$ 7,647	$ 29,960	$ 856	$ -	$ -	$

Commercial real estate - construction:															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$

Consumer & Mortgage lending credit exposure

Credit risk profile based on payment activity

As of June September 30, 2023

(dollars in thousands)	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total	2023	2022	2021	2020	2019	
Home equity installment															
Payment performance															
Performing	$ 5,192	$ 19,134	$ 10,606	$ 9,386	$ 4,302	$ 9,901	$ -	$ -	$ 58,521	$ 6,836	$ 18,607	$ 10,137	$ 8,759	$ 4,035	$
Non-performing	-	-	-	-	-	102	-	-	102	-	-	-	-	-	
Total home equity installment	$ 5,192	$ 19,134	$ 10,606	$ 9,386	$ 4,302	$ 10,003	$ -	$ -	$ 58,623	$ 6,836	$ 18,607	$ 10,137	$ 8,759	$ 4,035	$
Home equity installment															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Home equity line of credit															
Payment performance															
Performing	$ -	$ -	$ -	$ -	$ -	$ -	$ 41,542	$ 10,869	$ 52,411	$ -	$ -	$ -	$ -	$ -	$
Non-performing	-	-	-	-	-	-	90	-	90	-	-	-	-	-	
Total home equity line of credit	$ -	$ -	$ -	$ -	$ -	$ -	$ 41,632	$ 10,869	$ 52,501	$ -	$ -	$ -	$ -	$ -	$
Home equity line of credit															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Auto loans - recourse															
Payment performance															
Performing	$ 2,034	$ 2,431	$ 3,587	$ 2,451	$ 1,079	$ 333	$ -	$ -	$ 11,915	$ 2,619	$ 2,144	$ 3,188	$ 2,200	$ 938	$

Non-performing	-	-	-	-	-	9	-	-	9	-	12	-	-	-	
Total auto loans - recourse	$ 2,034	$ 2,431	$ 3,587	$ 2,451	$ 1,079	$ 342	$ -	$ -	$ 11,924	$ 2,619	$ 2,156	$ 3,188	$ 2,200	$ 938	$
Auto loans - recourse															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Auto loans - non-recourse															
Payment performance															
Performing	$ 29,298	$ 50,112	$ 21,359	$ 10,670	$ 6,356	$ 3,351	$ -	$ -	$ 121,146	$ 35,313	$ 46,059	$ 19,243	$ 9,358	$ 5,063	$
Non-performing	-	-	-	70	-	14	-	-	84	-	-	4	43	-	
Total auto loans - non-recourse	$ 29,298	$ 50,112	$ 21,359	$ 10,740	$ 6,356	$ 3,365	$ -	$ -	$ 121,230	$ 35,313	$ 46,059	$ 19,247	$ 9,401	$ 5,063	$
Auto loans - non-recourse															
Current period gross write-offs	$ -	$ -	$ 78	$ 17	$ 13	$ -	$ -	$ -	$ 108	$ -	$ 1	$ 82	$ 22	$ 15	$
Direct finance leases (1)															
Payment performance															
Performing	$ 7,103	$ 13,310	$ 9,036	$ 2,997	$ 266	$ 47	$ -	$ -	$ 32,759	$ 9,437	$ 12,092	$ 8,023	$ 2,115	$ 187	$
Non-performing	-	31	16	-	-	-	-	-	47	-	-	15	-	-	
Total direct finance leases	$ 7,103	$ 13,341	$ 9,052	$ 2,997	$ 266	$ 47	$ -	$ -	$ 32,806	$ 9,437	$ 12,092	$ 8,038	$ 2,115	$ 187	$
Direct finance leases															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Consumer - other															
Payment performance															
Performing	$ 3,686	$ 4,003	$ 2,228	$ 899	$ 634	$ 1,029	$ 1,402	$ -	$ 13,881	$ 4,883	$ 3,538	$ 2,096	$ 804	$ 645	$
Non-performing	-	-	-	-	-	1	-	-	1	-	-	-	-	-	
Total consumer - other	$ 3,686	$ 4,003	$ 2,228	$ 899	$ 634	$ 1,030	$ 1,402	$ -	$ 13,882	$ 4,883	$ 3,538	$ 2,096	$ 804	$ 645	$
Consumer - other															
Current period gross write-offs	$ 49	$ 53	$ 6	$ 5	$ 11	$ 13	$ -	$ -	$ 137	$ 85	$ 63	$ 13	$ 6	$ 14	$

Residential real estate															
Payment performance															
Performing	$ 29,359	$ 62,556	$ 136,270	$ 52,384	$ 31,128	$ 117,853	$ -	$ -	$ 429,550	$ 39,366	$ 71,782	$ 137,254	$ 51,726	$ 30,161	$
Non-performing	-	-	-	-	-	266	-	-	266	248	-	-	-	-	
Total residential real estate	$ 29,359	$ 62,556	$ 136,270	$ 52,384	$ 31,128	$ 118,119	$ -	$ -	$ 429,816	$ 39,614	$ 71,782	$ 137,254	$ 51,726	$ 30,161	$
Residential real estate															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$
Residential - construction															
Payment performance															
Performing	$ 2,227	$ 28,031	$ 12,749	$ 4,218	$ 422	$ 440	$ -	$ -	$ 48,087	$ 6,554	$ 21,488	$ 11,050	$ 3,460	$ 349	$
Non-performing	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Total residential - construction	$ 2,227	$ 28,031	$ 12,749	$ 4,218	$ 422	$ 440	$ -	$ -	$ 48,087	$ 6,554	$ 21,488	$ 11,050	$ 3,460	$ 349	$
Residential - construction															
Current period gross write-offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$

(1) Net of unearned lease revenue of $1.9 million. $2.0 million.

Commercial credit exposure

Credit risk profile by creditworthiness category

	December 31, 2022				
(dollars in thousands)	Pass	Special mention	Substandard	Doubtful	Total
Commercial and industrial	$ 231,614	$ 229	$ 2,635	$ -	$ 234,478
Commercial real estate - non-owner occupied	301,386	4,227	11,254	-	316,867
Commercial real estate - owner occupied	255,921	803	14,086	-	270,810
Commercial real estate - construction	18,941	-	-	-	18,941
Total commercial	$ 807,862	$ 5,259	$ 27,975	$ -	$ 841,096

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Consumer & Mortgage lending credit exposure

Credit risk profile based on payment activity

	December 31, 2022		
(dollars in thousands)	Performing	Non-performing	Total

Consumer			
Home equity installment	$ 59,118	$ -	$ 59,118
Home equity line of credit	52,357	211	52,568
Auto loans	131,767	169	131,936
Direct finance leases (2)	31,460	17	31,477
Other	7,611	-	7,611
Total consumer	282,313	397	282,710
Residential			
Real estate	398,133	3	398,136
Construction	42,232	-	42,232
Total residential	440,365	3	440,368
Total consumer & residential	$ 722,678	$ 400	$ 723,078

(2) Net of unearned lease revenue of $1.7 million.

Collateral dependent loans

Loans that do not share risk characteristics are evaluated on an individual basis. For loans that are individually evaluated and collateral dependent, financial loans where we have determined that foreclosure of the collateral is probable, or where the borrower is experiencing financial difficulty and we expect repayment of the financial asset to be provided substantially through the operation or sale of the collateral, the ACL is measured based on the difference between the fair value of the collateral and the amortized cost basis of the asset as of the measurement date. The following table presents the individually evaluated, collateral dependent loans as of June September 30, 2023:

(dollars in thousands)	Real Estate	Other	Total Collateral-Dependent Non-Accrual Loans	Real Estate	Other	Total Collateral-Dependent Non-Accrual Loans
At June 30, 2023						
At September 30, 2023						
Commercial and industrial:						
Commercial	$ -	$ 636	$ 636	$ -	$ 56	$ 56
Municipal	-	-	-	-	-	-
Commercial real estate:						
Non-owner occupied	167	-	167	168	-	168
Owner occupied	2,138	-	2,138	2,069	-	2,069
Consumer:						
Home equity installment	102	-	102	72	-	72
Home equity line of credit	90	-	90	289	-	289
Auto loans - Recourse	-	9	9	-	8	8
Auto loans - Non-recourse	-	84	84	-	59	59
Direct finance leases	-	-	-	-	-	-
Other	-	1	1	-	-	-
Residential:						
Real estate	266	-	266	284	-	284
Total	$ 2,763	$ 730	$ 3,493	$ 2,882	$ 123	$ 3,005

Allowance for credit losses

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for credit losses (ACL) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. When estimating the net amount expected to be collected, management considers the effects of past events, current conditions, and reasonable and supportable forecasts of the collectability of the Company's financial assets. Those estimates may be susceptible to significant change. Credit losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

The methodology to analyze the adequacy of the ACL is based on seven primary components:

- **Data:** The quality of the Company's data is critically important as a foundation on which the ACL estimate is generated. For its estimate, the Company uses both internal and external data with a preference toward internal data where possible. Data is complete, accurate, and relevant, and subjected to appropriate governance and controls.
- **Segmentation:** Financial assets are segmented based on similar risk characteristics.
- **Contractual term of financial assets:** The contractual term of financial assets is a significant driver of ACL estimates. Financial assets or pools of financial assets with shorter contractual maturities typically result in a lower reserve than those with longer contractual maturities. As the average life of a financial asset or pool of assets increases, there generally is a corresponding increase to the ACL estimate because the likelihood of default is considered over a longer time frame. As such, pool-based assumptions for a pool's contractual term (i.e., average life) are based on the contractual maturity of the financial assets within the pool and adjusted in accordance with GAAP, if appropriate.
- **Credit loss measurement method:** Multiple measurement methods for estimating ACLs are allowable per ASC Topic 326. The Company applies different estimation methods to different groups of financial assets. The discounted cash flow method is used for the Commercial & Industrial, Commercial Real Estate Non Owner Non-Owner Occupied, Commercial Real Estate Owner Occupied, Commercial Construction, Home Equity Installment Loan, Home Equity Line of Credit, Residential Real Estate, and Residential Construction pools. The weighted average remaining maturity (WARM) method is used for the Municipal, Non-Recourse Auto, Recourse Auto, Direct Finance Lease, and Consumer Other pools.
- **Reasonable and supportable forecasts:** ASC Topic 326 requires Management to consider reasonable and supportable forecasts that affect expected collectability of financial assets. As such, the Company's forecasts incorporate anticipated changes in the economic environment that may affect credit loss estimates over a time horizon when Management can reasonably support and document expectations. Forward-looking information may reflect positive or negative expectations relative to the current environment. As of the reporting date, management is using the median Federal Open Market Committee (FOMC) National Gross Domestic Product (GDP) and Unemployment Rate forecasts as well as the Federal Housing Finance Agency (FHFA) House Price Index (HPI) for its reasonable and supportable forecasts. The Company currently uses a 12 month (4 quarter) reasonable and supportable forecast period.
- **Reversion period:** ASC Topic 326 does not require Management to estimate a reasonable and supportable forecast for the entire contractual life of financial assets. Management may apply reversion techniques for the contractual life remaining after considering the reasonable and supportable forecast period, which allows Management to apply a historical loss rate to latter periods of the financial asset's life. The Company currently uses a 12 month (4 quarter) straight-line reversion period.
- **Qualitative factor adjustments:** The Company's ACL estimate considers all significant factors relevant to the expected collectability of its financial assets as of the reporting date; Qualitative factors reflect the impact of conditions not captured elsewhere, such as the historical loss data or within the economic forecast. The qualitative considerations can be captured directly within measurement models or as additional components in the overall ACL methodologies. Currently, the Company uses the following qualitative factors:

  - levels of and trends in delinquencies and non-accrual loans;
  - levels of and trends in charge-offs and recoveries;
  - trends in volume and terms of loans;
  - changes in risk selection and underwriting standards;
  - changes in lending policies and legal and regulatory requirements;
  - experience, ability and depth of lending management;
  - national and local economic trends and conditions;
  - changes in credit concentrations; and
  - changes in underlying collateral.

Assets are evaluated on a collective (or pool) basis or individually, as applicable consistent with ASC Topic 326. In accordance with ASC Topic 326, the Company will evaluate individual instruments for expected credit losses when those instruments do not share similar risk characteristics with instruments evaluated using a collective (pooled) basis. In contrast to legacy accounting standards, this criterion is broader than the "impairment" concept as management may evaluate assets individually even when no specific expectation of collectability is in place. Instruments will not be included in both collective and individual analysis. Individual analysis will establish a specific reserve for instruments in scope.

For individually evaluated assets, an ACL is determined separately for each financial asset. Management therefore measures the expected credit losses based on an appropriate method per ASC Subtopic 326-20, similar to collectively evaluated financial assets. As of the reporting date, the Company is using the collateral and cash flow methods.

ASC Topic 326 defines a collateral-dependent asset as a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower, based on Management's assessment, is experiencing financial difficulty. The ACL for a collateral-dependent loan is measured using the fair value of collateral, regardless of whether foreclosure is probable. The fair value of collateral must be adjusted for estimated costs to sell if repayment or satisfaction of the asset depends on the sale of the collateral. If repayment is dependent only on the operation of the collateral, and not on the sale of the collateral, the fair value of the collateral would not be adjusted for estimated costs to sell. If the fair value of the collateral, adjusted for costs to sell if applicable, is less than the amortized cost basis of the collateral-dependent asset, the difference is recorded as an ACL.

The Company's policy is to charge-off unsecured consumer loans when they become 90 days or more past due as to principal and interest. In the other portfolio segments, amounts are charged-off at the point in time when the Company deems the balance, or a portion thereof, to be uncollectible.

If the individually evaluated asset is determined to not be collateral dependent, the ACL is measured based on the expected cash flows. This measurement is based on the amount and timing of cash flows; the effective interest rate (EIR) used to discount the cash flows; and the basis for the determination of cash flows, including consideration of past events, current conditions, and reasonable and supportable forecasts about the future. These cash flows are discounted back by the EIR and compared to the amortized cost basis of the asset. If the present value of cash flows is less than the amortized cost, an ACL is recorded. When the present value of cash flows is equal to or greater than the amortized cost, no ACL is recorded.

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

A key control related to the allowance is the Company's Special Assets Committee. This committee meets quarterly, and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount, if applicable, based on current accounting guidance. The Special Assets Committee's focus is on ensuring the pertinent facts are considered regarding not only loans considered for specific reserves, but also the collectability of loans that may be past due in payment. The assessment process also includes the review of all loans on a non-accruing basis as well as a review of certain loans to which the lenders or the Company's Credit Administration function have assigned a criticized or classified risk rating.

Information related to the change in the allowance and the Company's recorded investment in loans by portfolio segment as of the period indicated is as follows:

As of and for the six months ended June 30, 2023 **As of and for the nine months ended September 30, 2023**							**As of and for the nine months ended September 30, 2023**					
(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Credit Losses:												
Beginning balance	$ 2,924	$ 7,162	$ 2,827	$ 4,169	$ 67	$ 17,149	$ 2,924	$ 7,162	$ 2,827	$ 4,169	$ 67	$ 17,149
Impact of adopting ASC 326	278	756	(547)	198	(67)	618	278	756	(547)	198	(67)	618
Initial allowance on loans purchased with credit deterioration	-	126	-	-	-	126	-	126	-	-	-	126
Charge-offs	(320)	(32)	(245)	-	-	(597)	(320)	(92)	(349)	-	-	(761)
Recoveries	22	41	126	10	-	199	23	44	148	30	-	245
Provision (credit) for loan losses	(543)	525	353	470	50	855	(1,039)	803	56	1,536	24	1,380
Ending balance	$ 2,361	$ 8,578	$ 2,514	$ 4,847	$ 50	$ 18,350	$ 1,866	$ 8,799	$ 2,135	$ 5,933	$ 24	$ 18,757
Ending balance: individually evaluated	$ 16	$ 219	$ 56	$ 4	$ -	$ 295	$ 16	$ 159	$ 52	$ 1	$ -	$ 228
Ending balance: collectively evaluated	$ 2,345	$ 8,359	$ 2,458	$ 4,843	$ 50	$ 18,055	$ 1,850	$ 8,640	$ 2,083	$ 5,932	$ 24	$ 18,529
Loans Receivables:												

Ending balance (2)	$ 212,182	$ 648,613	$ 290,966 (1)	$ 477,903	$ -	$ 1,629,664	$ 227,243	$ 645,652	$ 283,960 (1)	$ 488,353	$ -	$ 1,645,208
Ending balance: individually evaluated	$ 668	$ 7,000	$ 286	$ 609	$ -	$ 8,563	$ 86	$ 6,536	$ 429	$ 624	$ -	$ 7,675
Ending balance: collectively evaluated	$ 211,514	$ 641,613	$ 290,680	$ 477,294	$ -	$ 1,621,101	$ 227,157	$ 639,116	$ 283,531	$ 487,729	$ -	$ 1,637,533

(1) Net of unearned lease revenue of $1.9 million. $2.0 million. (2) Includes $4.9 million of net deferred loan costs.

As of and for the three months ended June 30, 2023

As of and for the three months ended September 30, 2023							**As of and for the three months ended September 30, 2023**					
(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:												
Beginning balance	$ 2,550	$ 8,157	$ 2,448	$ 4,683	$ 72	$ 17,910	$ 2,361	$ 8,578	$ 2,514	$ 4,847	$ 50	$ 18,350
Charge-offs	(150)	-	(143)	-	-	(293)	-	(59)	(105)	-	-	(164)
Recoveries	1	2	55	-	-	58	1	3	22	20	-	46
Provision	(40)	419	154	164	(22)	675	(496)	277	(296)	1,066	(26)	525
Ending balance	$ 2,361	$ 8,578	$ 2,514	$ 4,847	$ 50	$ 18,350	$ 1,866	$ 8,799	$ 2,135	$ 5,933	$ 24	$ 18,757

As of and for the year ended December 31, 2022

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 2,204	$ 7,422	$ 2,404	$ 3,508	$ 86	$ 15,624
Charge-offs	(371)	(67)	(377)	-	-	(815)
Recoveries	11	153	74	2	-	240
Provision	1,080	(346)	726	659	(19)	2,100
Ending balance	$ 2,924	$ 7,162	$ 2,827	$ 4,169	$ 67	$ 17,149
Ending balance: individually evaluated for impairment	$ 48	$ 112	$ 1	$ -	$ -	$ 161
Ending balance: collectively evaluated for impairment	$ 2,876	$ 7,050	$ 2,826	$ 4,169	$ 67	$ 16,988
Loans Receivables:						
Ending balance (2)	$ 234,478	$ 606,618	$ 282,710 (1)	$ 440,368	$ -	$ 1,564,174
Ending balance: individually evaluated for impairment	$ 719	$ 2,782	$ 364	$ 3	$ -	$ 3,868
Ending balance: collectively evaluated for impairment	$ 233,759	$ 603,836	$ 282,346	$ 440,365	$ -	$ 1,560,306

(1) Net of unearned lease revenue of $1.7 million. (2) Includes $4.6 million of net deferred loan costs.

As of and for the six months ended June 30, 2022

As of and for the nine months ended September 30, 2022	As of and for the nine months ended September 30, 2022

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:												
Beginning balance	$ 2,204	$ 7,422	$ 2,404	$ 3,508	$ 86	$ 15,624	$ 2,204	$ 7,422	$ 2,404	$ 3,508	$ 86	$ 15,624
Charge-offs	(31)	(1)	(136)	-	-	(168)	(323)	(1)	(226)	-	-	(550)
Recoveries	4	28	50	2	-	84	8	61	59	2	-	130
Provision	568	(486)	452	527	(11)	1,050	785	(320)	604	512	(6)	1,575
Ending balance	$ 2,745	$ 6,963	$ 2,770	$ 4,037	$ 75	$ 16,590	$ 2,674	$ 7,162	$ 2,841	$ 4,022	$ 80	$ 16,779

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As of and for the three months ended June 30, 2022												
As of and for the three months ended September 30, 2022							As of and for the three months ended September 30, 2022					
(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:												
Beginning balance	$ 2,780	$ 6,822	$ 2,547	$ 3,851	$ 81	$ 16,081	$ 2,745	$ 6,963	$ 2,770	$ 4,037	$ 75	$ 16,590
Charge-offs	(31)	-	(42)	-	-	(73)	(291)	-	(91)	-	-	(382)
Recoveries	2	19	36	-	-	57	5	33	8	-	-	46
Provision	(6)	122	229	186	(6)	525	215	166	154	(15)	5	525
Ending balance	$ 2,745	$ 6,963	$ 2,770	$ 4,037	$ 75	$ 16,590	$ 2,674	$ 7,162	$ 2,841	$ 4,022	$ 80	$ 16,779

Unfunded commitments

In accordance with ASC Topic 326, the Company estimates expected credit losses for off-balance-sheet credit exposures over the contractual period during which the Company is exposed to credit risk. The estimate of expected credit losses takes into consideration the likelihood that funding will occur (i.e., funding rate) as well as the amount expected to be collected over the estimated remaining contractual term of the off-balance-sheet credit exposures (i.e., loss rate). The Company does not record an estimate of expected credit losses for off-balance-sheet exposures that are unconditionally cancellable. On a quarterly basis, Management evaluates expected credit losses for off-balance-sheet credit exposures.

The Company's allowance for credit losses on unfunded commitments is recognized as a liability on the consolidated balance sheets, with adjustments to the reserve recognized in the provision for credit losses on unfunded commitments on the consolidated statements of income. The Company's activity in the allowance for credit losses on unfunded commitments for the period was as follows:

(dollars in thousands)	For the Six Months Ended June 30, 2023	For the Six Months Ended June 30, 2022	For the Nine Months Ended September 30, 2023	For the Nine Months Ended September 30, 2022
Beginning balance	$ 49	$ 63	$ 49	$ 63
Impact of adopting ASC 326	1,060	-	1,060	-
Provision (credit) for loan losses	175	(18)	(100)	(24)
Ending balance	$ 1,284	$ 45	$ 1,009	$ 39

Direct finance leases

The Company originates direct finance leases through two automobile dealerships. The carrying amount of the Company's lease receivables, net of unearned income, was $6.9 million $6.4 million and $7.9 million as of June September 30, 2023 and December 31, 2022, respectively. The residual value of the direct finance leases is fully guaranteed by the dealerships. Residual values amounted to $25.6 $25.2 million and $23.6 million at June September 30, 2023 and December 31, 2022, respectively, and are included in the carrying value of direct finance leases. As of June September 30, 2023, there was also $242 $317 thousand in deferred lease expense included in the carrying value of direct finance leases that is not included in the table below.

The undiscounted cash flows to be received on an annual basis for the direct finance leases are as follows:

(dollars in thousands)	Amount	Amount
2023	$ 6,253	$ 3,148
2024	12,652	12,851
2025	11,351	11,734
2026	3,657	5,084
2027	485	716
2028 and thereafter	51	52
Total future minimum lease payments receivable	34,449	33,585
Less: Unearned income	(1,885)	(1,989)
Undiscounted cash flows to be received	$ 32,564	$ 31,596

6. Earnings per share

Basic earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but also reflects the potential dilution that could occur from the grant of stock-based compensation awards. The Company maintains one active share-based compensation plan that may generate additional potentially dilutive common shares. For granted and unexercised stock-settled stock appreciation rights (SSARs), dilution would occur if Company-issued SSARs were exercised and converted into common stock. As of the three and six nine months ended June September 30, 2023, there were 17,725 11,297 and 18,983 16,469 potentially dilutive shares related to issued and unexercised SSARs compared to 17,094 17,996 and 20,406 19,636 for the same 2022 periods, respectively. The calculation did not include 46,423 weighted average unexercised SSARs that could potentially dilute earnings per share but their effect was antidilutive as of the three and six nine months ended June September 30, 2023. For restricted stock, dilution would occur from the Company's previously granted but unvested shares. There were 15,978 26,406 and 18,882 21,094 potentially dilutive shares related to unvested restricted share grants as of the three and six nine months ended June September 30, 2023 compared to 10,360 13,404 and 12,042 12,360 for the same 2022 periods, respectively. The calculation did not include 43,177 and 23,726 615 weighted average unvested restricted shares that could potentially dilute earnings per share but their effect was antidilutive as of the three and six nine months ended June September 30, 2023.

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In the computation of diluted EPS, the Company uses the treasury stock method to determine the dilutive effect of its granted but unexercised stock options and SSARs and unvested restricted stock. Under the treasury stock method, the assumed proceeds, as defined, received from shares issued in a hypothetical stock option exercise or restricted stock grant, are assumed to be used to purchase treasury stock. Proceeds include amounts received from the exercise of outstanding stock options and compensation cost for future service that the Company has not yet recognized in earnings. The Company does not consider awards from share-based grants in the computation of basic EPS.

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The following table illustrates the data used in computing basic and diluted EPS for the periods indicated:

	Three months ended June 30,		Six months ended June 30,		Three months ended September 30,		Nine months ended September 30,	
	2023	2022	**2023**	2022	**2023**	2022	**2023**	2022
(dollars in thousands except per share data)								
Basic EPS:								
Net income available to common shareholders	$ 5,362	$ 7,664	$ 12,402	$ 15,187	$ 5,340	$ 7,689	$ 17,742	$ 22,875
Weighted-average common shares outstanding	5,670,769	5,658,854	5,660,255	5,657,033	5,687,553	5,634,182	5,669,454	5,649,332
Basic EPS	$ 0.95	$ 1.35	$ 2.19	$ 2.68	$ 0.94	$ 1.36	$ 3.13	$ 4.05

Diluted EPS:								
Net income available to common shareholders	$ 5,362	$ 7,664	$ 12,402	$ 15,187	$ 5,340	$ 7,689	$ 17,742	$ 22,875
Weighted-average common shares outstanding	5,670,769	5,658,854	5,660,255	5,657,033	5,687,553	5,634,182	5,669,454	5,649,332
Potentially dilutive common shares	33,703	27,454	37,865	32,448	37,703	31,400	37,563	31,996
Weighted-average common and potentially dilutive shares outstanding	5,704,472	5,686,308	5,698,120	5,689,481	5,725,256	5,665,582	5,707,017	5,681,328
Diluted EPS	$ 0.94	$ 1.35	$ 2.18	$ 2.67	$ 0.93	$ 1.36	$ 3.11	$ 4.03

7. Stock plans

The Company has one stock-based compensation plan (the stock compensation plan) from which it can grant stock-based compensation awards and applies the fair value method of accounting for stock-based compensation provided under current accounting guidance. The guidelines require the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. The Company's stock compensation plan was shareholder-approved and permits the grant of share-based compensation awards to its employees and directors. The Company believes that the stock-based compensation plan will advance the development, growth and financial condition of the Company by providing incentives through participation in the appreciation in the value of the Company's common stock. In return, the Company hopes to secure, retain and motivate the employees and directors who are responsible for the operation and the management of the affairs of the Company by aligning the interest of its employees and directors with the interest of its shareholders. In the stock compensation plan, employees and directors are eligible to be awarded stock-based compensation grants which can consist of stock options (qualified and non-qualified), stock appreciation rights (SARs) and restricted stock.

At the 2022 annual shareholders' meeting, the Company's shareholders approved and the Company adopted the 2022 Omnibus Stock Incentive Plan which replaced the 2012 Omnibus Stock Incentive Plan and the 2012 Director Stock Incentive Plan (collectively, the 2012 stock incentive plans). The 2012 stock incentive plans expired in 2022. Unless terminated by the Company's board of directors, the 2022 Omnibus Stock Incentive Plan will expire on and no stock-based awards shall be granted after the year 2032.

In the 2022 Omnibus Stock Incentive Plan, the Company has reserved 500,000 shares of its no-par common stock for future issuance. The Company recognizes share-based compensation expense over the requisite service or vesting period. Since 2019, the Company has approved a Long-Term Incentive Plan (LTIP) each year that awarded restricted stock and/or stock-settled stock appreciation rights (SSARs) to senior officers and managers based on the attainment of performance goals. The SSAR awards have a ten-year term from the date of each grant.

During the first quarter of 2023, the Company approved a LTIP and awarded restricted stock to senior officers and managers in February 2023 based on 2022 performance. During the second quarter of 2023, the Company awarded 1,000 shares of restricted stock to one new employee.

During the first quarter of 2022, the Company approved a LTIP and awarded restricted stock to senior officers and managers in February 2022 based on 2021 performance.

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The following table summarizes the weighted-average fair value and vesting of restricted stock grants awarded during the periods ended June September 30, 2023 and 2022 under the 2022 and 2012 stock incentive plans:

	June 30, 2023		June 30, 2022		**September 30, 2023**		September 30, 2022	
	Shares granted	**Weighted-average grant date fair value**	**Shares granted**	**Weighted-average grant date fair value**	**Shares granted**	**Weighted-average grant date fair value**	**Shares granted**	**Weighted-average grant date fair value**
Director plan	-	$ -	18,000 (2)	$ 49.85	-	$ -	18,000 (2)	$ 49.85
Omnibus plan	18,000 (2)	49.43	16,520 (3)	49.85	18,000 (2)	49.43	16,520 (3)	49.85
Omnibus plan	17,684 (3)	49.43	50 (1)	35.91	17,684 (3)	49.43	50 (1)	35.91
Omnibus plan	50 (1)	49.43	-	-	50 (1)	49.43	-	-
Omnibus plan	1,000 (3)	44.06	-	-	1,000 (3)	44.06	-	-
Total	36,734	$ 49.28	34,570	$ 49.83	36,734	$ 49.28	34,570	$ 49.83

(1) Vest after 1 year (2) Vest after 3 years – 33% each year (3) Vest fully after 3 years

The fair value of the shares granted in 2023 and 2022 was calculated using the grant date closing stock price.

A summary of the status of the Company's non-vested restricted stock as of and changes during the period indicated are presented in the following table:

	2012 & 2022 Stock incentive plans				2012 & 2022 Stock incentive plans			
	Director	Omnibus	Total	Weighted-average grant date fair value	Director	Omnibus	Total	Weighted-average grant date fair value
Non-vested balance at December 31, 2022	23,872	38,614	62,486	$ 51.46	23,872	38,614	62,486	$ 51.46
Granted	-	36,734	36,734	49.28	-	36,734	36,734	49.28
Forfeited	-	-	-	-	-	-	-	-
Vested	(11,353)	(12,930)	(24,283)	52.57	(11,353)	(13,089)	(24,442)	52.57
Non-vested balance at June 30, 2023	12,519	62,418	74,937	$ 50.04				
Non-vested balance at September 30, 2023					12,519	62,259	74,778	$ 50.03

A summary of the status of the Company's SSARs as of and changes during the period indicated are presented in the following table:

	Awards	Weighted-average grant date fair value	Weighted-average remaining contractual term (years)	Awards	Weighted-average grant date fair value	Weighted-average remaining contractual term (years)
Outstanding December 31, 2022	87,133	$ 9.69	4.5	87,133	$ 9.69	4.5
Granted	-			-		
Exercised	(7,665)			(22,807)		
Forfeited	-			-		
Outstanding June 30, 2023	79,468	$ 10.18	4.1			
Outstanding September 30, 2023				64,326	$ 11.59	4.1

Of the SSARs outstanding at June September 30, 2023, all SSARs vested and were exercisable.

During the first halfnine months of 2023, there were 7,665 22,807 SSARs exercised. The intrinsic value recorded for these SSARs was $35,370. $99,072. The tax deduction realized from the exercise of these SSARs was $149,886 $495,300 resulting in a tax benefit of $31,476. $104,013. There were no SSARs exercised during the first halfnine months of 2022.

Share-based compensation expense is included as a component of salaries and employee benefits in the consolidated statements of income. The following tables illustrate stock-based compensation expense recognized on non-vested equity awards during the three and six nine months ended June September 30, 2023 and 2022 and the unrecognized stock-based compensation expense as of June September 30, 2023:

	Three months ended June 30,		Six months ended June 30,		Three months ended September 30,		Nine months ended September 30,	
(dollars in thousands)	**2023**	2022	**2023**	2022	**2023**	2022	**2023**	2022
Stock-based compensation expense:								
2012 Director stock incentive plan	$ 173	$ 263	$ 287	$ 372	$ 99	$ 126	$ 385	$ 497
2012 Omnibus stock incentive plan	118	150	259	315	119	132	378	447
2022 Omnibus stock incentive plan	227	-	383	-	140	-	524	1

Employee stock purchase plan	-	-	34	32	-	-	34	32
Total stock-based compensation expense	$ 518	$ 413	$ 963	$ 719	$ 358	$ 258	$ 1,321	$ 977

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(dollars in thousands)	As of June 30, 2023	As of September 30, 2023
Unrecognized stock-based compensation expense:		
2012 Director stock incentive plan	$ 486	$ 388
2012 Omnibus stock incentive plan	552	433
2022 Omnibus stock incentive plan	1,428	1,287
Total unrecognized stock-based compensation expense	$ 2,466	$ 2,108

The unrecognized stock-based compensation expense as of June September 30, 2023 will be recognized ratably over the periods ended February 2025, February 2025 and June 2026 for the 2012 Director Stock Incentive Plan, 2012 Omnibus Stock Incentive Plan and 2022 Omnibus Stock Incentive Plan, respectively.

In addition to the 2022 stock incentive plan, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 165,000 shares of its un-issued capital stock for issuance under the plan. The ESPP was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, participation is voluntary whereby employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement or termination dates, as defined. As of June September 30, 2023,101,827 shares have been issued under the ESPP. The ESPP is considered a compensatory plan and is required to comply with the provisions of current accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased, and it is included as a component of salaries and employee benefits in the consolidated statements of income.

During the second quarter of 2022, the Company announced that the Board of Directors approved a plan to purchase, in open market and privately negotiated transactions, up to 3% of its outstanding common stock. As of June September 30, 2023, the Company had repurchased 32,554 shares of common stock at an average price of $38.81 under the treasury stock repurchase plan.

8. Fair value measurements

The accounting guidelines establish a framework for measuring and disclosing information about fair value measurements. The guidelines of fair value reporting instituted a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - inputs are quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 - inputs are unobservable and are based on the Company's own assumptions to measure assets and liabilities at fair value. Level 3 pricing for securities may also include unobservable inputs based upon broker-traded transactions.

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company uses fair value to measure certain assets and, if necessary, liabilities on a recurring basis when fair value is the primary measure for accounting. Thus, the Company uses fair value for AFS securities. Fair value is used on a non-recurring basis to measure certain assets when adjusting carrying values to market values, such as impaired loans, other real estate owned (ORE) and other repossessed assets.

The following table represents the carrying amount and estimated fair value of the Company's financial instruments as of the periods indicated:

	June 30, 2023							
September 30, 2023					September 30, 2023			
		Quoted prices in active	Significant other	Significant other		Quoted prices in active	Significant other	Significant other

(dollars in thousands)	Carrying amount	Estimated fair value	markets (Level 1)	observable inputs (Level 2)	unobservable inputs (Level 3)	Carrying amount	Estimated fair value	markets (Level 1)	observable inputs (Level 2)	unobservable inputs (Level 3)
Financial assets:										
Cash and cash equivalents	$ 69,632	$ 69,632	$ 69,632	$ -	$ -	$ 110,471	$ 110,471	$ 110,471	$ -	$ -
Held-to-maturity securities	223,479	192,084	-	192,084	-	223,853	178,012	-	178,012	-
Available-for-sale debt securities	380,785	380,785	-	380,785	-	352,835	352,835	-	352,835	-
Restricted investments in bank stock	3,728	3,728	-	3,728	-	3,800	3,800	-	3,800	-
Loans and leases, net	1,611,314	1,476,610	-	-	1,476,610	1,626,451	1,477,587	-	-	1,477,587
Loans held-for-sale	1,808	1,851	-	1,851	-	2,345	2,354	-	2,354	-
Accrued interest receivable	8,343	8,343	-	8,343	-	8,758	8,758	-	8,758	-
Interest rate swaps	203	203	-	203	-	269	269	-	269	-
Financial liabilities:										
Deposits with no stated maturities	1,971,520	1,971,520	-	1,971,520	-	1,948,922	1,948,922	-	1,948,922	-
Time deposits	180,472	176,501	-	176,501	-	202,837	199,057	-	199,057	-
Short-term borrowings	76,111	76,114	-	76,114	-	124,000	124,011	-	124,011	-
Secured borrowings	7,498	7,632	-	-	7,632	7,439	7,325	-	-	7,325
Accrued interest payable	1,378	1,378	-	1,378	-	2,229	2,229	-	2,229	-
Interest rate swaps	203	203	-	203	-	374	374	-	374	-

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	December 31, 2022				
(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	$ 29,091	$ 29,091	$ 29,091	$ -	$ -
Held-to-maturity securities	222,744	187,280	-	187,280	-
Available-for-sale debt securities	420,862	420,862	-	420,862	-
Restricted investments in bank stock	5,268	5,268	-	5,268	-
Loans and leases, net	1,547,025	1,440,151	-	-	1,440,151
Loans held-for-sale	1,637	1,660	-	1,660	-
Accrued interest receivable	8,487	8,487	-	8,487	-
Interest rate swaps	213	213	-	213	-
Financial liabilities:					
Deposits with no stated maturities	2,049,689	2,049,689	-	2,049,689	-
Time deposits	117,224	113,252	-	113,252	-
Short-term borrowings	12,940	12,940	-	12,940	-
Secured borrowings	7,619	7,275	-	-	7,275
Accrued interest payable	448	448	-	448	-
Interest rate swaps	213	213	-	213	-

The carrying value of short-term financial instruments, as listed below, approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities, carry interest rates that approximate market and generally are recorded at amounts that are payable on demand:

- Cash and cash equivalents;
- Non-interest bearing deposit accounts;
- Savings, interest-bearing checking and money market accounts and
- Short-term borrowings.

Securities: Fair values on investment securities are determined by prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions.

Accruing loans and leases: The fair value of accruing loans is estimated by calculating the net present value of the future expected cash flows discounted at current offering rates for similar loans. Current offering rates consider, among other things, credit risk.

The carrying value that fair value is compared to is net of the allowance for credit losses and since there is significant judgment included in evaluating credit quality, loans are classified within Level 3 of the fair value hierarchy.

Non-accrual loans: Loans which the Company has measured as non-accruing are generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties. These loans are classified within Level 3 of the fair value hierarchy. The fair value consists of loan balances less the valuation allowance.

Loans held-for-sale: The fair value of loans held-for-sale is estimated using rates currently offered for similar loans and is typically obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank of Pittsburgh (FHLB).

Interest rate swaps: Fair values on investment securities derivative instruments are determined by prices valuations provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions.

Certificates of deposit: The fair value of certificates of deposit is based on discounted cash flows using rates which approximate market rates for deposits of similar maturities.

Secured borrowings: The fair value for these obligations uses an income approach based on expected cash flows on a pooled basis.

The following tables illustrate the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels as of the periods indicated:

(dollars in thousands)	Total carrying value June 30, 2023	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)	Total carrying value September 30, 2023	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:								
Agency - GSE	$ 26,946	$ -	$ 26,946	$ -	$ 26,459	$ -	$ 26,459	$ -
Obligations of states and political subdivisions	151,987	-	151,987	-	139,547	-	139,547	-
MBS - GSE residential	201,852	-	201,852	-	186,829	-	186,829	-
Total available-for-sale debt securities	$ 380,785	$ -	$ 380,785	$ -	$ 352,835	$ -	$ 352,835	$ -

(dollars in thousands)	Total carrying value December 31, 2022	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 31,533	$ -	$ 31,533	$ -
Obligations of states and political subdivisions	171,894	-	171,894	-
MBS - GSE residential	217,435	-	217,435	-

Total available-for-sale debt securities	$	420,862	$	-	$	420,862	$ -

Debt securities in the AFS portfolio are measured at fair value using market quotations provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Assets classified as Level 2 use valuation techniques that are common to bond valuations. That is, in active markets whereby bonds of similar characteristics frequently trade, quotes for similar assets are obtained.

There were no changes in Level 3 financial instruments measured at fair value on a recurring basis as of and for the periods ending June September 30, 2023 and December 31, 2022, respectively.

The following table illustrates the financial instruments measured at fair value on a non-recurring basis segregated by hierarchy fair value levels as of the periods indicated:

(dollars in thousands)	Valuation techniques	Total carrying value at June 30, 2023	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)	Valuation techniques	Total carrying value at September 30, 2023	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Individually evaluated loans	Fair value of collateral appraised value	$ 311	$ -	$ -	$ 311	Fair value of collateral appraised value	$ 216	$ -	$ -	$ 216
Individually evaluated loans	Discount cash flow	405			405	Discount cash flow	286			286
Other real estate owned	Fair value of asset less selling costs	1	-	-	1	Fair value of asset less selling costs	1	-	-	1
Total	Total	$ 717	$ -	$ -	$ 717	Total	$ 503	$ -	$ -	$ 503

(dollars in thousands)	Total carrying value at December 31, 2022	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Impaired loans	$ 1,515	$ -	$ -	$ 1,515
Other real estate owned	168	-	-	168
Total	$ 1,683	$ -	$ -	$ 1,683

From time-to-time, the Company may be required to record at fair value financial instruments on a non-recurring basis, such as impaired loans, ORE and other repossessed assets. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting on write downs of individual assets. The fair value of impaired loans was calculated using the value of the impaired loans with an allowance less the related allowance.

The following describes valuation methodologies used for financial instruments measured at fair value on a non-recurring basis. Individually evaluated loans that are collateral dependent are written down to fair value through the establishment of specific reserves, a component of the allowance for credit losses, and as such are carried at the lower of net recorded investment or the estimated fair value. Estimates of fair value of the collateral are determined based on a variety of information, including available valuations from certified appraisers for similar assets, present value of discounted cash flows and inputs that are estimated based on commonly used and generally accepted industry liquidation advance rates and estimates and assumptions developed by management.

Valuation techniques for individually evaluated, collateral dependent loans are typically determined through independent appraisals of the underlying collateral or may be determined through present value of discounted cash flows. Both techniques include various Level 3 inputs which are not identifiable. The valuation technique may be adjusted by management for estimated liquidation expenses and qualitative factors such as economic conditions. If real estate is not the primary source of repayment, present value of discounted cash flows and estimates using generally accepted industry liquidation advance rates and other factors may be utilized to determine fair value.

At June September 30, 2023 and December 31, 2022, the range of liquidation expenses and other valuation adjustments applied to individually evaluated, collateral dependent loans ranged from -27.56% -21.31% and -32.02% -21.31% and from -19.61% to -29.58%, respectively. The weighted average of liquidation expenses and other valuation adjustments applied to individually evaluated, collateral dependent loans amounted to -30.02% -21.31% as of June September 30, 2023 and -21.77% as of December 31, 2022, respectively. Due to the multitude of assumptions, many of which are subjective in nature, and the varying inputs and techniques used to determine fair value, the Company recognizes that valuations could differ across a wide spectrum of techniques employed. Accordingly, fair value estimates for individually evaluated, collateral dependent loans are classified as Level 3.

For ORE, fair value is generally determined through independent appraisals of the underlying properties which generally include various Level 3 inputs which are not identifiable. Appraisals form the basis for determining the net realizable value from these properties. Net realizable value is the result of the appraised value less certain costs or discounts associated with liquidation which occurs in the normal course of business. Management's assumptions may include consideration of the location and occupancy of the property, along with current economic conditions. Subsequently, as these properties are actively marketed, the estimated fair values may be periodically adjusted through incremental subsequent write-downs. These write-downs usually reflect decreases in estimated values resulting from sales price observations as well as changing economic and market conditions. At June September 30, 2023 and December 31, 2022, the discounts applied to the appraised values of ORE ranged from -77.60% to -77.60% and from -39.07% to -77.60%, respectively. As of June September 30, 2023 and December 31, 2022, the weighted average of discount to the appraisal values of ORE amounted to -77.60% and -39.61%, respectively.

At June September 30, 2023 and December 31, 2022, there were no other repossessed assets. The Company refers to the National Automobile Dealers Association (NADA) guide to determine a vehicle's fair value.

9. Employee Benefits

Bank-Owned Life Insurance (BOLI)

The Company has purchased single premium BOLI policies on certain officers. The policies are recorded at their cash surrender values. Increases in cash surrender values are included in non-interest income in the consolidated statements of income. The policies' cash surrender value totaled $53.9 $54.2 million and $54.0 million, respectively, as of June September 30, 2023 and December 31, 2022 and is reflected as an asset on the consolidated balance sheets. During the first quarter of 2023, the Company received $0.9 million in proceeds from a BOLI death claim, of which $0.8 million was return of cash surrender value and $0.1 million was additional income which was recorded in fees and other revenue on the consolidated statements of income. For the six nine months ended June September 30, 2023 and 2022, the Company has recorded income of $645 $980 thousand and $638 $965 thousand, respectively, due to an increase in cash surrender values.

Officer Life Insurance

In 2017, the Bank entered into separate split dollar life insurance arrangements (Split Dollar Agreements) with eleven officers. This plan provides each officer a specified death benefit should the officer die while in the Bank's employ. The Bank paid the insurance premiums in March 2017 and the arrangements were effective in March 2017. In March 2019, the Bank entered into a new Split Dollar Agreement with one officer. In January 2021, the Bank entered into Split Dollar Agreements with fifteen officers. The Bank owns the policies and all cash values thereunder. Upon death of the covered employee, the agreed-upon amount of death proceeds from the policies will be paid directly to the insured's beneficiary. As of June September 30, 2023, the policies had total death benefits of $53.9 $54.2 million o of f whi wch hich $8.8 million would have been paid to the officer's beneficiaries and the remaining $45.1 $45.4 million would have been paid to the Bank. In addition, four executive officers have the opportunity to retain a split dollar benefit equal to two times their highest base salary after separation from service if the vesting requirements are met. As of June September 30, 2023 and December 31, 2022, the Company had a balance in accrued expenses of $310 $331 thousand and $269 thousand for the split dollar benefit.

Supplemental Executive Retirement plan (SERP)

On March 29, 2017, the Bank entered into separate supplemental executive retirement agreements (individually the "SERP Agreement") with five officers, pursuant to which the Bank will credit an amount to a SERP account established on each participant's behalf while they are actively employed by the Bank for each calendar month from March 1, 2017 until retirement. On March 20, 2019, the Bank entered into a SERP Agreement with one officer, pursuant to which the Bank will credit an amount to a SERP account established for the participant's behalf while they are actively employed by the Bank for each calendar month from March 1, 2019 until normal retirement age. As a result of the acquisition of Landmark, the Company acquired a SERP agreement with one former employee. As of June September 30, 2023 and December 31, 2022, the Company had a balance in accrued expenses of $4.2 $4.3 million and $4.0 million in connection with the SERP.

10. Revenue Recognition

The Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606) and all subsequent ASUs that modified Topic 606.

The majority of the Company's revenues are generated through interest earned on securities and loans, which is explicitly excluded from the scope of the guidance. In addition, certain non-interest income streams such as fees associated with mortgage servicing rights, loan service charges, life insurance earnings, rental income and gains/losses on the sale of loans and securities are not in the scope of the new guidance. The main types of contracts with customers that are in the scope of the new guidance are:

- Service charges on deposit accounts – Deposit service charges represent fees charged by the Company for the performance obligation of providing services to a customer's deposit account. The transaction price for deposit services includes both fixed and variable amounts based on the Company's fee schedules. Revenue is recognized and payment is received either at a point in time for transactional fees or on a monthly basis for non-transactional fees.

- Interchange fees – Interchange fees represent fees charged by the Company for customers using debit cards. The contract is between the Company and the processor and the performance obligation is the ability of customers to use debit cards to make purchases at a point in time. The transaction price is a percentage of debit card usage and the processor pays the Company and revenue is recorded throughout the month as the performance obligations are being met.

- Fees from trust fiduciary activities – Trust fees represent fees charged by the Company for the management, custody and/or administration of trusts. These are mostly monthly fees based on the market value of assets in the trust account at the prior month end. Payment is generally received a few weeks after month end through a direct charge to customers' accounts. Estate fees are recognized and charged as the Company reaches each of six different stages of the estate administration process.

- Fees from financial services – Financial service fees represent fees charged by the Company for the performance obligation of providing various services for an investment account. Revenue is recognized twice monthly for fees on sales transactions and on a monthly basis for advisory fees and quarterly for trail fees.

- Gain/loss on ORE sales – Gain/loss on the sale of ORE is recognized at the closing date when the sales proceeds are received. In seller-financed ORE transactions, the contract is made subject to our normal underwriting standards and pricing. The Company does not have any obligation or right to repurchase any sales of ORE.

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 the 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 already received payment (or payment is due) from the customer. The Company's non-interest income 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 typically does not enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June September 30, 2023 and December 31, 2022, the Company did not have any significant contract balances.

Remaining performance obligations

The Company's performance obligations have an original expected duration of less than one year and follow the relevant guidance for recognizing revenue over time. There is no variable consideration subject to constraint that is not included in information about transaction price.

Contract acquisition costs

An entity is required to capitalize and subsequently amortize into expense, certain incremental costs of obtaining a contract if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less.

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11. Leases

ASU 2016-02 Leases (Topic 842) became effective for the Company on January 1, 2019. For all operating lease contracts where the Company is lessee, a right-of-use (ROU) asset and lease liability were recorded as of the effective date. The Company assumed all renewal terms will be exercised when calculating the ROU assets and lease liabilities. For leases existing at the transition date, any prepaid or deferred rent was added to the ROU asset to calculate the lease liability. The discount rate used to calculate the present value of future payments at the transition date was the Company's incremental borrowing rate. The Company used the FHLB fixed rate borrowing rates as the discount rates. For all classes of underlying assets, the Company has elected not to record short-term leases (leases with a term of 12 months or less) on the balance sheet when the Company is lessee. Instead, the Company will recognize the lease payment on a straight-line basis over the lease term and variable lease payments in the period in which the obligation for those payments is incurred. For all asset classes, the Company has elected, as a lessee, not to separate nonlease components from lease components and instead to account for each separate lease component and nonlease components associated with that lease component as a single lease component.

Management determines if an arrangement is or contains a lease at contract inception. If an arrangement is determined to be or contains a lease, the Company recognizes a ROU asset and a lease liability when the asset is placed in service.

The Company's operating leases, where the Company is lessee, include property, land and equipment. As of June September 30, 2023, ten of the Company's branch properties and one administrative office were leased under operating leases. In four of the branch leases, the Company leases the land from an unrelated third party, and the buildings are the Company's own capital improvement. The Company also leases two standalone ATMs under operating leases. Additionally, the Company has one property lease and four equipment leases classified as finance leases.

The following is an analysis of the leased property under finance leases:

(dollars in thousands)	June 30, 2023	December 31, 2022	September 30, 2023	December 31, 2022
Property and equipment	$ 1,695	$ 1,695	$ 1,998	$ 1,695
Less accumulated depreciation and amortization	(726)	(606)	(779)	(606)
Leased property under finance leases, net	$ 969	$ 1,089	$ 1,219	$ 1,089

The following is a schedule of future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of June September 30, 2023:

(dollars in thousands)	Amount	Amount
2023	$ 100	$ 60
2024	171	239
2025	161	229
2026	150	218
2027	150	219
2028 and thereafter	312	358
Total minimum lease payments (a)	1,044	1,323
Less amount representing interest (b)	(53)	(85)
Present value of net minimum lease payments	$ 991	$ 1,238

(a) The future minimum lease payments have not been reduced by estimated executory costs (such as taxes and maintenance) since this amount was deemed immaterial by management.

(b) Amount necessary to reduce net minimum lease payments to present value calculated at the Company's incremental borrowing rate upon lease inception.

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As of June September 30, 2023, the Company leased its Green Ridge, Pittston, Peckville, Back Mountain, Mountain Top, Abington, Nazareth, Easton, Bethlehem and Wyoming branches under the terms of operating leases. During 2022, the Company entered into a new lease of administrative office space in Scranton. Common area maintenance is included in variable lease payments in the table below. The Abington branch has variable lease payments which are calculated as a percentage of the national prime rate of interest and are expensed as incurred. The Bethlehem and Easton branches have branch has variable lease payments that increase annually and are expensed as incurred.

(dollars in thousands)	June 30, 2023	June 30, 2022	September 30, 2023	September 30, 2022
Lease cost				
Finance lease cost:				
Amortization of right-of-use assets	$ 120	$ 119	$ 173	$ 180

Interest on lease liabilities	9	11	14	16
Operating lease cost	384	366	561	555
Short-term lease cost	38	74	61	112
Variable lease cost	32	15	43	23
Total lease cost	$ 583	$ 585	$ 852	$ 886
Other information				
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from finance leases	$ 9	$ 11	$ 14	$ 16
Operating cash flows from operating leases (Fixed payments)	$ 352	$ 303	$ 526	$ 470
Operating cash flows from operating leases (Liability reduction)	$ 187	$ 152	$ 278	$ 239
Financing cash flows from finance leases	$ 118	$ 116	$ 176	$ 173
Right-of-use assets obtained in exchange for new finance lease liabilities	$ -	$ -	$ 303	$ 119
Right-of-use assets obtained in exchange for new operating lease liabilities	$ -	$ -	$ -	$ 22
Weighted-average remaining lease term - finance leases (in years)	6.28	6.82	5.84	6.66
Weighted average remaining lease term - operating leases (in years)	20.33	21.08	20.15	20.68
Weighted-average discount rate - finance leases	1.68%	1.75%	2.49%	1.74%
Weighted-average discount rate - operating leases	3.39%	3.39%	3.51%	3.39%

During the first six nine months of 2023, $571 $835 thousand of the total lease cost was included in premises and equipment expense and $12 $17 thousand was included in other expenses on the consolidated statements of income. During the first six nine months of 2022, $568 $862 thousand of the total lease cost was included in premises and equipment expense and $17 $24 thousand was included in other expenses on the consolidated statements of income. Operating lease expense is recognized on a straight-line basis over the lease term. We recognized both the interest expense and amortization expense for finance leases in premises and equipment expense since the interest expense portion was immaterial.

The future minimum lease payments for the Company's branch network and equipment under operating leases that have lease terms in excess of one year as of June September 30, 2023 are as follows:

(dollars in thousands)	Amount	Amount
2023	$ 347	$ 175
2024	659	662
2025	639	643
2026	646	650
2027	655	658
2028 and thereafter	10,195	10,221
Total future minimum lease payments	13,141	13,009
Less variable payment adjustment	(192)	(228)
Less amount representing interest	(3,779)	(3,702)
Present value of net future minimum lease payments	$ 9,170	$ 9,079

The Company leases one property, where the Company is lessor, under an operating lease to an unrelated party. The undiscounted cash flows to be received on an annual basis for the property are as follows:

(dollars in thousands)	Amount	Amount
2023	$ 24	$ 12
2024	51	51
2025	54	54
2026	54	54
2027	27	27

2028 and thereafter	-	-
Total lease payments to be received	$ 210	$ 198

The Company also indirectly originates automobile leases classified as direct finance leases. See Footnote 5, “Loans and leases”, for more information about the Company’s direct finance leases.

Lease income recognized from direct finance leases was included in interest income from loans and leases on the consolidated statements of income. Lease income related to operating leases is included in fees and other revenue on the consolidated statements of income. The Company only receives a variable payment for taxes from one of its lessees, but the amount is immaterial and excluded from rental income. The amount of lease income recognized on the consolidated statements of income was as follows for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,		For the three months ended September 30,		For the nine months ended September 30,	
(dollars in thousands)	**2023**	2022	**2023**	2022	**2023**	2022	**2023**	2022
Lease income - direct finance leases								
Interest income on lease receivables	$ 275	$ 267	$ 595	$ 491	$ 273	$ 285	$ 868	$ 776
Lease income - operating leases	12	62	24	120	12	55	36	175
Total lease income	$ 287	$ 329	$ 619	$ 611	$ 285	$ 340	$ 904	$ 951

12. Derivative Instruments

The Company is exposed to certain risks relating to its ongoing business operations and economic conditions. The Company uses derivative financial instruments primarily to manage risks to the Company associated with changing interest rates and to assist customers with their risk management objectives. All derivative instruments are recognized as either assets or liabilities at fair value in the statement of financial position.

Interest rate derivative - no hedge designation

The Company is a party to interest rate derivatives that are not designated as hedging instruments. The Company enters into interest rate swaps that allow certain commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. These interest rate swaps with customers are simultaneously offset by interest rate swaps that the Company executes with a third-party financial institution, such that the Company minimizes its net interest rate risk exposure resulting from such transactions. The interest rate swap agreements are free-standing derivatives and are recorded at fair value in the Company’s consolidated balance sheets (asset positions are included in other assets and liability positions are included in other liabilities). As the interest rate swaps are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however there may be fair value adjustments related to credit-quality variations between counterparties, which may impact earnings as required by FASB ASC 820. There was no effect on earnings in any periods presented.

(dollars in thousands)	Notional Amount	Weighted Average Maturity (Years)	Interest Rate Paid	Interest Rate Received	Fair Value
September 30, 2023					
Classified in Other assets:					
Customer interest rate swaps	$ 1,920	14.16	30 Day SOFR + Margin	Fixed	$ 269
Classified in Accrued interest payable and other liabilities:					
Third party interest rate swaps	$ 1,920	14.16	Fixed	30 Day SOFR + Margin	$ 269

Interest rate derivative - fair value hedge designation

The Company’s objectives in using interest rate derivatives are to add stability to interest income and expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company has entered into interest rate swaps as part of its interest rate risk management strategy. This interest rate swap is designated as a fair value hedge and limits the risk to the investment portfolio of rising interest rates. The Company entered into an interest rate swap with a third-party financial institution to convert fixed rate investment securities to adjustable rate to produce a more asset sensitive profile. The Company recorded the fair value of the fair value hedge in other assets and accrued interest payable and other liabilities on the consolidated balance sheet. The hedged items (fixed rate securities available-for-sale) are also recorded at fair value which offsets the adjustment to the fair value hedge. The related gains and losses are reported in interest income investment securities - U.S. government agencies and corporations and interest income investment securities - state and political subdivisions (nontaxable) in the consolidated statements of income. For the nine months ended September 30, 2023, there was $4 thousand in interest income investment securities - U.S. government agencies and corporations and $4 thousand in interest income investment securities - state and political subdivisions (nontaxable). A qualitative assessment of hedge effectiveness was applied at inception of the hedge. Future hedge effectiveness will be determined on a qualitative basis each quarter. The hedge is expected to remain effective as long as the balance of the hedged item is projected to remain at or above the notional amount of the swap.

(dollars in thousands)		Notional Amount	Weighted Average Maturity (Years)		Fair Value
September 30, 2023					
Pay-fixed interest rate swap agreements - securities AFS	$	100,000	3	$	(104)

The Company had $1 million $2 million in investment securities pledged as collateral on its interest rate swaps with a third-party financial institution as of June September 30, 2023.

(dollars in thousands)		Notional Amount	Weighted Average Maturity (Years)	Interest Rate Paid	Interest Rate Received		Fair Value
June 30, 2023							
Classified in Other assets:							
Customer interest rate swaps	$	1,945	14.42	30 Day SOFR + Margin	Fixed	$	203
Classified in Accrued interest payable and other liabilities:							
Third party interest rate swaps	$	1,945	14.42	Fixed	30 Day SOFR + Margin	$	203

13. Subsequent Event

Due to the levels of borrowings during October 2023 and the need to fund loan growth, the Company evaluated a liquidity strategy to deleverage the reliance on short-term borrowings. As a result of this evaluation, in November 2023, the Company sold certain available-for-sale securities with a carrying value of $35.6 million for a $6.5 million loss recognized in gain (loss) on sale of available-for-sale debt securities. This loss will be reflected in and adversely affect the Company's fourth quarter 2023 operating results. The $29.1 million in proceeds received were used to pay down short-term borrowings that replenished available borrowing capacity at that time.

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of the significant changes in the consolidated financial condition of the Company as of June 30, 2023 September 30, 2023 compared to December 31, 2022 and a comparison of the results of operations for the three and six nine months ended June 30, 2023 September 30, 2023 and 2022. Current performance may not be indicative of future results. This discussion should be read in conjunction with the Company's 2022 Annual Report filed on Form 10-K.

Forward-looking statements

Certain of the matters discussed in this Quarterly Report on Form 10-Q may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "estimate," and similar expressions are intended to identify such forward-looking statements.

The Company's actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- local, regional and national economic conditions and changes thereto;
- the short-term and long-term effects of inflation, and rising costs to the Company, its customers and on the economy;
- the risks of changes and volatility of interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- securities markets and monetary fluctuations and volatility;

- disruption of credit and equity markets;
- impacts of the capital and liquidity requirements of the Basel III standards and other regulatory pronouncements, regulations and rules;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- effects of short- and long-term federal budget and tax negotiations and their effect on economic and business conditions;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- the impact of new or changes in existing laws and regulations, including laws and regulations concerning taxes, banking, securities and insurance and their application with which the Company and its subsidiaries must comply;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- the effects of economic conditions of any pandemic, epidemic or other health-related crisis such as COVID-19 and responses thereto on current customers and the operations of the Company, specifically the effect of the economy on loan customers' ability to repay loans;
- the effects of bank failures, banking system instability, deposit fluctuations, loan and securities value changes;
- technological changes;
- the interruption or breach in security of our information systems, continually evolving cybersecurity and other technological risks and attacks resulting in failures or disruptions in customer account management, general ledger processing and loan or deposit updates and potential impacts resulting therefrom including additional costs, reputational damage, regulatory penalties, and financial losses;
- acquisitions and integration of acquired businesses;
- the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities;
- acts of war or terrorism; and
- the risk that our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

The Company cautions readers not to place undue reliance on forward-looking statements, which reflect analyses only as of the date of this document. The Company has no obligation to update any forward-looking statements to reflect events or circumstances after the date of this document.

Readers should review the risk factors described in other documents that we file or furnish, from time to time, with the Securities and Exchange Commission, including Annual Reports to Shareholders, Annual Reports filed on Form 10-K and other current reports filed or furnished on Form 8-K.

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Executive Summary

The Company is a Pennsylvania corporation and a bank holding company, whose wholly-owned state chartered commercial bank and trust company is The Fidelity Deposit and Discount Bank. The Company is headquartered in Dunmore, Pennsylvania. We consider Lackawanna, Northampton, Lehigh and Luzerne Counties our primary marketplace.

As a leading Northeastern and Eastern Pennsylvania community bank, our goals are to enhance shareholder value while continuing to build a full-service community bank. We focus on growing our core business of retail and business lending and deposit gathering while maintaining strong asset quality and controlling operating expenses. We continue to implement strategies to diversify earning assets (see "Funds Deployed" section of this management's discussion and analysis) and to increase the amount of relationship core deposits (see "Funds Provided" section of this management's discussion and analysis). These strategies include a greater level of commercial lending and the ancillary business products and services supporting our commercial customers' needs as well as residential lending strategies and an array of consumer products. We focus on developing a full banking relationship with existing, as well as new business prospects. The Bank has a personal and corporate trust department and also provides alternative financial and insurance products with asset management services. In addition, we explore opportunities to selectively expand and optimize our franchise footprint, consisting presently of our 20-branch 21-branch network.

We are impacted by both national, regional and regional market area economic factors, with commercial, commercial real estate and residential mortgage loans concentrated in Northeastern Pennsylvania, primarily in Lackawanna and Luzerne counties, and Eastern Pennsylvania, primarily Northampton Northampton and Lehigh counties. The Federal Open Market Committee (FOMC) increased interest rates by 425 basis points during 2022 and another 25 basis points each in February, March, May and July 2023. According to the U.S. Bureau of Labor Statistics, the national unemployment rate for June September 2023 was 3.6% 3.8%, up 0.1 0.3 percentage point points from December 2022. 2022. The unemployment rates in the Scranton - Wilkes-Barre – Hazleton (market area north) and the Allentown – Bethlehem – Easton (market area south) Metropolitan Statistical Areas (local) remained at a higher level than were in line with the national unemployment rate. The local unemployment rates at June September 30, 2023 were 4.4% 3.5% in market area north and 4.0% 3.4% in market area south, respectively, a decrease of 0.1 1.0 percentage point points and an increase of 0.3 percentage points from the 4.5% and 3.7%, respectively, at December 31, 2022. The rising rate environment and historically low inventory has reduced the amount of home purchases below 2022 levels. The median home values in the Scranton-Wilkes-Barre-Hazleton metro and Allentown-Bethlehem-Easton metro increased 5.3% 4.5% and 4.8% 5.2%, respectively, from a year ago, according to

Zillow, an online database advertising firm providing access to its real estate search engines to various media outlets, and values are expected to grow 6.2% 1.7% and 6.2% 2.6% in the next year. In light of these expectations, we are uncertain if real estate values could continue to increase at these levels with the current elevated rate environment, however we will continue to monitor the economic climate in our region and scrutinize growth prospects with credit quality as a principal consideration.

For the six nine months ended June 30, 2023 September 30, 2023, net income was $12.4 $17.7 million, or $2.18 $3.11 diluted earnings per share, compared to $15.2 million, $22.9 million, or $2.67 $4.03 diluted earnings per share, for the six nine months ended June 30, 2022 September 30, 2022.

As of June 30, 2023 September 30, 2023 and June 30, 2022 September 30, 2022, tangible common book value per share (non-GAAP) was $27.59 $25.37 and $24.99, $22.24, respectively. See reconciliation on page 39. The increase in tangible book value was due primarily to the improvement in tangible common equity resulting within AOCI from the after tax net unrealized losses on available-for-sale securities. retained earnings. These non-GAAP measures should be reviewed in connection with the reconciliation of these non-GAAP ratios. See "Non-GAAP Financial Measures" located below within this management's discussion and analysis.

Branch managers, relationship bankers, mortgage originators and our business service partners are all focused on developing a mutually profitable full banking relationship with our clients. We understand our markets, offer products and services along with financial advice that is appropriate for our community, clients and prospects. The Company continues to focus on the trusted financial advisor model by utilizing the team approach of experienced bankers that are fully engaged and dedicated towards maintaining and growing profitable relationships.

In addition to the challenging economic environment in which we compete, the regulation and oversight of our business has changed significantly in recent years. As described more fully in Part II, Item 1A, "Risk Factors" below, as well as Part I, Item 1A, "Risk Factors," and in the "Supervisory and Regulation" section of management's discussion and analysis of financial condition and results of operations in our 2022 Annual Report filed on Form 10-K, certain aspects of the Dodd-Frank Wall Street Reform Act (Dodd-Frank Act) continue to have a significant impact on us.

Non-GAAP Financial Measures

The following are non-GAAP financial measures which provide useful insight to the reader of the consolidated financial statements but should be supplemental to GAAP used to prepare the Company's financial statements and should not be read in isolation or relied upon as a substitute for GAAP measures. In addition, the Company's non-GAAP measures may not be comparable to non-GAAP measures of other companies. The Company's tax rate used to calculate the fully-taxable equivalent (FTE) adjustment was 21% at June 30, 2023 September 30, 2023 and 2022.

The following table reconciles the non-GAAP financial measures of FTE net interest income:

	Three months ended		Six months ended		Three months ended		Nine months ended	
(dollars in thousands)	June 30, 2023	June 30, 2022	June 30, 2023	June 30, 2022	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Interest income (GAAP)	$ 22,979	$ 19,065	$ 45,317	$ 37,244	$ 23,678	$ 20,135	$ 68,995	$ 57,378
Adjustment to FTE	725	682	1,485	1,350	700	687	2,186	2,038
Interest income adjusted to FTE (non-GAAP)	23,704	19,747	46,802	38,594	24,378	20,822	71,181	59,416
Interest expense (GAAP)	7,497	920	12,810	1,807	9,039	1,625	21,849	3,431
Net interest income adjusted to FTE (non-GAAP)	$ 16,207	$ 18,827	$ 33,992	$ 36,787	$ 15,339	$ 19,197	$ 49,332	$ 55,985

The efficiency ratio is non-interest expenses as a percentage of FTE net interest income plus non-interest income. The following table reconciles the non-GAAP financial measures of the efficiency ratio to GAAP:

	Three months ended		Six months ended		Three months ended		Nine months ended	
(dollars in thousands)	**June 30, 2023**	June 30, 2022	**June 30, 2023**	June 30, 2022	**September 30, 2023**	September 30, 2022	**September 30, 2023**	September 30, 2022
Efficiency Ratio (non-GAAP)								
Non-interest expenses (GAAP)	$ 13,425	$ 12,807	$ 26,281	$ 25,472	$ 12,784	$ 13,028	$ 39,066	$ 38,484
Net interest income (GAAP)	15,482	18,145	32,507	35,437	14,639	18,510	47,146	53,947
Plus: taxable equivalent adjustment	725	682	1,485	1,350	700	687	2,186	2,038

Non-interest income (GAAP)	4,535	4,256	9,023	8,810	4,325	3,911	13,349	12,722
Net interest income (FTE) plus non-interest income (non-GAAP)	$ 20,742	$ 23,083	$ 43,015	$ 45,597	$ 19,664	$ 23,108	$ 62,681	$ 68,707
Efficiency ratio (non-GAAP)	64.72 %	55.49 %	61.10 %	55.86 %	65.01 %	56.38 %	62.33 %	56.01 %

The following table provides a reconciliation of the tangible common equity (non-GAAP) and the calculations of tangible book value per share and tangible common equity ratio:

(dollars in thousands)	**June 30, 2023**	June 30, 2022	**September 30, 2023**	September 30, 2022
Tangible Book Value per Share (non-GAAP)				
Total assets (GAAP)	$ 2,441,232	$ 2,414,940	$ 2,476,820	$ 2,435,768
Less: Intangible assets, primarily goodwill	(20,981)	(21,360)	(20,897)	(21,264)
Tangible assets	2,420,251	2,393,580	2,455,923	2,414,504
Total shareholders' equity (GAAP)	177,744	162,619	165,432	146,487
Less: Intangible assets, primarily goodwill	(20,981)	(21,360)	(20,897)	(21,264)
Tangible common equity	$ 156,763	$ 141,259	$ 144,535	$ 125,223
Common shares outstanding, end of period	5,681,260	5,651,777	5,696,351	5,630,332
Tangible Common Book Value per Share (non-GAAP)	$ 27.59	$ 24.99	$ 25.37	$ 22.24
Tangible Common Equity Ratio (non-GAAP)	6.48 %	5.90 %	5.89 %	5.19 %
Unrealized losses on held-to-maturity securities, net of tax	(24,802)	(17,826)	(36,214)	(31,706)
Adjusted tangible common equity ratio (non-GAAP)	5.45 %	5.16 %	4.41 %	3.87 %

The following table provides a reconciliation of pre-provision net revenue (PPNR) to average assets (non-GAAP):

	Three months ended		Six months ended		Three months ended		Nine months ended	
(dollars in thousands)	**June 30, 2023**	June 30, 2022	**June 30, 2023**	June 30, 2022	**September 30, 2023**	September 30, 2022	**September 30, 2023**	September 30, 2022
Pre-Provision Net Revenue to Average Assets								
Income before taxes (GAAP)	$ 5,967	$ 9,076	$ 14,219	$ 17,743	$ 5,930	$ 8,868	$ 20,149	$ 26,610
Plus: Provision for credit losses	625	518	1,030	1,032	250	519	1,280	1,551
Total pre-provision net revenue (non-GAAP)	6,592	9,594	15,249	18,775	6,180	9,387	21,429	28,161
Total (annualized) (non-GAAP)	$ 26,441	$ 38,481	$ 30,751	$ 37,861	$ 24,517	$ 37,242	$ 28,650	$ 37,651
Average assets	$ 2,407,600	$ 2,378,584	$ 2,403,455	$ 2,398,890	$ 2,408,336	$ 2,407,887	$ 2,405,100	$ 2,401,922
Pre-Provision Net Revenue to Average Assets (non-GAAP)	1.10 %	1.62 %	1.28 %	1.58 %	1.02 %	1.55 %	1.19 %	1.57 %

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General

The Company’s earnings depend primarily on net interest income. Net interest income is the difference between interest income and interest expense. Interest income is generated from yields earned on interest-earning assets, which consist principally of loans and investment securities. Interest expense is incurred from rates paid on interest-bearing liabilities, which consist of deposits and borrowings. Net interest income is determined by the Company’s interest rate spread (the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. Interest rate spread is significantly impacted by: changes in interest rates and market yield curves and their related impact on cash flows; the composition and characteristics of interest-earning assets and interest-bearing liabilities; differences in the maturity and re-pricing characteristics of assets compared to the maturity and re-pricing characteristics of the liabilities that fund them and by the competition in the marketplace.

The Company's earnings are also affected by the level of its non-interest income and expenses and by the provisions for loan credit losses and income taxes. Non-interest income mainly consists of: service charges on the Company's loan and deposit products; interchange fees; trust and asset management service fees; increases in the cash surrender value of the bank owned life insurance and from net gains or losses from sales of loans and securities. Non-interest expense consists of: compensation and related employee benefit costs; occupancy; equipment; data processing; advertising and marketing; FDIC insurance premiums; professional fees; loan collection; net other real estate owned (ORE) expenses; supplies and other operating overhead.

Net interest income, net interest rate margin, net interest rate spread and the efficiency ratio are presented in the MD&A on a fully-taxable equivalent (FTE) basis. The Company believes this presentation to be the preferred industry measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts.

Comparison of the results of operations

three and six nine months ended June 30, 2023 September 30, 2023 and 2022

Overview

For the second third quarter of 2023, the Company generated net income of $5.4 $5.3 million, or $0.94 $0.93 per diluted share, compared to $7.7 million, or $1.35 $1.36 per diluted share, for the second third quarter of 2022. The $2.3 $2.4 million, or 30% 31%, decrease in net income for the comparative quarters was primarily the result of $2.7 $3.9 million lower net interest income and $0.6 million higher non-interest expenses partially offset by a $0.8 million $0.6 million decrease in the provision for income taxes, and $0.3 million $0.4 million increase in non-interest income. income, $0.3 million net benefit in the provision for credit losses on unfunded commitments and $0.3 million lower non-interest expenses. In the year-to-date comparison, net income decreased by $2.8 million $5.1 million to $12.4 million $17.7 million, or $2.18 $3.11 per diluted share, from $15.2 million, $22.8 million, or $2.67 $4.03 per diluted share. share for the comparative period. The decline was primarily caused by a reduction of $2.9 million $6.8 million in net interest income. An income along with an increase of $0.8 million $0.6 million in non-interest expenses was expenses. These increases were partially offset by a $0.7 million $1.3 million decrease in the provision for income taxes, $0.3 million reduction in provision for credit losses on loans and $0.2 million unfunded commitments and $0.6 million higher non-interest income year-over-year.

Return on average assets (ROA) was 0.89% 0.88% and 1.29% 1.27% for the second third quarters of 2023 and 2022, respectively, and 1.04% 0.99% and 1.28% 1.27% for the six nine months ended June 30, 2023 September 30, 2023 and 2022, respectively. During the same time periods, return on average shareholders' equity (ROE) was 12.19% 11.96% and 18.16% 18.23%, respectively, and 14.52% 13.64% and 16.45% 17.01%, respectively. ROA decreased due to the decline in net income relative to the increase in average assets for the quarter-over-quarter and year-over-year comparisons. ROE decreased primarily due to the net income decreases over the same time periods. Pre-provision net revenue to average assets (non-GAAP) was 1.10% 1.02% and 1.62% 1.55% for the three months ended June 30, 2023 September 30, 2023 and 2022, respectively, and 1.28% 1.19% and 1.58% 1.57% for the six nine months ended June 30, 2023 September 30, 2023, respectively. See reconciliation on page 39. The decreases were due to a decline in income before taxes quarter-over-quarter and year-over-year.

Net interest income and interest sensitive assets / liabilities

For the second third quarter of 2023, net interest income decreased $2.7 $3.9 million, or 15% 21%, to $15.5 million $14.6 million from $18.2 $18.5 million for the second third quarter of 2022 due to interest expense growing faster than interest income. The $3.9 million $3.5 million growth in interest income was produced by the addition of $47.4 $19.0 million in average interest-earning assets and the effect of a 62 58 basis point increase in FTE yields earned on those assets. The loan portfolio contributed the most to this growth by providing $4.3 $4.2 million more in FTE interest income, which absorbed $0.5 million lower fees earned under the Paycheck Protection Program (PPP) and $0.3 million less from fair value purchase accounting adjustment accretion, due to $142.9 $129.1 million more in average loans and a 69 basis point increase in the FTE yields earned thereon. In the investment portfolio, the average balance of total securities declined $64.7 million $60.1 million from security sales and paydowns on mortgage-backed securities which produced $0.4 million less in FTE interest income. On the liability side, total interest-bearing liabilities grew $44.5 $30.6 million, on average, with a 161 177 basis point increase in rates paid thereon. The 146 171 basis point increase in rates paid on deposits resulted in $5.7 million $6.9 million more interest expense on deposits for the second third quarter of 2023 compared to the 2022 like period. The Company also utilized $64.4 million $37.6 million more in average short-term borrowings during the second third quarter of 2023 which added $0.8 million $0.4 million in interest expense.

Net interest income decreased $2.9 million, $6.8 million, or 8% 13%, from $35.4 million $53.9 million for the six nine months ended June 30, 2022 September 30, 2022 to $32.5 million $47.1 million for the six nine months ended June 30, 2023 September 30, 2023, due to $11.0 million $18.4 million higher interest expense partially offset by the $8.1 million $11.6 million increase in interest income. Total average interest-earning assets increased $32.6 million $28.0 million and FTE yields earned on these assets rose 67 64 basis points resulting in $8.2 million $11.8 million of growth in FTE interest income. In the loan portfolio, the Company experienced average balance growth of $142.6 million $138.1 million and an additional 71 basis point in FTE yields which had the effect of producing $8.7 million $12.9 million more FTE interest income, despite $1.2 million less in fees earned under the Paycheck Protection Program (PPP) and $0.7 million less from fair value purchase accounting accretion during the first half nine months of 2023. The average balance of the investment portfolio declined $64.3 million $62.9 million which resulted in $0.6 million in $1.0 million lower FTE interest income. On the liability side, total interest-bearing liabilities grew $28.8 million $29.4 million on average with a 136 150 basis point increase in rates paid on these interest-bearing liabilities. The 122 139 basis point increase in rates paid on interest-bearing deposits resulted in interest expense growth of $9.5 million. $16.4 million. An additional $1.4 million $1.8 million in interest expense was incurred from the utilization of $56.7 million $50.2 million more in average short-term borrowings.

The FTE net interest rate spread decreased by 99 119 and 69 86 basis points and margin decreased by 52 69 and 29 42 basis points, respectively, for the three and six nine months ended June 30, 2023 September 30, 2023 compared to the same 2022 periods. In the quarter-over-quarter comparison, and year-over-year comparisons, the spread and margin decreased due to the rise in rates paid on interest-bearing liabilities which increased faster than the yields earned on interest-earning assets. In the year-to-date comparison, the increase in rates paid on interest-bearing liabilities outpaced the higher yields on interest-earning assets resulting in the lower spread and margin. The overall 137 163 and 117 133 basis points cost of funds for the three and six nine months ended June 30, 2023 September 30, 2023, which includes the impact of non-interest bearing deposits, increased 120 134 and 100 112 basis points compared to the same 2022 periods. The primary reason for the increase was the higher rates paid on deposits compared to the same 2022 periods due to the increases in market interest rates during the period. periods.

For the remainder of 2023, the Company is uncertain about the expected interest rate environment. However, management Management is primarily reliant on the Federal Open Market Committee's statements and forecast. The Company's net interest income performance has been reduced by assetyields being outpaced by higher cost of funds compressing net interest spread. The risk to net interest income improvement is rapid acceleration of deposit rates in the Company's market area. The FOMC increased the federal funds rate by 425 basis points during 2022 and another 25 100 basis points in each of the months of February, March, May and July 2023, which had a disproportional effect on rates paid on interest-bearing liabilities in 2023. On the asset side, the Prime interest rate, the benchmark rate that banks use as a base rate for adjustable rate loans was also increased 425 basis points during 2022 and another 100 basis points through July September 2023. Consensus economic forecasts are predicting a gradual increases no change in short-term rate increases rates throughout the rest of 2023. For the remainder of 2023 into early 2024, the Company currently maintains a loan pipeline which we expect will grow the loan portfolio which will be funded by borrowing capacity until such time deposit growth will be able to pay down these short-term borrowings. The 2023 focus is to manage net interest income through a rising an elevated forecasted rate cycle by exercising disciplined and proactive loan pricing and managing deposit costs to maintain a reasonable spread, to the extent possible, in order to mitigate further margin compression.
Due to volatility in the levels of borrowings during October 2023 and the increasing expected dependency on borrowing capacity from experiencing deposit fluctuations while funding loan growth, the Company evaluated a liquidity strategy to deleverage the reliance on short-term borrowings. As a result of this evaluation, in November 2023, the Company sold certain available-for-sale securities with a carrying value of $35.6 million for a $6.5 million loss recognized in gain (loss) on sale of available-for-sale debt securities. This loss will be reflected in and adversely affect the Company's fourth quarter 2023 operating results. The $29.1 million in proceeds received were used to pay down short-term borrowings that replenished available borrowing capacity at that time.

Continued growth in the loan portfolios is expected to boost interest income, and when coupled with a proactive relationship approach to deposit cost setting strategies should help mitigate spread compression and contain the interest rate margin, preventing further reductions below acceptable levels.

The Company's cost of interest-bearing liabilities was 1.84% 2.17% and 1.59% 1.79% for the three and six nine months ended June 30, 2023 September 30, 2023, or 161 177 and 136 150 basis points higher than the cost for the same 2022 periods. For the month of July October 2023, the cost of interest-bearing liabilities was 43 was 50 basis points higher than the first half nine months of 2023 at 2.02% 2.29% which shows the higher costs are expected to continue. The The increase in interest paid on deposits contributed to the higher cost of interest-bearing liabilities supplemented by the short-term borrowings utilized during the first half nine months of 2023. The FOMC is expected to gradually increase hold the federal funds rate in the immediate future, but the Company may continue to experience pressure to further increase rates paid on deposits. To help mitigate the impact of the imminent change to the economic landscape, the Company has successfully developed and will continue to strengthen its association with existing customers, develop new business relationships and generate new loan volumes, and retain and generate higher levels of average non-interest bearing deposit balances. volumes. Strategically deploying non-interest bearing and relationship deposits into interest earning-assets is an effective margin-preserving strategy that the Company expects to continue to pursue and expand to help stabilize net interest margin.

The Company's Asset Liability Management (ALM) team meets regularly to discuss among other things, interest rate risk and when deemed necessary adjusts interest rates. ALM is actively addressing the Company's sensitivity to a changing rate environment to ensure interest rate risks are contained within acceptable levels. ALM also discusses revenue enhancing strategies to help combat the potential for a decline in net interest income. The Company's marketing department, together with ALM, and service-driven branch and relationship managers, continue to develop prudent strategies that will grow the loan portfolio and accumulate relationship driven deposits at costs lower than borrowing costs to improve net interest income performance.

The table that follows sets forth a comparison of average balances of assets and liabilities and their related net tax equivalent yields and rates for the periods indicated. Within the table, interest income was FTE adjusted, using the corporate federal tax rate of 21% for June 30, 2023 September 30, 2023 and 2022 to recognize the income from tax-exempt interest-earning assets as if the interest was taxable. See "Non-GAAP Financial Measures" within this management's discussion and analysis for the FTE adjustments. This treatment allows a uniform comparison among yields on interest-earning assets. Loans include loans held-for-sale (HFS) and non-accrual loans but exclude the allowance for credit losses. Home equity lines of credit (HELOC) are included in the residential real estate category since they are secured by real estate. Net deferred loan (cost amortization)/fee accretion of ($0.3 million) and ($0.2 million) and $0.2 million during the second third quarters of 2023 and 2022, respectively, and ($0.5 0.7 million) and $0.6 million $0.4 million for the six nine months ended June 30, 2023 September 30, 2023 and 2022, respectively, are included in interest income from loans. MNB Merchants Bank of Bangor and Landmark Community bank loan fair value purchase accounting adjustments of $0.7 million $0.5 million and $1.0 million $0.9 million are included in interest income from loans and $10 $7 thousand and $115 $13 thousand reduced interest expense on deposits and borrowings for the three months ended June 30, 2023 September 30, 2023 and 2022. MNB Merchants Bank of Bangor and Landmark Community Bank loan fair value purchase accounting adjustments of $1.6 million $2.0 million and $1.8 million $2.8 million are included in interest income from loans and $21 $27 thousand and $136 $149 thousand reduced interest expense on deposits and borrowings for the six nine months ended June 30, 2023 September 30, 2023 and 2022. Average balances are based on amortized cost and do not reflect net unrealized gains or losses. Residual values for direct finance leases are included in the average balances for consumer loans. Net interest margin is calculated by dividing net interest income-FTE by total average interest-earning assets. Cost of funds includes the effect of average non-interest bearing deposits as a funding source:

	Three months ended						Three months ended					
(dollars in thousands)	June 30, 2023			June 30, 2022			September 30, 2023			September 30, 2022		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets												
Interest-bearing deposits	$ 9,454	$ 121	5.13 %	$ 40,554	$ 80	0.79 %	$ 9,278	$ 60	2.57 %	$ 59,409	$ 351	2.34 %
Restricted investments in bank stock	3,834	75	7.88	3,538	33	3.78	3,763	59	6.24	3,645	56	6.06
Investments:												
Agency - GSE	111,797	404	1.45	116,625	443	1.52	112,089	407	1.44	116,914	445	1.51
MBS - GSE residential	241,246	1,071	1.78	272,801	1,171	1.72	234,792	1,054	1.78	264,249	1,157	1.74
State and municipal (nontaxable)	230,657	1,666	2.90	258,728	1,951	3.02	230,129	1,658	2.86	255,736	1,916	2.97
State and municipal (taxable)	85,991	445	2.08	86,230	450	2.09	86,029	444	2.05	86,262	449	2.06
Total investments	669,691	3,586	2.15	734,384	4,015	2.19	663,039	3,563	2.13	723,161	3,967	2.18
Loans and leases:												
C&I and CRE (taxable)	757,786	10,902	5.77	753,969	9,175	4.88	779,406	11,575	5.89	749,154	9,428	4.99
C&I and CRE (nontaxable)	104,855	1,047	4.01	70,739	576	3.27	89,290	930	4.13	70,700	620	3.48
Consumer	239,985	2,589	4.33	210,034	2,013	3.85	235,411	2,617	4.41	224,753	2,184	3.85
Residential real estate	522,883	5,384	4.13	447,886	3,855	3.45	536,304	5,574	4.12	466,661	4,216	3.58
Total loans and leases	1,625,509	19,922	4.92	1,482,628	15,619	4.23	1,640,411	20,696	5.01	1,511,268	16,448	4.32
Total interest-earning assets	2,308,488	23,704	4.12 %	2,261,104	19,747	3.50 %	2,316,490	24,378	4.18 %	2,297,483	20,822	3.60 %
Non-interest earning assets	99,112			117,480			91,845			110,404		
Total assets	$ 2,407,600			$ 2,378,584			$ 2,408,336			$ 2,407,887		
Liabilities and shareholders' equity												
Interest-bearing liabilities												
Deposits:												
Interest-bearing checking	$ 651,384	$ 2,424	1.49 %	$ 710,692	$ 503	0.28 %	$ 664,391	$ 3,269	1.95 %	$ 703,101	$ 577	0.33 %
Savings and clubs	223,298	165	0.30	246,242	26	0.04	214,078	166	0.31	245,589	59	0.10
MMDA	517,622	2,978	2.31	493,481	318	0.26	537,334	3,609	2.66	541,799	801	0.59
Certificates of deposit	169,108	1,040	2.47	128,736	103	0.32	191,990	1,444	2.98	124,083	113	0.36
Total interest-bearing deposits	1,561,412	6,607	1.70	1,579,151	950	0.24	1,607,793	8,488	2.09	1,614,572	1,550	0.38
Secured borrowings	7,529	118	6.30	9,644	(31)	(1.29)	7,470	123	6.53	7,708	75	3.85
Short-term borrowings	64,558	772	4.80	206	1	1.09	37,595	428	4.51	10	-	0.43
Total interest-bearing liabilities	1,633,499	7,497	1.84 %	1,589,001	920	0.23 %	1,652,858	9,039	2.17 %	1,622,290	1,625	0.40 %
Non-interest bearing deposits	568,202			593,120			548,682			589,228		
Non-interest bearing liabilities	29,479			27,164			29,638			29,030		
Total liabilities	2,231,180			2,209,285			2,231,178			2,240,548		
Shareholders' equity	176,420			169,299			177,158			167,339		

Total liabilities and shareholders' equity	$ 2,407,600			$ 2,378,584			$ 2,408,336			$ 2,407,887		
Net interest income - FTE		$ 16,207			$ 18,827			$ 15,339			$ 19,197	
Net interest spread			2.28 %			3.27 %			2.01 %			3.20 %
Net interest margin			2.82 %			3.34 %			2.63 %			3.32 %
Cost of funds			1.37 %			0.17 %			1.63 %			0.29 %

	Six months ended						Nine months ended					
(dollars in thousands)	June 30, 2023			June 30, 2022			September 30, 2023			September 30, 2022		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets												
Interest-bearing deposits	$ 6,669	$ 152	4.60 %	$ 53,620	$ 113	0.43 %	$ 7,548	$ 212	3.76 %	$ 55,571	$ 464	1.12 %
Restricted investments in bank stock	4,622	181	7.89	3,384	64	3.83	4,332	240	7.41	3,472	120	4.62
Investments:												
Agency - GSE	112,358	818	1.47	118,630	863	1.47	112,267	1,224	1.46	118,052	1,309	1.48
MBS - GSE residential	245,101	2,177	1.79	270,652	2,260	1.68	241,628	3,232	1.79	268,494	3,416	1.70
State and municipal (nontaxable)	234,619	3,407	2.93	263,457	3,894	2.98	233,105	5,066	2.91	260,855	5,811	2.98
State and municipal (taxable)	86,033	891	2.09	89,657	900	2.02	86,032	1,335	2.08	88,513	1,348	2.04
Total investments	678,111	7,293	2.17	742,396	7,917	2.15	673,032	10,857	2.16	735,914	11,884	2.16
Loans and leases:												
C&I and CRE (taxable)	759,483	21,571	5.73	757,641	17,959	4.78	766,197	33,146	5.78	754,781	27,387	4.85
C&I and CRE (nontaxable)	106,760	2,182	4.12	68,973	1,091	3.19	100,873	3,112	4.13	69,555	1,711	3.29
Consumer	237,784	5,013	4.25	204,056	3,886	3.84	236,984	7,630	4.30	211,031	6,070	3.85
Residential real estate	513,599	10,410	4.09	444,368	7,564	3.43	521,251	15,984	4.10	451,880	11,780	3.49
Total loans and leases	1,617,626	39,176	4.88	1,475,038	30,500	4.17	1,625,305	59,872	4.93	1,487,247	46,948	4.22
Total interest-earning assets	2,307,028	46,802	4.09 %	2,274,438	38,594	3.42 %	2,310,217	71,181	4.12 %	2,282,204	59,416	3.48 %
Non-interest earning assets	96,427			124,452			94,883			119,718		
Total assets	$ 2,403,455			$ 2,398,890			$ 2,405,100			$ 2,401,922		
Liabilities and shareholders' equity												
Interest-bearing liabilities												
Deposits:												
Interest-bearing checking	$ 646,320	$ 3,745	1.17 %	$ 719,153	$ 952	0.27 %	$ 652,409	$ 7,013	1.44 %	$ 713,743	$ 1,529	0.29 %
Savings and clubs	228,666	339	0.30	244,779	52	0.04	223,750	506	0.30	245,052	112	0.06
MMDA	530,474	5,529	2.10	490,357	546	0.22	532,786	9,138	2.29	507,693	1,346	0.35
Certificates of deposit	154,858	1,612	2.10	131,337	222	0.34	167,371	3,056	2.44	128,893	334	0.35
Total interest-bearing deposits	1,560,318	11,225	1.45	1,585,626	1,772	0.23	1,576,316	19,713	1.67	1,595,381	3,321	0.28
Secured borrowings	7,538	229	6.13	10,111	34	0.68	7,515	352	6.26	9,301	109	1.56
Short-term borrowings	56,791	1,356	4.82	104	1	1.09	50,322	1,784	4.74	72	1	1.06

Total interest-bearing liabilities	1,624,647	12,810	1.59%	1,595,841	1,807	0.23%	1,634,153	21,849	1.79%	1,604,754	3,431	0.29%
Non-interest bearing deposits	577,045			589,760			567,487			589,581		
Non-interest bearing liabilities	29,565			27,087			29,590			27,741		
Total liabilities	2,231,257			2,212,688			2,231,230			2,222,076		
Shareholders' equity	172,198			186,202			173,870			179,846		
Total liabilities and shareholders' equity	$ 2,403,455			$ 2,398,890			$ 2,405,100			$ 2,401,922		
Net interest income - FTE		$ 33,992			$ 36,787			$ 49,332			$ 55,985	
Net interest spread			2.50%			3.19%			2.33%			3.19%
Net interest margin			2.97%			3.26%			2.86%			3.28%
Cost of funds			1.17%			0.17%			1.33%			0.21%

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Changes in net interest income are a function of both changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities. The following table presents the extent to which changes in interest rates and changes in volumes of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (1) the changes attributable to changes in volume (changes in volume multiplied by the prior period rate), (2) the changes attributable to changes in interest rates (changes in rates multiplied by prior period volume) and (3) the net change. The combined effect of changes in both volume and rate has been allocated proportionately to the change due to volume and the change due to rate. Tax-exempt income was not converted to a tax-equivalent basis on the rate/volume analysis:

	Six months ended June 30,						Nine months ended September 30,					
(dollars in thousands)	2023 compared to 2022			2022 compared to 2021			2023 compared to 2022			2022 compared to 2021		
	Increase (decrease) due to						Increase (decrease) due to					
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
Interest income:												
Interest-bearing deposits	$ (179)	$ 218	$ 39	$ (48)	$ 101	$ 53	$ (655)	$ 403	$ (252)	$ (92)	$ 442	$ 350
Restricted investments in bank stock	30	87	117	8	(12)	(4)	35	85	120	10	14	24
Investments:												
Agency - GSE	(46)	1	(45)	388	37	425	(63)	(21)	(84)	415	74	489
MBS - GSE residential	(222)	139	(83)	916	228	1,144	(353)	168	(185)	1,098	407	1,505
State and municipal	(333)	(68)	(401)	1,345	(43)	1,302	(464)	(146)	(610)	1,552	-	1,552
Total investments	(601)	72	(529)	2,649	222	2,871	(880)	1	(879)	3,065	481	3,546
Loans and leases:												
Residential real estate	1,280	1,566	2,846	2,318	(262)	2,056	1,957	2,248	4,205	3,096	(77)	3,019
C&I and CRE	937	3,536	4,473	3,227	(231)	2,996	1,550	5,313	6,863	2,925	(110)	2,815
Consumer	684	443	1,127	795	(30)	765	792	768	1,560	1,042	(98)	944
Total loans and leases	2,901	5,545	8,446	6,340	(523)	5,817	4,299	8,329	12,628	7,063	(285)	6,778
Total interest income	2,151	5,922	8,073	8,949	(212)	8,737	2,799	8,818	11,617	10,046	652	10,698
Interest expense:												
Deposits:												
Interest-bearing checking	(106)	2,898	2,792	279	(121)	158	(142)	5,626	5,484	309	(38)	271
Savings and clubs	(4)	291	287	14	(24)	(10)	(11)	405	394	19	5	24
Money market	48	4,935	4,983	138	(109)	29	70	7,722	7,792	212	396	608
Certificates of deposit	47	1,344	1,391	45	(155)	(110)	128	2,594	2,722	-	(165)	(165)
Total deposits	(15)	9,468	9,453	476	(409)	67	45	16,347	16,392	540	198	738
Secured borrowings	(11)	206	195	34	-	34	(25)	268	243	36	(48)	(12)

Overnight borrowings	1,353	2	1,355	-	1	1	1,781	2	1,783	-	1	1
FHLB advances	-	-	-	(26)	-	(26)	-	-	-	(26)	-	(26)
Total interest expense	1,327	9,676	11,003	484	(408)	76	1,801	16,617	18,418	550	151	701
Net interest income	$ 824	$ (3,754)	$ (2,930)	$ 8,465	$ 196	$ 8,661	$ 998	$ (7,799)	$ (6,801)	$ 9,496	$ 501	$ 9,997

Provision for credit losses

The provision for credit losses represents the necessary amount to charge against current earnings, the purpose of which is to increase the allowance for credit losses to a level that represents management's best estimate of expected credit losses in the Company's loan portfolio. Loans determined to be uncollectible are charged off against the allowance. The required amount of the provision for credit losses, based upon the adequate level of the allowance, is subject to the ongoing analysis of the loan portfolio. The Company's Special Assets Committee meets periodically to review problem loans. The committee is comprised of management, including credit administration officers, loan officers, loan workout officers and collection personnel.

Management continuously reviews the risks inherent in the loan portfolio. The determination of the amounts of the allowance for credit losses and the provision for credit losses is based on management's current judgments about the credit quality of the Company's financial assets and known and expected relevant internal and external factors that significantly affect collectability such as historical loss information. current conditions, and reasonable and supportable forecasts, including significant qualitative factors.

On January 1, 2023, the Company adopted Accounting Standard Update 2016-13, *Financial Instruments - Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments (CECL)* and recorded an increase of $0.7 million in the allowance for credit losses on loans and an increase of $1.1 million in the allowance for credit losses on unfunded loan commitments. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP.

For the three months ended June 30, 2023 September 30, 2023, the provision for credit losses on loans was $0.7 million $0.5 million due to a reduction growth and change in composition of $33.1 million the loan portfolio along with slower prepayment speeds and curtailment rates, which are key assumptions used in the balance of municipal loans which were replaced by $22.9 million in commercial real estate and $12.8 in residential mortgage growth in the loan portfolio. estimate. The provision for credit losses on unfunded loan commitments decreased was a net benefit of $0.3 million due to a reduction in the level of unfunded commitments during the quarter which resulted along with lower loss rates related to an improved economic forecast and updated probability of default models used in a $0.1 million credit to that provision. the estimate.

For the six nine months ended June 30, 2023 September 30, 2023, the provision for credit losses on loans was $0.9 million $1.4 million due to $65.6 million the growth and change in composition of growth in the loan portfolio for along with slower prepayment speeds and curtailment rates, which are key assumptions used in the first half of 2023. estimate. The provision for credit losses on unfunded loan commitments increased by $0.2 million was a net benefit of $0.1 million due to six large a reduction in unfunded commercial loan commitments originated during the year. quarter along with lower loss rates related to an improved economic forecast and updated probability of default models used in the estimate.

Due to the Company's adoption of ASU 2016-13 on January 1, 2023, comparability of the prior period provision is not considered relevant.

The provision for credit losses derives from the reserve required from the allowance for credit losses calculation. The Company continued provisioning for the three and six nine ended June 30, 2023 September 30, 2023 to maintain an allowance level that management deemed adequate.

For a discussion on the allowance for credit losses, see "Allowance for credit losses," located in the comparison of financial condition section of management's discussion and analysis contained herein.

Other income

For the second third quarter of 2023, non-interest income amounted to $4.5 million $4.3 million, an increase of $0.3 $0.4 million, or 7% 11%, compared to $4.2 million $3.9 million recorded for the same 2022 period. The increase was due to $0.3 million in $0.2 million more trust fees, from commercial loans with interest rate hedges, $0.2 million higher $0.1 million additional service charges on deposits $0.1 million more trust fees and $0.1 million in recoveries from acquired charged-off loans. Partially offsetting these increases were $0.2 $0.1 million lower higher gains on loan sales from less mortgage activity during the second quarter of 2023 compared to the second quarter of 2022. The Company also had a $0.2 million write-down from a branch closure with the property moved to held-for-sale during the second quarter of 2023..

Non-interest income totaled $9.0 million $13.3 million for the six nine months ended June 30, 2023 September 30, 2023, an increase of $0.2 million $0.6 million, or 2% 5%, from the $8.8 million $12.7 million recorded for the six nine months ended June 30, 2022 September 30, 2022. The increase was primarily due to $0.4 million higher deposit service charges, $0.3 million higher trust fiduciary fees, $0.3 million in recoveries from acquired charged-off loans, $0.3 million higher deposit service charges, $0.2 million in additional commercial loans fees from interest rate hedges, $0.2 million higher trust fiduciary more debit card interchange fees and $0.1 million recorded for a death claim on BOLI and $0.1

million more debit card interchange fees. BOLI. Partially offsetting these increases were $0.8 $0.7 million lower gains on loan sales and $0.2 million less loan service charges due to scaled back demand for mortgages and less service fees recorded on commercial loans.

Operating expenses

For the quarter ended June 30, 2023 September 30, 2023, total non-interest expenses were $13.4 million $12.8 million, an increase a decrease of $0.6 million $0.2 million, or 5% 2%, compared to $12.8 million $13.0 million for the same 2022 quarter. Premises and equipment expenses increased $0.4 million, or 19%, primarily due to higher equipment maintenance and rental expenses from investments in new technology. The FDIC assessment expense increased $0.3 million due to the higher assessment rate for 2023 that was approved during 2022. Other increases in non-interest expenses are as follows: $0.2 million in fraud losses and $0.2 million in professional services. Partially offsetting these increases, salary Salary and employee benefits declined $0.5 million, or 7% 8%, to $6.4 million $6.3 million for the second third quarter of 2023 from $6.9 million $6.8 million for the second third quarter of 2022. The decrease was primarily due to lower employee incentives. incentives and insurance expenses. Advertising and marketing expenses decreased $0.3 million due to a donation made to Fidelity D & D Charitable Foundation during the third quarter of 2022. Partially offsetting these decreases, premises and equipment expenses increased $0.4 million, or 23%, primarily due to higher equipment maintenance and rental expenses and depreciation from investments in new technology and infrastructure. The FDIC assessment expense increased $0.1 million due to the higher assessment rate for 2023. Other increases in non-interest expenses are as follows: $0.1 million in professional services and $0.1 million in data processing and communications expenses.

For the six nine months ended June 30, 2023 September 30, 2023, non-interest expenses increased $0.8 million $0.6 million, or 3% 1%, compared to the six nine months ended June 30, 2022 September 30, 2022, from $25.5 million $38.5 million to $26.3 million $39.1 million. Premises and equipment expenses increased $0.6 million $1.0 million, or 15% 17%, due primarily to higher expenses for equipment maintenance and rentals. rentals along with higher depreciation expense. Professional service expenses grew $0.5 million $0.6 million due to additional consulting, legal and audit expenses. Fraud losses increased $0.3 million due to more counterfeit checks. Partially offsetting these increases, salaries and employee benefit expenses declined $0.7 million $1.3 million, or 5% 6%. The decrease was primarily due to less incentive expense. PA shares tax expense was also $0.3 million $0.5 million lower from declines in shareholders' equity.

The ratios of non-interest expense less non-interest income to average assets, known as the expense ratio, were 1.45% 1.43% and 1.40% 1.44% for the six nine months ended June 30, 2023 September 30, 2023 and 2022. The expense ratio increased was relatively unchanged because of higher the increase in non-interest expenses. expenses was offset by a similar increase in non-interest income. The efficiency ratio (non-GAAP) increased from 55.86% 56.01% at June 30, 2022 September 30, 2022 to 61.10% 62.33% at June 30, 2023 September 30, 2023 due to non-interest expenses increasing as net interest income declined. For more information on the calculation of the efficiency ratio, see “Non-GAAP Financial Measures” located within this management’s discussion and analysis.

Provision for income taxes

The provision for income taxes decreased $0.7 million $1.3 million for the six nine months ended June 30, 2023 September 30, 2023 compared to the same 2022 period due to tax credits from plug-in hybrid electric vehicles and lower income before taxes. The Company's effective tax rate was 12.8% 11.9% at June 30, 2023 September 30, 2023 compared to 14.4% 14.0% at June 30, 2022 September 30, 2022. The difference between the effective rate and the enacted statutory corporate rate of 21% is due mostly to the effect of tax-exempt income in relation to the level of pre-tax income. The decrease in the effective tax rate was primarily due to lower pre-tax income and the aforementioned tax credits. Due to challenges relating to current market conditions, the Company may not have the ability to make a reliable estimate of all or part of its ordinary income which could cause volatility in the effective tax rate. If the federal corporate tax rate is increased, the Company’s net deferred tax liabilities and deferred tax assets will be re-valued upon adoption of the new tax rate. A federal tax rate increase will increase net deferred tax assets with a corresponding decrease to provision for income taxes.

Comparison of financial condition at
June 30, 2023 September 30, 2023 and December 31, 2022

Overview

Consolidated assets increased $62.9 million $98.4 million to $2.5 billion as of September 30, 2023 from $2.4 billion as of June 30, 2023 approximately the same as December 31, 2022. The increase in assets occurred primarily in the loan portfolio and cash and cash equivalents partially offset by a decline in the investment portfolio. The reduction in the investment portfolio was primarily caused by the sale of securities in order to pay down short-term borrowings. Loan portfolio increases were funded by growth in short-term borrowings.

Funds Deployed:

Investment securities

At the time of purchase, management classifies investment securities into one of three categories: trading, available-for-sale (AFS) or held-to-maturity (HTM). To date, management has not purchased any securities for trading purposes. Some of the securities the Company purchases are classified as AFS even though there is no immediate intent to sell them. The AFS designation affords management the flexibility to sell securities and position the balance sheet in response to capital levels, liquidity needs or changes in market conditions. Debt securities AFS are carried at fair value on the consolidated balance sheets with unrealized gains and losses, net of deferred income taxes, reported separately within shareholders' equity as a component of accumulated other comprehensive income (AOCI). Securities designated as HTM are carried at amortized cost and represent debt securities that the Company has the ability and intent to hold until maturity. For the six nine months ended June 30, 2023 September 30, 2023, AOCI improved declined by $5.0 million $11.7 million due to the change in fair value of the Company's investment securities.

Effective April 1, 2022, the Company transferred agency and municipal bonds with a book value of $245.5 million from AFS to HTM in order to apply the accounting for securities HTM to mitigate the effect AFS accounting has on the balance sheet. The bonds that were transferred had the highest price volatility and consisted of fixed-rate securities representing 70% of the agency portfolio, 70% of the taxable municipal portfolio each laddered out on the short to intermediate part of the yield curve and 35% of the tax-exempt municipal portfolio on the long end of the yield curve were identified as the best candidates given the Company's ability to hold those bonds to maturity. The market value of the securities on the date of the transfer was $221.7 million, after netting unrealized losses totaling $18.9 million. The $18.9 million, net of deferred taxes, will be accreted into other comprehensive income over the life of the bonds. As of June 30, 2023 September 30, 2023, the carrying value of held-to-maturity securities was $223.5 million $223.9 million, net of $16.6 million $16.2 million in remaining transferred after-tax unrealized losses.

The Company utilized a fair value hedge to designate and swap a portion of the fixed rate AFS portfolio. The Company has an approved Derivative Policy that requires Board pre-approval on such balance sheet hedging activates as well as ongoing reporting to its ALCO Committee. The Board has approved up to $200 million in notional amount of pay-fixed interest rate swap and the Company has executed on $100 million to date.
During September 2023, the Company entered into a $100 million interest rate swap with a third-party financial institution to limit the risk to the investment portfolio of rising interest rates. The interest rate swap was designated as a fair value hedge and utilized a pay fixed interest rate swap to hedge the change in fair value attributable to the movement in the Secured Overnight Financing Rate ("SOFR"). The Company designated $50 million of the swap's notional balance as a hedge against the closed portfolio of 20-year mortgage-backed securities and $50 million as a hedge against the closed portfolio of tax-free municipal bonds. As of June 30, 2023 September 30, 2023, the Company recorded the fair value of the swap of $104 thousand in accrued interest payable and other liabilities on the consolidated balance sheet offset by a $104 thousand increase to the carrying value of designated investment securities.
As of September 30, 2023, the carrying value of investment securities amounted to $604.3 million, $576.7 million, or 25% 23% of total assets, compared to $643.6 million, or 27% of total assets, as of December 31, 2022. On June 30, 2023 September 30, 2023, 33% 32% of the carrying value of the investment portfolio was comprised of U.S. Government Sponsored Enterprise residential mortgage-backed securities (MBS – GSE residential or mortgage-backed securities) that amortize and provide monthly cash flow that the Company can use for reinvestment, loan demand, unexpected deposit outflow, facility expansion or operations. The mortgage-backed securities portfolio includes only pass-through bonds issued by Fannie Mae, Freddie Mac and the Government National Mortgage Association (GNMA).

The Company's municipal (obligations of states and political subdivisions) portfolio is comprised of tax-free municipal bonds with a book value of $238.8 $238.0 million and taxable municipal bonds with a book value of $92.2 $92.1 million. The overall credit ratings of these municipal bonds was as follows: 38% AAA, 61% AA, and 1% A. For municipal securities HTM, the Company utilized a third-party model to analyze whether a credit loss reserve is needed for these bonds. The amount of the credit loss reserve calculated was immaterial because of the underlying strong credit quality of the municipal portfolio.

During the first six nine months of 2023, the carrying value of total investments decreased $39.3 million, $66.9 million, or 6% 10%. During January 2023 with the 10-year U.S. Treasury yield declining, $31.2 million of securities were able to be sold yielding 3.62% (FTE yield of 4.33%) at a breakeven level. These proceeds were used to pay down FHLB overnight borrowings costing 4.80% at that time. Additionally, principal reductions during the first six nine months of 2023 totaled $13.4 million. Partially offsetting the decreases, $19.4 million and there was an improvement a decline in the unrealized loss position of $6.3 million $14.8 million in the AFS portfolio. The Company attempts to maintain a well-diversified and proportionate investment portfolio that is structured to complement the strategic direction of the Company. Its growth typically supplements the lending activities but also considers the current and forecasted economic conditions, the Company's liquidity needs and interest rate risk profile. profile, to the extent possible.

A comparison of investment securities at June 30, 2023 September 30, 2023 and December 31, 2022 is as follows:

	June 30, 2023				December 31, 2022				September 30, 2023				December 31, 2022			
(dollars in thousands)	Amount	%	Book yield	Reprice term	Amount	%	Book yield	Reprice term	Amount	%	Book yield	Reprice term	Amount	%	Book yield	Reprice term
HTM securities:																
Obligations of states & political subdivisions - tax exempt	$ 83,453	13.8%	2.1%	21.3	$ 83,426	13.0%	3.8%	21.8	$ 83,469	14.4%	2.1%	21.1	$ 83,426	13.0%	3.8%	21.8

Obligations of states & political subdivisions - taxable	59,188	9.8	2.1	11.8	59,012	9.1	3.1	12.3	59,277	10.3	2.1	11.6	59,012	9.1	3.1	12.3
Agency - GSE	80,838	13.4	1.4	6.9	80,306	12.5	2.6	7.4	81,107	14.1	1.4	6.7	80,306	12.5	2.6	7.4
Total HTM securities	$ 223,479	37.0%	1.8%	13.6	$ 222,744	34.6%	3.2%	14.1	$ 223,853	38.8%	1.8%	13.4	$ 222,744	34.6%	3.2%	14.1
AFS debt securities:																
MBS - GSE residential	$ 201,852	33.3%	1.8%	6.5	$ 217,435	33.8%	1.8%	6.4	$ 186,829	32.4%	1.8%	6.4	$ 217,435	33.8%	1.8%	6.4
Obligations of states & political subdivisions - tax exempt	129,110	21.4	2.1	11.5	149,131	23.2	2.6	11.4	117,122	20.3	2.1	18.4	149,131	23.2	2.6	11.4
Obligations of states & political subdivisions - taxable	22,877	3.8	1.6	6.1	22,763	3.5	1.6	6.6	22,425	3.9	1.6	5.9	22,763	3.5	1.6	6.6
Agency - GSE	26,946	4.5	1.2	4.8	31,533	4.9	1.4	4.6	26,459	4.6	1.2	4.5	31,533	4.9	1.4	4.6
Total AFS debt securities	$ 380,785	63.0%	1.9%	8.0	$ 420,862	65.4%	2.0%	8.0	$ 352,835	61.2%	1.9%	10.3	$ 420,862	65.4%	2.0%	8.0
Total securities	$ 604,264	100.0%	1.9%	10.0	$ 643,606	100.0%	2.4%	9.9	$ 576,688	100.0%	1.9%	11.4	$ 643,606	100.0%	2.4%	9.9

The investment securities portfolio contained no private label mortgage-backed securities, collateralized mortgage obligations, collateralized debt obligations, or trust preferred securities, and no off-balance sheet derivatives were in use. securities. The portfolio had no adjustable-rate instruments as of June 30, 2023 September 30, 2023 and December 31, 2022. However, management is currently evaluating, with a third-party derivative expert company, an opportunity to utilize fair value hedge portfolio layer method to designate and swap a portion of the fixed rate AFS portfolio. The Company has an approved Derivative Policy that requires Board pre-approval on such balance sheet hedging activates as well as ongoing reporting to its ALCO Committee.

Investment securities were comprised of AFS and HTM securities as of June 30, 2023 September 30, 2023 and December 31, 2022. The AFS securities were recorded with a net unrealized loss of $61.6 million $82.7 million and a net unrealized loss of $67.9 million as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively. Of the $6.3 million $14.8 million net improvement; $4.2 million decline; $7.7 million was attributable to municipal securities; $1.7 million $6.9 million was attributable to mortgage-backed securities and $0.4 $0.2 million was attributable to agency securities. During the second quarter of 2022, securities with net unrealized losses totaling $23.9 million were transferred to HTM and for the six nine months ended June 30, 2023 $1.1 million September 30, 2023 $1.7 million was accreted against other comprehensive income. The direction and magnitude of the change in value of the Company's investment portfolio is attributable to the direction and magnitude of the change in interest rates along the treasury yield curve. Generally, the values of debt securities move in the opposite direction of the changes in interest rates. As interest rates along the treasury yield curve rise, especially at the intermediate and long end, the values of debt securities tend to decline. Whether or not the value of the Company's investment portfolio will change above or below its amortized cost will be largely dependent on the direction and magnitude of interest rate movements and the duration of the debt securities within the Company's investment portfolio. Management does not consider the reduction in value attributable to changes in credit quality. Correspondingly, when interest rates decline, the market values of the Company's debt securities portfolio could be subject to market value increases.

As of June 30, 2023September 30, 2023, the Company had $291.7 million had $307.1 million in public deposits, or 14% of total deposits. As of June 30, 2023September 30, 2023, trust deposits were $96.7 million, $102.7 million, or 4% 5% of total deposits. Pennsylvania state law requires the Company to maintain pledged securities on public and trust deposits or otherwise obtain a FHLB letter of credit or FDIC insurance for these customers. As of June 30, 2023September 30, 2023, the balance of pledged securities required for public and trust deposits was $382.0 million, $415.9 million, or 63% 72% of total securities.

Quarterly, management performs a review of the investment portfolio to determine the causes of declines in the fair value of each security. The Company uses inputs provided by independent third parties to determine the fair value of its investment securities portfolio. Inputs provided by the third parties are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether impairment exists and whether the impairment is temporary or other-than-temporary. credit losses on debt securities exist. Considerations such as the Company's intent and ability to hold the securities until or sell prior to maturity, recoverability of the invested amounts over the intended holding period, the length of time and the severity in pricing decline below cost, the interest rate environment, the receipt of amounts contractually due and whether or not there is an active market for the securities, for example, are applied, along with an analysis of the financial condition of the issuer for management to make a realistic judgment of the probability that the Company will be unable to collect all amounts (principal and interest) due in determining whether a security is other-than-temporarily impaired. has credit losses. If a decline in value is deemed to be other-than-temporary, credit losses, a contra-asset is recorded for the OTTI on both HTM and AFS securities, limited by the amount that the fair value is less than the amortized cost basis. During the quarter ended June 30, 2023 September 30, 2023, the Company did not incur other-than-temporary impairment charges any credit losses on debit securities from its investment securities portfolio.

Due to volatility in the levels of borrowings during October 2023 and the increasing expected dependency on borrowing capacity from experiencing deposit fluctuations while funding loan growth, the Company evaluated a liquidity strategy to deleverage the reliance on short-term borrowings. As a result of this evaluation, in November 2023, the Company sold longer term available-for-sale general market tax-free municipal securities with a carrying value of $35.6 million as part of a liquidity and net interest margin enhancement strategy for a $6.5 million loss recognized in gain (loss) on sale of available-for-sale debt securities. This loss will be reflected in and adversely affect the Company's fourth quarter 2023 operating results. The $29.1 million in proceeds received were used to retire short-term borrowings with a cost of approximately 5.50%. Management made the decision to sell these particular securities because they had a weighted average yield of 1.28% with a 13.5 year weighted average maturity. While the Company has ample funding sources available, management felt it prudent to create additional capacity for the borrowings over the near term should the banking industry again experience funding pressures as it did in March of this year. In addition, since the municipal securities sold were purchased in a much lower rate environment, there is an immediate improvement in net interest margin (NIM) of over 5 bps as a result of paying down the borrowing with the sale proceeds. The sale removes a 422 basis point negative spread and will incrementally improve net interest income, earnings per share and NIM every year starting in 2024. The cost savings from paying down the advances with the sale of low yielding bonds will also allow the pre-tax loss of $6.5 million realized on the sale to be fully recouped prior to the term of the bonds sold. The effect of the security sales is expected to reduce regulatory ratios by 25-30 basis points for 2023.

Restricted investments in bank stock

Investment in Federal Home Loan Bank (FHLB) stock is required for membership in the organization and is carried at cost since there is no market value available. The amount the Company is required to invest is dependent upon the relative size of outstanding borrowings the Company has with the FHLB of Pittsburgh. Excess stock is repurchased from the Company at par if the amount of borrowings decline to a predetermined level. In addition, the Company earns a return or dividend based on the amount invested. Atlantic Community Bankers Bank (ACBB) stock totaled $82 thousand as of June 30, 2023 September 30, 2023 and December 31, 2022. The balance in FHLB stock was $3.6 million $3.7 million and $5.2 million as of June 30, 2023 September 30, 2023 and December 31, 2022, respectively. The dividends received from the FHLB totaled $161 $229 thousand and $66 $109 thousand for the six nine months ended June 30, 2023 September 30, 2023 and 2022, respectively.

Loans held-for-sale (HFS)

Upon origination, most residential mortgages and certain Small Business Administration (SBA) guaranteed loans may be classified as held-for-sale (HFS). In the event of market rate increases, fixed-rate loans and loans not immediately scheduled to re-price would no longer produce yields consistent with the current market. In declining interest rate environments, the Company would be exposed to prepayment risk as rates on fixed-rate loans decrease, and customers look to refinance loans. Consideration is given to the Company's current liquidity position and projected future liquidity needs. To better manage prepayment and interest rate risk, loans that meet these conditions may be classified as HFS. Occasionally, residential mortgage and/or business loans may be transferred from the loan portfolio to HFS. The carrying value of loans HFS is based on the lower of cost or estimated fair value. If the fair values of these loans decline below their original cost, the difference is written down and charged to current earnings. Subsequent appreciation in the portfolio is credited to current earnings but only to the extent of previous write-downs.

As of June 30, 2023 September 30, 2023 and December 31, 2022, loans HFS consisted of residential mortgages with carrying amounts of $1.8 million $2.3 million and $1.6 million, respectively, which approximated their fair values. During the six nine months ended June 30, 2023 September 30, 2023, residential mortgage loans with principal balances of $23.2 million $37.9 million were sold into the secondary market and the Company recognized net gains of $0.4 million $0.7 million, compared to $52.3 million $68.0 million and $1.2 $1.4 million, respectively, during the six nine months ended June 30, 2022 September 30, 2022.

The Company retains mortgage servicing rights (MSRs) on loans sold into the secondary market. MSRs are retained so that the Company can foster personal relationships. At June 30, 2023 September 30, 2023 and December 31, 2022, the servicing portfolio balance of sold residential mortgage loans was $469.9 million $473.0 million and $465.7 million, respectively, with mortgage servicing rights of $1.5 million and $1.6 million for the same periods, respectively.

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Loans and leases

As of June 30, 2023 September 30, 2023, the Company had gross loans and leases totaling over $1.6 billion, an increase of $65.6 $81.2 million, or 4% 5%, compared to almost $1.6 billion at December 31, 2022.

During the six nine months ended June 30, 2023 September 30, 2023, the growth in the portfolio was primarily attributed to a $19.7 million $31.8 million increase in the commercial portfolio and a $37.5 million $48.0 million increase in the residential portfolio, the result of a higher percentage of adjustable rate mortgages recorded as held-for-investment during this period.

As management continues to identify ways to optimize the Company's balance sheet, the focus is to lend in areas that provide better risk-adjusted returns and improved opportunities to deepen relationships with our customers. This could result in a change in the composition of the loan portfolio in future periods.
The composition of the loan portfolio at June 30, 2023 September 30, 2023 and December 31, 2022 is summarized as follows:

	June 30, 2023		December 31, 2022		September 30, 2023		December 31, 2022	
(dollars in thousands)	Amount	%	Amount	%	Amount	%	Amount	%
Commercial and industrial:								
Commercial	$ 135,164	8.3 %	$ 141,122	9.0 %	$ 145,185	8.8 %	$ 141,122	9.0 %
Municipal	77,018	4.7	72,996	4.7	82,058	5.0	72,996	4.7
Commercial real estate:								
Non-owner occupied	314,838	19.3	318,296	20.3	311,306	18.9	318,296	20.3
Owner occupied	294,718	18.1	284,677	18.2	291,573	17.7	284,677	18.2
Construction	39,057	2.4	24,005	1.5	42,773	2.6	24,005	1.5
Consumer:								
Home equity installment	58,623	3.6	59,118	3.8	57,856	3.5	59,118	3.8
Home equity line of credit	52,501	3.2	52,568	3.4	51,409	3.1	52,568	3.4
Auto loans - Recourse	11,924	0.7	12,929	0.8	11,358	0.7	12,929	0.8
Auto loans - Non-recourse	121,230	7.4	114,909	7.3	117,266	7.1	114,909	7.3
Direct finance leases	34,691	2.1	33,223	2.1	33,902	2.1	33,223	2.1
Other	13,882	0.9	11,709	0.7	14,158	0.9	11,709	0.7
Residential:								
Real estate	429,816	26.4	398,136	25.5	445,016	27.0	398,136	25.5
Construction	48,087	2.9	42,232	2.7	43,337	2.6	42,232	2.7
Gross loans	1,631,549	100.0 %	1,565,920	100.0 %	1,647,197	100.0 %	1,565,920	100.0 %
Less:								
Allowance for credit losses	(18,350)		(17,149)		(18,757)		(17,149)	
Unearned lease revenue	(1,885)		(1,746)		(1,989)		(1,746)	
Net loans	$ 1,611,314		$ 1,547,025		$ 1,626,451		$ 1,547,025	
Loans held-for-sale	$ 1,808		$ 1,637		$ 2,345		$ 1,637	

Commercial & industrial (C&I) and commercial real estate (CRE)

As of June 30, 2023 September 30, 2023, the commercial portfolio increased by $19.7 million $31.8 million, or 2% 4%, to $860.8 million $872.9 million compared to the December 31, 2022 balance of $841.1 million due to two owner-occupied growth of $13.1 million in total commercial and industrial loans and $18.7 million in growth in commercial real estate loans totaling $19.6 million. loans.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum values have been established by the Company and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, independent collateral appraisals, etc.

For the six nine months ended June 30, 2023 September 30, 2023, commercial and industrial loans decreased $5.9 million increased $4.1 million, or 4% 3%, from $141.1 million at December 31, 2022 to $135.2 million $145.2 million at June 30, 2023 September 30, 2023, which was the result of originations and line advances not keeping pace with outpacing scheduled payments and line pay-downs/offs, as most businesses utilized excess cash balances to repay floating-rate debt. offs.

Municipal loans are secured by the full faith and credit of respective local government units located in the Commonwealth of Pennsylvania authorized in accordance with the Local Government Unit Debt Act. These loans have a long history of performance within contractual terms with no defaults noted.

For the six nine months ended June 30, 2023 September 30, 2023, municipal loans increased $4.0 million $9.1 million, or 6% 12%, from $73.0 million at December 31, 2022 to $77.0 million $82.1 million at June 30, 2023 September 30, 2023, which was attributed to $3.3 million $6.6 million in originations during the year excluding municipal loans originated and paid off during the first half of 2023, along with advances on loan commitments.

Commercial real estate loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the complexities involved in valuing the underlying collateral whose values tend to move inversely with interest rates. These loans are generally secured with mortgages, or commercial real estate mortgages (CREM) against the subject property. In underwriting commercial real estate construction loans, the Company performs a robust analysis of the financial condition of the borrower, the borrower's credit history, and the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate loans originated by the Company are performed by independent appraisers consistent with Uniform Standards of Professional Appraisal Practice (USPAP) standards and compliant with Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

Non-owner occupied CRE loans are commercial loans not occupied by their owners and thus rely on income from third parties, including multi-family residential tenants and commercial tenants representing various industries. Underwriting on non-owner occupied CRE loans evaluates cash flow derived from the respective tenants and the industries they occupy. As such, management considers non-owner occupied CRE loans as having a higher risk profile than owner occupied CRE loans. In keeping with its risk appetite and relationship management strategy, the Company avoids speculative commercial office space and prefers loans to projects that have sufficient equity, or loan to value, and have either S&P rated tenants with long term leases, loans structured with personal guarantees of owners whose personal financial strength provides meaningful cash flow support to supplement rental income volatility, residential projects with stable rents in desirable locations, or projects with sufficient diversity and industries proven to provide lower risk over the long term.

For the six nine months ended June 30, 2023 September 30, 2023, non-owner occupied commercial real estate decreased $3.5 million $7.0 million, or 1% 2%, from $318.3 million at December 31, 2022 to $314.8 million $311.3 million at June 30, 2023 September 30, 2023, which was attributed to scheduled monthly payments.

Owner occupied commercial real estate loans are occupied by their owners which rely on income generated from the respective owners' businesses. Therefore, underwriting on owner occupied CRE loans emphasizes the owner's cash flow and financial conditions while the real estate typically represents the owners' primary business location. As such, management considers owner occupied CRE loans as having a lower risk profile than non-owner occupied CRE loans.

For the six nine months ended June 30, 2023 September 30, 2023, owner occupied commercial real estate increased $10.0 million $6.9 million, or 4% 2%, from $284.7 million at December 31, 2022 to $294.7 million $291.6 million at June 30, 2023 September 30, 2023, which was attributed to a $10 million CRE loan originated during the second quarter.

Construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans. Management prefers lending to well-established developers with a proven track record and strong business and guaranteed with owners' personal financial conditions.

For the six nine months ended June 30, 2023 September 30, 2023, commercial construction increased $15.1 million $18.8 million, or 63% 78%, from $24.0 million at December 31, 2022 to $39.1 million $42.8 million at June 30, 2023 September 30, 2023, which was primarily attributable to $10.8 million $12.4 million in fundings on four large construction loans originated prior to December 31, 2022 and $4.1 million in originations. $7.6 million commercial construction loans originated during 2023.

Consumer

The consumer loan portfolio consisted of home equity installment, home equity line of credit, non-recourse auto loans, recourse auto loans, direct finance leases and other consumer loans.

As of June 30, 2023 September 30, 2023, the consumer loan portfolio increased by $8.4 million $1.5 million, or 3% 1%, to $292.8 million $285.9 million compared to the December 31, 2022 balance of $284.4 million, primarily due to growth in the non-recourse auto portfolio from continued demand for higher priced automobiles and new dealer relationships.

Residential

As of June 30, 2023 September 30, 2023, the residential loan portfolio increased by $37.5 million $47.9 million, or 9% 11%, to $477.9 million $488.3 million compared to the December 31, 2022 balance of $440.4 million. The increase was due to a shift from mortgage loans sold to loans held-for-investment due to increased jumbo loans, the pricing of loans in the secondary market and $22.4 million $28.9 million more adjustable-rate mortgages which are not being sold in the secondary market.

The residential loan portfolio consisted primarily of held-for-investment residential loans for primary residences, including approximately $363 million$372 million in fixed-rate and $67 million$73 million in adjustable-rate mortgages as of June 30, 2023September 30, 2023. Management expects the sudden historic rise in interest rates to impact demand for residential mortgages for the remainder of 2023.

The Company considers its portfolio segmentation, including the real estate secured portfolio, to be normal and reasonably diversified. The banking industry is affected by general economic conditions including, among other things, the effects of real estate values. The Company ensures that its mortgage lending adheres to standards of secondary market compliance. Furthermore, the Company's credit function strives to mitigate the negative impact of economic conditions by maintaining strict underwriting principles for all loan types.

Allowance for credit losses

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for credit losses (ACL) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. When estimating the net amount expected to be collected, Management considers the effects of past events, current conditions, and reasonable and supportable forecasts of the collectability of the Company's financial assets. Those estimates may be susceptible to significant change. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

The methodology to analyze the adequacy of the ACL is based on seven primary components:

- **Data:** The quality of the Company's data is critically important as a foundation on which the ACL estimate is generated. For its estimate, the Company uses both internal and external data with a preference toward internal data where possible. Data is complete, accurate, and relevant, and subjected to appropriate governance and controls.
- **Segmentation:** Financial assets are segmented based on similar risk characteristics.
- **Contractual term of financial assets:** The contractual term of financial assets is a significant driver of ACL estimates. Financial assets or pools of financial assets with shorter contractual maturities typically result in a lower reserve than those with longer contractual maturities. As the average life of a financial asset or pool of assets increases, there generally is a corresponding increase to the ACL estimate because the likelihood of default is considered over a longer time frame. As such, pool-based assumptions for a pool's contractual term (i.e., average life) are based on the contractual maturity of the financial assets within the pool and adjusted in accordance with GAAP, if appropriate.
- **Credit loss measurement method:** Multiple measurement methods for estimating ACLs are allowable per ASC Topic 326. The Company applies different estimation methods to different groups of financial assets. The discounted cash flow method is used for the commercial & industrial, commercial real estate non-owner occupied, commercial real estate owner occupied, commercial construction, home equity installment loan, home equity line of credit, residential real estate, and residential construction pools. The weighted average remaining maturity (WARM) method is used for the municipal, non-recourse auto, recourse auto, direct finance lease, and consumer other pools.
- **Reasonable and supportable forecasts:** ASC Topic 326 requires management to consider reasonable and supportable forecasts that affect expected collectability of financial assets. As such, the Company's forecasts incorporate anticipated changes in the economic environment that may affect credit loss estimates over a time horizon when management can reasonably support and document expectations. Forward-looking information may reflect positive or negative expectations relative to the current environment. As of the reporting date, management is using the median Federal Open Market Committee (FOMC) National Gross Domestic Product (GDP) and unemployment rate forecasts as well as the Federal Housing Finance Agency (FHFA) House Price Index (HPI) for its reasonable and supportable forecasts. The Company currently uses a 12-month (4 quarter) reasonable and supportable forecast period.
- **Reversion period:** ASC Topic 326 does not require management to estimate a reasonable and supportable forecast for the entire contractual life of financial assets. Management may apply reversion techniques for the contractual life remaining after considering the reasonable and supportable forecast period, which allows management to apply a historical loss rate to latter periods of the financial asset's life. The Company currently uses a 12 month (4 quarter) straight-line reversion period.
- **Qualitative factor adjustments:** The Company's ACL estimate considers all significant factors relevant to the expected collectability of its financial assets as of the reporting date; Qualitative factors reflect the impact of conditions not captured elsewhere, such as the historical loss data or within the economic forecast. The qualitative considerations can be captured directly within measurement models or as additional components in the overall ACL methodologies. Currently, the Company uses the following qualitative factors:

    - levels of and trends in delinquencies and non-accrual loans;
    - levels of and trends in charge-offs and recoveries;
    - trends in volume and terms of loans;
    - changes in risk selection and underwriting standards;
    - changes in lending policies and legal and regulatory requirements;
    - experience, ability and depth of lending management;
    - national and local economic trends and conditions;
    - changes in credit concentrations; and

o changes in underlying collateral.

A key control related to the allowance is the Company's Special Assets Committee. This committee meets quarterly, and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount, if applicable, based on current accounting guidance. The Special Assets Committee's focus is on ensuring the pertinent facts are considered regarding not only loans considered for specific reserves, but also the collectability of loans that may be past due in payment. The assessment process also includes the review of all loans on a non-accruing basis as well as a review of certain loans to which the lenders or the Company's Credit Administration function have assigned a criticized or classified risk rating.

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The following tables set forth the activity in the allowance for credit losses and certain key ratios for the period indicated:

(dollars in thousands)	As of and for the three months ended June 30, 2023	As of and for the twelve months ended December 31, 2022	As of and for the six months ended June 30, 2022	As of and for the nine months ended September 30, 2023	As of and for the twelve months ended December 31, 2022	As of and for the nine months ended September 30, 2022
Balance at beginning of period	$ 17,149	$ 15,624	$ 15,624	$ 17,149	$ 15,624	$ 15,624
Charge-offs:						
Commercial and industrial	(320)	(371)	(31)	(320)	(371)	(323)
Commercial real estate	(32)	(67)	(1)	(92)	(67)	(1)
Consumer	(245)	(377)	(136)	(349)	(377)	(226)
Residential	-	-	-	-	-	-
Total	(597)	(815)	(168)	(761)	(815)	(550)
Recoveries:						
Commercial and industrial	22	11	4	23	11	8
Commercial real estate	41	153	28	44	153	61
Consumer	126	74	50	148	74	59
Residential	10	2	2	30	2	2
Total	199	240	84	245	240	130
Net charge-offs	(398)	(575)	(84)	(516)	(575)	(420)
Impact of adopting ASC 326	618	-	-	618	-	-
Initial allowance on loans purchased with credit deterioration	126	-	-	126	-	-
Provision for credit losses on loans	855	2,100	1,050	1,380	2,100	1,575
Balance at end of period	$ 18,350	$ 17,149	$ 16,590	$ 18,757	$ 17,149	$ 16,779
Allowance for credit losses to total loans	1.13 %	1.10 %	1.11 %	1.14 %	1.10 %	1.13 %
Net charge-offs to average total loans outstanding	0.05 %	0.04 %	0.01 %	0.04 %	0.04 %	0.04 %
Average total loans	$ 1,617,626	$ 1,500,796	$ 1,475,038	$ 1,625,305	$ 1,500,796	$ 1,487,247
Loans 30 - 89 days past due and accruing	$ 1,148	$ 1,838	$ 1,168	$ 2,044	$ 1,838	$ 852
Loans 90 days or more past due and accruing	$ 47	$ 33	$ 49	$ 275	$ 33	$ 50
Non-accrual loans	$ 3,493	$ 2,535	$ 3,206	$ 3,005	$ 2,535	$ 3,020
Allowance for credit losses to non-accrual loans	5.25 x	6.76 x	5.17 x	6.24 x	6.76 x	5.56 x
Allowance for credit losses to non-performing loans	5.18 x	6.68 x	5.10 x	5.72 x	6.68 x	5.47 x

For the six nine months ended June 30, 2023 September 30, 2023, the allowance increased $1.2 million $1.6 million, or 7% 9%, to $18.3 million $18.7 million from $17.1 million at December 31, 2022. The increase in the allowance was based on a $0.7 million adjustment related to the adoption of CECL on January 1, 2023 including a $0.1 million initial allowance on Purchase Credit Deteriorated (PCD) loans related to the reclassification of Purchase Credit Impaired (PCI) loans to PCD along with provisioning of $0.9 million $1.4 million partially offset by net charge-offs of $0.4 million $0.5 million.

The allowance for credit losses as a percentage of total loans increased to 1.13% 1.14% as of June 30, 2023 September 30, 2023 compared to 1.10% at December 31, 2022 as the increase in the allowance (7% (9%) outpaced the growth in the loan portfolio (4% (5%).

Management believes that the current balance in the allowance for credit losses is sufficient to meet the identified potential credit quality issues that may arise and other issues unidentified but inherent to the portfolio. Potential problem loans are those where there is known information that leads management to believe repayment of principal and/or interest is in jeopardy and the loans are currently neither on non-accrual status nor past due 90 days or more.

Although key loss driver assumptions used in the ACL estimate remained largely stable from the day one estimate to the estimate as of June 30, 2023 September 30, 2023, the ACL estimate increased based on growth in the loan and lease portfolio and changes in the composition of the portfolio. portfolio along with slower prepayment and curtailment rates. Key loss driver assumptions included the median Federal Open Market Committee (FOMC) National Gross Domestic Product (GDP) and unemployment rate forecasts, the Federal Housing Finance Agency (FHFA) House Price Index (HPI), prepayment and curtailment rates, and estimated remaining loan lives.

Qualitative factors for the ACL estimate as of June 30, 2023 increased slightly September 30, 2023 were largely unchanged compared to the day one estimate based on as an increase related to higher delinquency in the HELOC portfolio during the second quarter was offset by a reduction related to improvement in the experience, depth, and an increased weighted ability of lending management. average risk rating in the commercial real estate portfolio. portfolio during the first quarter.

The allocation of net charge-offs among major categories of loans are as follows for the periods indicated:

(dollars in thousands)	For the six months ended June 30, 2023	% of Total Net Charge-offs	For the six months ended June 30, 2022	% of Total Net Charge-offs	For the nine months ended September 30, 2023	% of Total Net Charge-offs	For the nine months ended September 30, 2022	% of Total Net Charge-offs
Net charge-offs								
Commercial and industrial	$ (298)	75%	$ (27)	32%	$ (297)	58%	$ (315)	75%
Commercial real estate	9	(2)	27	(32)	(48)	9	60	(14)
Consumer	(119)	30	(86)	102	(201)	39	(167)	40
Residential	10	(3)	2	(2)	30	(6)	2	(1)
Total net charge-offs	$ (398)	100%	$ (84)	100%	$ (516)	100%	$ (420)	100%

For the six nine months ended June 30, 2023 September 30, 2023, net charge-offs against the allowance totaled $398 $516 thousand compared with net charge-offs of $84 $420 thousand for the six nine months ended June 30, 2022 September 30, 2022, representing a $314 $96 thousand, or 23%, increase due to an increase in commercial & industrial real estate and consumer net charge-offs, which was driven by a $300 thousand charge-off to a single borrower. charge-offs. Net charge-offs increased were unchanged as a percentage of the total loan portfolio at 0.05% 0.04% for the six nine months ended June 30, 2023 September 30, 2023 compared to 0.01% 0.04% for the six nine months ended June 30, 2023 September 30, 2022.

For a discussion on the provision for credit losses, see the “Provision for credit losses,” located in the results of operations section of management’s discussion and analysis contained herein.

The allowance for credit losses can generally absorb losses throughout the loan portfolio. However, in some instances an allocation is made for specific loans or groups of loans. Allocation of the allowance for credit losses for different categories of loans is based on the methodology used by the Company, as previously explained. The changes in the allocations from period-to-period are based upon quarter-end reviews of the loan portfolio.

Allocation of the allowance among major categories of loans for the periods indicated, as well as the percentage of loans in each category to total loans, is summarized in the following table. This table should not be interpreted as an indication that charge-offs in future periods will occur in these amounts or proportions, or that the allocation indicates future charge-off trends. When present, the portion of the allowance designated as unallocated is within the Company’s guidelines:

	June 30, 2023	December 31, 2022	June 30, 2022	September 30, 2023	December 31, 2022	September 30, 2022
	Category % of	Category % of	Category % of	Category % of	Category % of	Category % of

(dollars in thousands)	Allowance	Loans	Allowance	Loans	Allowance	Loans	Allowance	Loans	Allowance	Loans	Allowance	Loans
Category												
Commercial real estate	$ 8,578	40 %	$ 7,162	39 %	$ 6,963	40 %	$ 8,799	39 %	$ 7,162	39 %	$ 7,162	39 %
Commercial and industrial	2,361	13	2,924	15	2,745	15	1,866	14	2,924	15	2,674	15
Consumer	2,514	18	2,827	18	2,770	18	2,135	17	2,827	18	2,841	18
Residential real estate	4,847	29	4,169	28	4,037	27	5,933	30	4,169	28	4,022	28
Unallocated	50	-	67	-	75	-	24	-	67	-	80	-
Total	$ 18,350	100 %	$ 17,149	100 %	$ 16,590	100 %	$ 18,757	100 %	$ 17,149	100 %	$ 16,779	100 %

As of June 30, 2023 September 30, 2023, the commercial loan portfolio, consisting of CRE and C&I loans, comprised 60% 57% of the total allowance for credit losses compared with 59% on December 31, 2022. The commercial loan allowance allocation increased decreased based on the adoption of CECL and changes in how reserves are estimated compared to the previous incurred loss methodology.

As of June 30, 2023 September 30, 2023, the consumer loan portfolio comprised 14% 11% of the total allowance for credit losses compared with 17% on December 31, 2022 due to the relative growth in the consumer portfolio.. The consumer loan allowance allocation decreased based on the adoption of CECL and changes in how reserves are estimated compared to the previous incurred loss methodology.

As of June 30, 2023 September 30, 2023, the residential loan portfolio comprised 26% 32% of the total allowance for credit losses compared with 24% on December 31, 2022. The residential loan allowance allocation increased based on the adoption of CECL and changes in how reserves are estimated compared to the previous incurred loss methodology.

As of June 30, 2023 September 30, 2023, the unallocated reserve, representing the portion of the allowance not specifically identified with a loan or groups of loans, was less than 1% of the total allowance for credit losses, unchanged from December 31, 2022.

Non-performing assets

The Company defines non-performing assets as accruing loans past due 90 days or more, non-accrual loans, other real estate owned (ORE) and repossessed assets. Based on the Company's adoption of ASU 2022-02, *Financial Instruments-Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosure*s, the recognition and measurement guidance related to troubled debt restructurings (TDR) has been eliminated. As such, TDRs were removed from non-performing assets at June 30, 2023 September 30, 2023, December 31, 2022, and June 30, 2022 September 30, 2022 in the following table to adhere to this standard and provide better comparability.

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The following table sets forth non-performing assets data as of the period indicated:

(dollars in thousands)	June 30, 2023	December 31, 2022	June 30, 2022	September 30, 2023	December 31, 2022	September 30, 2022
Loans past due 90 days or more and accruing	$ 47	$ 33	$ 49	$ 275	$ 33	$ 50
Non-accrual loans	3,493	2,535	3,206	3,005	2,535	3,020
Total non-performing loans	3,540	2,568	3,255	3,280	2,568	3,070
Other real estate owned and repossessed assets	87	168	128	87	168	103
Total non-performing assets	$ 3,627	$ 2,736	$ 3,383	$ 3,367	$ 2,736	$ 3,173
Total loans, including loans held-for-sale	$ 1,631,472	$ 1,565,811	$ 1,494,316	$ 1,647,553	$ 1,565,811	$ 1,524,328
Total assets	$ 2,441,232	$ 2,378,372	$ 2,414,940	$ 2,476,820	$ 2,378,372	$ 2,435,768
Non-accrual loans to total loans	0.21 %	0.16 %	0.21 %	0.18 %	0.16 %	0.20 %
Non-performing loans to total loans	0.22 %	0.16 %	0.22 %	0.20 %	0.16 %	0.20 %
Non-performing assets to total assets	0.15 %	0.12 %	0.14 %	0.14 %	0.12 %	0.13 %

Management continually monitors the loan portfolio to identify loans that are either delinquent or are otherwise deemed by management unable to repay in accordance with contractual terms. Generally, loans of all types are placed on non-accrual status if a loan of any type is past due 90 or more days or if collection of principal and interest is in doubt.

Further, unsecured consumer loans are charged-off when the principal and/or interest is 90 days or more past due. Uncollected interest income accrued on all loans placed on non-accrual is reversed and charged to interest income.

Non-performing assets represented 0.15% 0.14% of total assets at June 30, 2023 September 30, 2023 compared with 0.12% at December 31, 2022. The increase resulted from a $0.9 million $0.6 million, or 33% 23%, increase in non-performing assets which outpaced the growth in total assets (3% (4%) during this period. Non-performing assets increased due to a $0.2 million increase in loans past due 90 days or more and accruing along with the recognition of $1.5 million in Purchase Credit Deteriorated (PCD) loans, now classified as non-accrual loans, consistent with the changes in financial reporting under ASC Topic 326 (CECL). This was partially offset by a $0.5 million $1.0 million decrease in non-PCD non-accrual loans as well as a $0.1 million decrease in other real estate owned.

At June 30, 2023 September 30, 2023, there were a total of 33 31 non-accrual loans to 28 26 unrelated borrowers with balances that ranged from less than $1 thousand to $1.3 million, or $3.5 million $3.0 million in the aggregate. At December 31, 2022, there were a total of 39 non-accrual loans to 29 unrelated borrowers with balances that ranged from less than $1 thousand to $0.6 million, or $2.5 million in the aggregate.

There were two Loans past due 90 days or more accruing totaled $275 thousand, which was comprised of one direct finance leases totaling $47 lease for $15 thousand, that was over 90 days past due one indirect recourse auto loan for $12 thousand, and one residential real estate loan for $248 thousand as of June 30, 2023 September 30, 2023 compared to one direct finance lease and one non-recourse auto loan totaling $33 thousand that were over 90 days past due as of December 31, 2022. All loans were well secured and in the process of collection.

The Company seeks payments from all past due customers through an aggressive customer communication process. Unless well-secured and in the process of collection, past due loans will be placed on non-accrual at the 90-day point when it is deemed that a customer is non-responsive and uncooperative to collection efforts.

The composition of non-performing loans as of June 30, 2023 September 30, 2023 is as follows:

(dollars in thousands)	Gross loan balances	Past due 90 days or more and still accruing	Non-accrual loans	Total non-performing loans	% of gross loans	Gross loan balances	Past due 90 days or more and still accruing	Non-accrual loans	Total non-performing loans	% of gross loans
Commercial and industrial:										
Commercial	$ 135,164	$ -	$ 636	$ 636	0.47 %	$ 145,185	$ -	$ 56	$ 56	0.04 %
Municipal	77,018	-	-			82,058	-	-		
Commercial real estate:										
Non-owner occupied	314,838	-	168	168	0.05 %	311,306	-	168	168	0.05 %
Owner occupied	294,718	-	2,137	2,137	0.73 %	291,573	-	2,069	2,069	0.71 %
Construction	39,057	-	-	-	-	42,773	-	-	-	-
Consumer:										
Home equity installment	58,623	-	102	102	0.17 %	57,856	-	72	72	0.12 %
Home equity line of credit	52,501	-	90	90	0.17 %	51,409	-	289	289	0.56 %
Auto loans-Recourse	11,924	-	9	9	0.08 %	11,358	12	8	20	0.18 %
Auto loans-Non Recourse	121,230	-	84	84	0.07%	117,266	-	59	59	0.05%
Direct finance leases *	32,806	47	-	47	0.14 %	31,913	15	-	15	0.05 %
Other	13,882	-	1	1	0.01 %	14,158	-	-	-	-
Residential:										
Real estate	429,816	-	266	266	0.06 %	445,016	248	284	532	0.12 %
Construction	48,087	-	-	-	-	43,337	-	-	-	-
Loans held-for-sale	1,808	-	-	-	-	2,345	-	-	-	-
Total	$ 1,631,472	$ 47	$ 3,493	$ 3,540	0.22 %	$ 1,647,553	$ 275	$ 3,005	$ 3,280	0.20 %

*Net of unearned lease revenue of $1.9 million. $2.0 million.

Payments received from non-accrual loans are recognized on a cost recovery method. Payments are first applied to the outstanding principal balance, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of interest income. If the non-accrual loans that were outstanding as of June 30, 2023 September 30, 2023 had been performing in accordance with their original terms, the Company would have recognized interest income with respect to such loans of $195 $228 thousand.

Foreclosedassets held-for-sale

From December 31, 2022 to June 30, 2023 September 30, 2023, foreclosed assets held-for-sale (ORE) declined from $168 thousand to $87 thousand, a an $81 thousand decrease, which was attributed to one ORE property being transferred to non-accrual due to administrative error during the first quarter. One property totaling $86 thousand was added to ORE during 2023.

The following table sets forth the activity in the ORE component of foreclosed assets held-for-sale:

	June 30, 2023		December 31, 2022		September 30, 2023		December 31, 2022	
(dollars in thousands)	Amount	#	Amount	#	Amount	#	Amount	#
Balance at beginning of period	$ 168	2	$ 434	5	$ 168	2	$ 434	5
Additions	86	1	762	3	86	1	762	3
Pay downs	-		(6)		-		(6)	
Write downs	-		(17)		-		(17)	
Transfers	(167)	(1)	-		(167)	(1)	-	
Sold	-	-	(1,005)	(6)	-	-	(1,005)	(6)
Balance at end of period	$ 87	2	$ 168	2	$ 87	2	$ 168	2

As of June 30, 2023 September 30, 2023, ORE consisted of two properties securing loans to two unrelated borrowers totaling $87 thousand. One property ($86 thousand) was added in 2023 and one property ($1 thousand) was added in 2017. Both properties are listed for sale.

As of June 30, 2023 September 30, 2023 and December 31, 2022, the Company had no other repossessed assets held-for-sale.

Cash surrender value of bank owned life insurance

The Company maintains bank owned life insurance (BOLI) for a chosen group of employees at the time of purchase, namely its officers, where the Company is the owner and sole beneficiary of the policies. BOLI is classified as a non-interest earning asset. Increases in the cash surrender value are recorded as components of non-interest income. The BOLI is profitable from the appreciation of the cash surrender values of the pool of insurance and its tax-free advantage to the Company. This profitability is used to offset a portion of current and future employee benefit costs. The BOLI cash surrender value build-up can be liquidated if necessary, with associated tax costs. However, the Company intends to hold this pool of insurance, because it provides income that supports employee benefit cost increases which enhances the Company's capital position. Therefore, the Company has not provided for deferred income taxes on the earnings from the increase in cash surrender value. The Company received a death benefit claim on two owned policies and received $0.8 million in return of cash surrender value and $0.1 million in other income during the first quarter of 2023.

Premises and equipment

Net of depreciation, premises and equipment was relatively unchanged increased $1.3 million during the first half nine months of 2023. The Company purchased $0.7 million $1.1 million in fixed assets and added $1.9 million $3.4 million in construction in process during the first half nine months of 2023. These increases were partially offset by $1.2 million $1.9 million in depreciation expense. The Company closed the Hazle Township branch on March 31, 2023 and listed it for sale during the second quarter of 2023 resulting in a transfer of $0.7 million from premises and equipment to other assets held-for-sale. The Company is planning to open opened a new branch in Wilkes-Barre in 2023. The Company has recently begun remodeling the Main Branch located in Dunmore, PA and remaining estimated costs for the project are currently $3.9 million. approximately $2.0 million and construction is expected to be completed in early 2024. The Company began corporate headquarters construction which may continue to increase construction in process and is evaluating its branch network looking for consolidation that makes sense for more efficient operations. The Company recently entered into a branch relocation lease and is currently negotiating a land lease for a de novo branch in the Lehigh Valley. Construction on these leased properties over the upcoming year is expected to increase bank premises and equipment by approximately $2.6 million.

On December 23, 2020, the Commonwealth of Pennsylvania authorized the release of $2.0 million in Redevelopment Assistance Capital Program (RACP) funding for the Company's headquarters project in Lackawanna County. On December 2, 2021, the Company announced it would be receiving an additional $2.0 million in RACP funding in support of the project. The $4.0 million in total RACP grant funds will be allocated to the renovation and rehabilitation of the historic building located in downtown Scranton which will be used for the new corporate headquarters. The Company currently estimates net remaining costs for the corporate headquarters could range from $15 million to $20 million. This range estimate may expand because it is subject to supply chain issues, commodities pricing and results of final planning over approximately two years through early 2025. In addition, the Company currently is in the process of pursuing a federal historic preservation tax credit which would provide a 20% tax credit on qualified improvements on the historic property.

Other assets

During the first half nine months of 2023, the $0.4 million decrease $4.1 million increase in other assets was due mostly to a $1.1 million decrease $3.4 million increase in deferred tax assets primarily from lower higher net unrealized losses in the investment portfolio partially offset by and a $0.6 million increase in other assets held-for-sale.

Funds Provided:

Deposits

The Company is a community based commercial depository financial institution, member FDIC, which offers a variety of deposit products with varying ranges of interest rates and terms. Generally, deposits are obtained from consumers, businesses and public entities within the communities that surround the Company's 20 21 branch offices and all deposits are insured by the FDIC up to the full extent permitted by law. Deposit products consist of transaction accounts including: savings; clubs; interest-bearing checking; money market and non-interest bearing checking (DDA). The Company also offers short- and long-term time deposits or certificates of deposit (CDs). CDs are deposits with stated maturities which can range from seven days to ten years. Cash flow from deposits is influenced by economic conditions, changes in the interest rate environment, pricing and competition. To determine interest rates on its deposit products, the Company considers local competition, spreads to earning-asset yields, liquidity position and rates charged for alternative sources of funding such as short-term borrowings and FHLB advances.

The following table represents the components of deposits as of the date indicated:

	June 30, 2023		December 31, 2022		September 30, 2023		December 31, 2022	
(dollars in thousands)	Amount	%	Amount	%	Amount	%	Amount	%
Interest-bearing checking	$ 646,304	30.0 %	$ 664,439	30.7 %	$ 632,992	29.4 %	$ 664,439	30.7 %
Savings and clubs	218,903	10.2	238,174	11.0	210,750	9.8	238,174	11.0
Money market	523,840	24.3	544,468	25.1	555,439	25.8	544,468	25.1
Certificates of deposit	180,472	8.4	117,224	5.4	202,837	9.5	117,224	5.4
Total interest-bearing	1,569,519	72.9	1,564,305	72.2	1,602,018	74.5	1,564,305	72.2
Non-interest bearing	582,473	27.1	602,608	27.8	549,741	25.5	602,608	27.8
Total deposits	$ 2,151,992	100.0 %	$ 2,166,913	100.0 %	$ 2,151,759	100.0 %	$ 2,166,913	100.0 %

Total deposits decreased $14.9 million $15.2 million, or 1%, to $2.2 billion at June 30, 2023 September 30, 2023 from $2.2 billion at December 31, 2022. During the first half of 2023, one relationship transferred approximately $35 million from money market accounts to interest-bearing checking accounts at the bank. Money market accounts declined $20.6 million primarily due to this transfer and shifting of funds to CD accounts partially offset by a $21.7 million increase in a trust sweep account, transfers in from non-interest bearing checking accounts and other business account growth. Non-interest bearing checking accounts decreased $20.1 million $52.9 million primarily due to declines in personal and business checking accounts from shifts to interest-bearing products. Savings products and club accounts also decreased $19.3 million primarily due to personal savings declines and shifts to CDs and money market accounts. increased spending. IInterest-bearing nterest-bearing checking accounts decreased $18.1 million $31.4 million during the first half nine months of 2023 primarily from outflow of public funds from municipalities withdrawing American Rescue Plan Act funds and seasonal decline in school district public accounts along with personal and business account decreases. Savings and club accounts also decreased $27.4 million primarily due to personal savings declines and shifts to CDs and money market accounts. Partially offsetting these decreases, money market accounts increased $11.0 million primarily due to a $28.6 million increase in trust sweep accounts and a new large business relationship. The Company focuses on obtaining a full-banking relationship with existing checking account customers as well as forming new customer relationships. The Company will continue to execute on its relationship development strategy, explore the demographics within its marketplace and develop creative targeted programs for its customers to maintain and grow core deposits. For the first half nine months of 2023, the Company experienced deposit balance declines as clients transferred their deposits to investments to earn higher interest and pay down debts and consumer spending. We currently expect this trend of cash usage due to the impact of inflation on consumer and business spending and deposit mix shifts due to the high interest rate environment to continue throughout the second half last quarter of 2023. Seasonal public deposit fluctuations are expected to remain volatile and at times may partially offset future deposit growth.

Partially offsetting these non-maturing deposit decreases, CDs increased $63.2 million, $85.6 million, or 54% 73%, during the first half nine months of 2023. CD balances started to improve increase as promotional rates increased. rate offerings expanded. Some maturing CDs were closed as customers could earn higher yields by investing the money into other products. The Company will continue to pursue strategies to grow and retain retail and business customers with an emphasis on deepening and broadening existing and creating new relationships.

The Company uses the Certificate of Deposit Account Registry Service (CDARS) reciprocal program and Insured Cash Sweep (ICS) reciprocal program to obtain FDIC insurance protection for customers who have large deposits that at times may exceed the FDIC maximum insured amount of $250,000. The Company did not have any had $1.4 million in CDARs as of June 30, 2023 September 30, 2023 and no CDARs as of December 31, 2022. As of June 30, 2023 September 30, 2023 and December 31, 2022, ICS reciprocal deposits represented $81.0 million $78.7 million and $26.3 million, or 4% and 1%, of total deposits which are included in interest-bearing checking accounts in the table above. The $54.7 million $52.4 million increase in ICS deposits is primarily due to one large business relationship that transferred deposits to ICS accounts from other interest-bearing checking accounts.

As of June 30, 2023 September 30, 2023, total uninsured deposits were estimated to be $878.7 million, $896.4 million, or 41% 42% of total deposits. The estimate of uninsured deposits is based on the same methodologies and assumptions used for regulatory reporting requirements. The Company aggregates deposit products by taxpayer identification number and classifies into ownership categories to estimate amounts over the FDIC insurance limit. As of June 30, 2023 September 30, 2023, the ratio of uninsured and non-collateralized deposits to total deposits was approximately 23% 22%. Collateralized deposits totaled $382.0 million $415.9 million, or 18% 19%, of total deposits as of June 30, 2023 September 30, 2023.

The maturity distribution of certificates of deposit that meet or exceed the FDIC limit, by account, at June 30, 2023 September 30, 2023 is as follows:

(dollars in thousands)		
Three months or less	$ 3,955	$ 3,867
More than three months to six months	4,387	7,293
More than six months to twelve months	21,501	27,298
More than twelve months	24,164	27,750
Total	$ 54,007	$ 66,208

Approximately 22% 11% of the CDs, with a weighted-average interest rate of 0.94% 1.39%, are scheduled to mature in the second half last quarter of 2023 and an additional 60% 71%, with a weighted-average interest rate of 3.32% 3.51%, are scheduled to mature in 2024. Renewing CDs are currently expected to re-price to higher market rates depending on the rate on the maturing CD, the pace and direction of interest rate movements, the shape of the yield curve, competition, the rate profile of the maturing accounts and depositor preference for alternative, non-term products. The Company plans to continue to address repricing CDs in the ordinary course of business on a relationship pricing basis and is prepared to match rates when prudent to maintain relationships. Growth in CD accounts is challenged by the current and expected rate environment and clients' preference for short-term rates. The Company will continue to develop CD promotional programs when the Company deems that it is economically feasible to do so or when demand exists. The Company will consider the needs of the customers and simultaneously be mindful of the liquidity levels, borrowing rates and the interest rate sensitivity exposure of the Company.

Short-term borrowings

Borrowings are used as a complement to deposit generation as an alternative funding source whereby the Company will borrow under advances from the FHLB of Pittsburgh and other correspondent banks for asset growth and liquidity needs.

Short-term borrowings may include overnight balances with FHLB FHLB's line of credit and/or correspondent bank's federal funds lines which the Company may require to fund daily liquidity needs such as deposit outflow, loan demand and operations. The Company used $76.1 million $124.0 million in short-term borrowings to fund loan growth and an increase in interest-bearing cash balances for the first half nine months of 2023. The short-term borrowings included $32.0 million borrowed through the Federal Reserve Bank Term Funding Program (BTFP) up to one year costing 4.38% by pledging $32.0 million in securities. As of June 30, 2023 September 30, 2023, the Company had the ability to borrow $172.9 million an additional $36.5 million from the Federal Reserve borrower-in-custody program, $145.9 million in overnight borrowings with the FHLB open-repo line of credit and $20.0 million from lines of credit with correspondent banks.

In November 2023, the Company sold securities and used $29.1 million in proceeds received to pay down short-term borrowings that replenished available borrowing capacity at that time.

Secured borrowings

As of June 30, 2023 September 30, 2023 and December 31, 2022, the Company had 8 secured borrowing agreements with third parties with a fair value of $7.5 million $7.4 million and $7.6 million, respectively, related to certain sold loan participations that did not qualify for sales treatment acquired from Landmark. Secured borrowings are expected to decrease for 2023 from scheduled amortization and, when possible, early pay-offs.

FHLB advances

The Company had no FHLB advances as of June 30, 2023 September 30, 2023 and December 31, 2022. As of June 30, 2023 September 30, 2023, the Company had the ability to borrow an additional $637.8 million $647.4 million from the FHLB, including any overnight borrowings. The Company does not expect to have any FHLB advances in the second half last quarter of 2023.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Management of interest rate risk and market risk analysis.

The adequacy and effectiveness of an institution's interest rate risk management process and the level of its exposures are critical factors in the regulatory evaluation of an institution's sensitivity to changes in interest rates and capital adequacy. Management believes the Company's interest rate risk measurement framework is sound and provides an effective means to measure, monitor, analyze, identify and control interest rate risk in the balance sheet.

The Company is subject to the interest rate risks inherent in its lending, investing and financing activities. Fluctuations of interest rates will impact interest income and interest expense along with affecting market values of all interest-earning assets and interest-bearing liabilities, except for those assets or liabilities with a short term remaining to maturity. Interest rate risk management is an integral part of the asset/liability management process. The Company has instituted certain procedures and policy guidelines to manage the interest rate risk position. Those internal policies enable the Company to react to changes in market rates to protect net interest income from significant fluctuations. The primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on net interest income along with creating an asset/liability structure that maximizes earnings.

Asset/Liability Management. One major objective of the Company when managing the rate sensitivity of its assets and liabilities is to stabilize net interest income. The management of and authority to assume interest rate risk is the responsibility of the Company's Asset/Liability Committee (ALCO), which is comprised of senior management and members of the board of directors. ALCO meets quarterly to monitor the relationship of interest sensitive assets to interest sensitive liabilities. The process to review interest rate risk is a regular part of managing the Company. Consistent policies and practices of measuring and reporting interest rate risk exposure, particularly regarding the treatment of non-contractual assets and liabilities, are in effect. In addition, there is an annual process to review the interest rate risk policy with the board of directors which includes limits on the impact to earnings from shifts in interest rates.

Interest Rate Risk Measurement. Interest rate risk is monitored through the use of three complementary measures: static gap analysis, earnings at risk simulation and economic value at risk simulation. While each of the interest rate risk measurements has limitations, collectively, they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company and the distribution of risk along the yield curve, the level of risk through time and the amount of exposure to changes in certain interest rate relationships.

Static Gap. The ratio between assets and liabilities re-pricing in specific time intervals is referred to as an interest rate sensitivity gap. Interest rate sensitivity gaps can be managed to take advantage of the slope of the yield curve as well as forecasted changes in the level of interest rate changes.

To manage this interest rate sensitivity gap position, an asset/liability model commonly known as cumulative gap analysis is used to monitor the difference in the volume of the Company's interest sensitive assets and liabilities that mature or re-price within given time intervals. A positive gap (asset sensitive) indicates that more assets will re-price during a given period compared to liabilities, while a negative gap (liability sensitive) indicates the opposite effect. The Company employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO in gauging the effects of interest rate changes on interest-sensitive assets and liabilities in order to determine what impact these rate changes will have upon the net interest spread. At June 30, 2023 September 30, 2023, the Company maintained a one-year cumulative gap of negative (liability sensitive) $181.6 million, $177.0 million, or -7%, of total assets. The effect of this negative gap position provided a mismatch of assets and liabilities which may expose the Company to interest rate risk during periods of rising interest rates. Conversely, in a decreasing interest rate environment, net interest income could be positively impacted because more liabilities than assets will re-price downward during the one-year period.

Certain shortcomings are inherent in the method of analysis discussed above and presented in the next table. Although certain assets and liabilities may have similar maturities or periods of re-pricing, they may react in different degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the table amounts. The ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

The following table reflects the re-pricing of the balance sheet or “gap” position at June 30, 2023 September 30, 2023:

(dollars in thousands)	Three months or less	More than three months to twelve months	More than one year to three years	More than three years	Total	Three months or less	More than three months to twelve months	More than one year to three years	More than three years	Total
Cash and cash equivalents	$ 34,338	$ -	$ -	$ 35,294	$ 69,632	$ 82,040	$ -	$ -	$ 28,431	$ 110,471
Investment securities (1)(2)	6,279	16,992	47,790	536,931	607,992	5,405	17,092	54,488	503,503	580,488
Loans and leases (2)	311,595	236,362	457,003	608,162	1,613,122	326,833	227,640	455,596	618,726	1,628,795
Fixed and other assets	-	53,892	-	96,594	150,486	-	54,226	-	102,840	157,066
Total assets	$ 352,212	$ 307,246	$ 504,793	$ 1,276,981	$ 2,441,232	$ 414,278	$ 298,958	$ 510,084	$ 1,253,500	$ 2,476,820
Total cumulative assets	$ 352,212	$ 659,458	$ 1,164,251	$ 2,441,232		$ 414,278	$ 713,236	$ 1,223,320	$ 2,476,820	
Non-interest-bearing transaction deposits (3)	$ -	$ 58,306	$ 160,064	$ 364,103	$ 582,473	$ -	$ 55,029	$ 151,069	$ 343,643	$ 549,741
Interest-bearing transaction deposits (3)	591,648	-	318,960	478,439	1,389,047	667,010	-	292,870	439,304	1,399,184
Certificates of deposit	17,551	91,211	66,165	5,545	180,472	22,956	115,021	61,331	3,526	202,834
Secured borrowings	6,213	-	1,285	-	7,498	6,178	-	1,261	-	7,439
Short-term borrowings	76,111	-	-	-	76,111	124,000	-	-	-	124,000
Other liabilities	-	-	-	27,887	27,887	-	-	-	28,189	28,189
Total liabilities	$ 691,523	$ 149,517	$ 546,474	$ 875,974	$ 2,263,488	$ 820,144	$ 170,050	$ 506,531	$ 814,662	$ 2,311,387
Total cumulative liabilities	$ 691,523	$ 841,040	$ 1,387,514	$ 2,263,488		$ 820,144	$ 990,194	$ 1,496,725	$ 2,311,387	
Interest sensitivity gap	$ (339,311)	$ 157,729	$ (41,681)	$ 401,007		$ (405,866)	$ 128,908	$ 3,553	$ 438,838	
Cumulative gap	$ (339,311)	$ (181,582)	$ (223,263)	$ 177,744		$ (405,866)	$ (276,958)	$ (273,405)	$ 165,433	
Off-balance sheet:										
Swap - portfolio hedge						$ 100,000	$ -	$ (100,000)	$ -	
Cumulative gap						$ (305,866)	$ (176,958)	$ (273,405)	$ 165,433	
Cumulative gap to total assets	(13.9)%	(7.4)%	(9.1)%	7.3%		(12.3)%	(7.1)%	(11.0)%	6.7%	

(1) Includes restricted investments in bank stock and the net unrealized gains/losses on available-for-sale securities.

(2) Investments and loans are included in the earlier of the period in which interest rates were next scheduled to adjust or the period in which they are due. In addition, loans were included in the periods in which they are scheduled to be repaid based on scheduled amortization. For amortizing loans and MBS – GSE residential, annual prepayment rates are assumed reflecting historical experience as well as management's knowledge and experience of its loan products.

(3) The Company's demand and savings accounts were generally subject to immediate withdrawal. However, management considers a certain amount of such accounts to be core accounts having significantly longer effective maturities based on the retention experiences of such deposits in changing interest rate environments. The effective maturities presented are the recommended maturity distribution limits for non-maturing deposits based on historical deposit studies.

Earnings at Risk and Economic Value at Risk Simulations. The Company recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet that extend beyond static re-pricing gap analysis. Although it will continue to measure its re-pricing gap position, the Company utilizes additional modeling for identifying and measuring the interest rate risk in the overall balance sheet. The ALCO is responsible for focusing on "earnings at risk" and "economic value at risk", and how both relate to the risk-based capital position when analyzing the interest rate risk.

Earnings at Risk. An earnings at risk simulation measures the change in net interest income and net income should interest rates rise and fall. The simulation recognizes that not all assets and liabilities re-price one-for-one with market rates (e.g., savings rate). The ALCO looks at "earnings at risk" to determine income changes from a base case scenario under an increase and decrease of 200 basis points in interest rate simulation models.

Economic Value at Risk. An earnings at risk simulation measures the short-term risk in the balance sheet. Economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from the Company's existing assets and liabilities. The ALCO examines this ratio quarterly utilizing an increase and decrease of 200 basis points in interest rate simulation models. The ALCO recognizes that, in some instances, this ratio may contradict the "earnings at risk" ratio.

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The following table illustrates the simulated impact of an immediate 200 basis points upward or downward movement in interest rates on net interest income, net income and the change in the economic value (portfolio equity). This analysis assumed that the adjusted interest-earning asset and interest-bearing liability levels at June 30, 2023 September 30, 2023 remained constant. The impact of the rate movements was developed by simulating the effect of the rate change over a twelve-month period from the June 30, 2023 September 30, 2023 levels:

	% change		% change	
	Rates +200	Rates -200	Rates +200	Rates -200
Earnings at risk:				
Net interest income	(8.4)%	(0.1)%	(8.0)%	(3.6)%
Net income	(18.8)	(1.7)	(19.4)	(11.2)
Economic value at risk:				
Economic value of equity	(19.1)	7.7	(19.3)	10.9
Economic value of equity as a percent of total assets	(2.1)	0.9	(1.8)	1.0

In the scenarios in the above table, the Board-approved policy has the following guidelines: net interest income within +/- 10%, net income within +/- 25%, economic value of equity within +/- 25%, economic value of equity as a percent of total assets within +/-5%.

Economic value has the most meaning when viewed within the context of risk-based capital. Therefore, the economic value may normally change beyond the Company's policy guideline for a short period of time as long as the risk-based capital ratio (after adjusting for the excess equity exposure) is greater than 10%. At June 30, 2023 September 30, 2023, the Company's risk-based capital ratio was 14.71% 14.76%.

Given the existing economic and interest rate conditions along with the recent increase in earnings at risk exposure to rising rates, management is evaluating to pursue balance sheet hedging opportunities on both sides of balance sheet with an independent third-party vendor with derivative expertise in response to mitigate these interest rate risks on net interest income. The Company has a derivative policy in place and any balance sheet hedges require Board pre-approval along with quarterly monitoring requirements by the Company's ALCO Committee.

The table below summarizes estimated changes in net interest income over a twelve-month period beginning July 1, 2023 October 1, 2023, under alternate interest rate scenarios using the income simulation model described above:

Net interest	$	%	Net interest	$	%

(dollars in thousands)	income	variance	variance	income	variance	variance
Simulated change in interest rates						
+200 basis points	$ 63,178	$ (5,816)	(8.4)%	$ 59,910	$ (5,183)	(8.0)%
+100 basis points	66,491	(2,503)	(3.6)%	62,570	(2,523)	(3.9)%
Flat rate	68,994	-	- %	65,093	-	- %
-100 basis points	68,953	(41)	(0.1)%	63,971	(1,122)	(1.7)%
-200 basis points	68,929	(65)	(0.1)%	62,771	(2,322)	(3.6)%

Simulation models require assumptions about certain categories of assets and liabilities. The models schedule existing assets and liabilities by their contractual maturity, estimated likely call date or earliest re-pricing opportunity. MBS – GSE residential securities and amortizing loans are scheduled based on their anticipated cash flow including estimated prepayments. For investment securities, the Company uses a third-party service to provide cash flow estimates in the various rate environments. Savings, money market and interest-bearing checking accounts do not have stated maturities or re-pricing terms and can be withdrawn or re-price at any time. This may impact the margin if more expensive alternative sources of deposits are required to fund loans or deposit runoff. Management projects the re-pricing characteristics of these accounts based on historical performance and assumptions that it believes reflect their rate sensitivity. The model reinvests all maturities, repayments and prepayments for each type of asset or liability into the same product for a new like term at current product interest rates. As a result, the mix of interest-earning assets and interest bearing-liabilities is held constant.

Liquidity

Liquidity management ensures that adequate funds will be available to meet customers' needs for borrowings, deposit withdrawals and maturities, facility expansion and normal operating expenses. Sources of liquidity are cash and cash equivalents, asset maturities and pay-downs within one year, loans HFS, investments AFS, growth of core deposits, utilization of borrowing capacities from the FHLB, correspondent banks, IntraFi's ICS and One-Way Buy program, the Discount Window of the Federal Reserve Bank of Philadelphia (FRB), Atlantic Community Bankers Bank (ACBB) and proceeds from the issuance of capital stock. Though regularly scheduled investment and loan payments are dependable sources of daily liquidity, sales of both loans HFS and investments AFS, deposit activity and investment and loan prepayments are significantly influenced by general economic conditions including the interest rate environment. During low and declining interest rate environments, prepayments from interest-sensitive assets tend to accelerate and provide significant liquidity that can be used to invest in other interest-earning assets but at lower market rates. Conversely, in periods of high or rising interest rates, prepayments from interest-sensitive assets tend to decelerate causing prepayment cash flows from mortgage loans and mortgage-backed securities to decrease. Rising interest rates may also cause deposit inflow but priced at higher market interest rates or could also cause deposit outflow due to higher rates offered by the Company's competition for similar products. The Company closely monitors activity in the capital markets and takes appropriate action to ensure that the liquidity levels are adequate for funding, investing and operating activities.

The Company's contingency funding plan (CFP) sets a framework for handling liquidity issues in the event circumstances arise which the Company deems to be less than normal. The Company established guidelines for identifying, measuring, monitoring and managing the resolution of potentially serious liquidity crises. The CFP outlines required monitoring tools, acceptable alternative funding sources and required actions during various liquidity scenarios. Thus, the Company has implemented a proactive means for the measurement and resolution for handling potentially significant adverse liquidity conditions. At least quarterly, the CFP monitoring tools, current liquidity position and monthly projected liquidity sources and uses are presented and reviewed by the Company's Asset/Liability Committee. As of June 30, 2023September 30, 2023, the Company had not experienced any adverse issues that would give rise to its inability to raise liquidity in an emergency situation.

During the sixnine months ended June 30, 2023September 30, 2023, the Company generated $40.5 million$81.4 million of cash. During the period, the Company's operations provided approximately $15.1 million mostly$21.4 million mostly from $34.4 million$50.2 million of net cash inflow from the components of net interest income partially offset by net non-interest expense/income related paymentspayments of $17.4 million$25.5 million and $1.7 million$2.6 million in quarterly estimated tax payments. CashCash inflow from interest-earning assets, the sale of securities, short-term borrowings and loan payments were used to fund the loan portfolio, invest in bank premises and equipment and make net dividend payments. The Company received a large amount of public deposits over the past six years. The seasonal nature of deposits from municipalities and other public funding sources requires the Company to be prepared for the inherent volatility and the unpredictable timing of cash outflow from this customer base, including maintaining the requirements to pledge investment securities. Accordingly, the use of short-term overnight borrowings could be used to fulfill funding gap needs. The CFP is a tool to help the Company ensure that alternative funding sources are available to meet its liquidity needs.

During January 2023, the Company sold $31.2 million in AFS securities at breakeven to generate liquidity in order to pay down overnight borrowings which will result in interest expense savings. Management will continue to execute strategies to generate liquidity when it makes sense for the Company's operations.

During 2021 and 2022, the Company also experienced deposit inflow resulting from businesses and municipalities that received relief from the CARES Act, American Rescue Plan Act ("ARPA") and other government stimulus. There is uncertainty about the length of time that these deposits will remain which could require the Company to maintain elevated cash balances. During the first halfnine months of 2023, the Company experienced an outflow of $54.3 million$66.1 million in ARPA funds, or approximately 56%68% of the balance of these funds from the end 2022. The Company will continue to monitor deposit fluctuations for other significant changes.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers and in connection with the overall interest rate management strategy. These instruments involve, to a varying degree, elements of credit, interest rate and liquidity risk. In accordance with GAAP, these instruments are either not recorded in the consolidated financial statements or are recorded in amounts that differ from the notional amounts. Such instruments primarily include lending commitments.

Lending commitments include commitments to originate loans and commitments to fund unused lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. fee. Unfunded commitments of existing loan facilities totaled $364.0 million, $365.3 million, standby letters of credit totaled $17.0 million $19.0 million and the level of uninsured and non-collateralized deposits was $496.7 million $480.5 million at June September 30, 2023. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

As of June 30, 2023 September 30, 2023, the Company maintained $69.6 million $110.5 million in cash and cash equivalents and $382.6 million $355.2 million of investments AFS and loans HFS. Also as of June September 30, 2023, the Company had approximately $637.8 million $647.4 million available to borrow from the FHLB, $20.0 million from correspondent banks, $172.9 million $36.5 million from the FRB and $366.2 million $371.5 million from the IntraFi Network One-Way Buy program. The combined total of $1,649.1 $1,541.1 million represented 68% 62% of total assets at June September 30, 2023. The Company also has the ability to pledge securities to borrow at par from the Federal Reserve Bank Term Funding Program to gain liquidity. Management believes this level of liquidity to be strong and adequate to support current operations.

Capital

During the six nine months ended June 30, 2023 September 30, 2023, total shareholders' equity increased $14.8 million, $2.5 million, or 9% 2%, due principally to $12.4 million $17.7 million in net income added into retained earnings and a $5.9 million after tax improvement in the net unrealized loss position in the Company's investment portfolio. earnings. Capital was enhanced by $0.3 million from investments in the Company's common stock via the Employee Stock Purchase Plan (ESPP), $1.0 million $1.3 million from stock-based compensation expense from the ESPP and restricted stock and $0.8 million $1.2 million from the re-issuance of treasury stock for the dividend reinvestment plan. Partially offsetting these increases were $4.1 million a $10.4 million after tax decline in the net unrealized loss position in the Company's investment portfolio. $6.2 million of cash dividends declared on the Company's common stock, a $1.3 million cumulative effect adjustment for adoption of CECL and $0.1 million $0.2 million in treasury stock purchases to cover employee withholdings. The Company's dividend payout ratio, defined as the rate at which current earnings are paid to shareholders, was 33.2% 34.9% for the six nine months ended June 30, 2023 September 30, 2023. The balance of earnings is retained to further strengthen the Company's capital position.

As of June 30, 2023 September 30, 2023, the Company reported a net unrealized loss position of $65.3 $81.5 million, net of tax, from the securities AFS portfolio compared to a net unrealized loss of $71.2 million as of December 31, 2022 December 31, 2022. The $5.9 million improvement $10.4 million decline during the first half nine months of 2023 was from the $5.0 million improvement $11.7 million decline in net unrealized losses on AFS securities, net of tax, and $0.9 million $1.3 million in accretion of net unrealized losses on HTM securities transferred from AFS, net of tax. Lower Higher unrealized losses on all types of securities contributed to the improvement decline in the investment portfolio. Management believes that changes in fair value of the Company's securities are due to changes in interest rates and not in the creditworthiness of the issuers.

Generally, when U.S. Treasury rates rise, investment securities' pricing declines and fair values of investment securities also decline. Volatility has existed in the yield curve within the past twelve months and the Company is uncertain about the expected rate environment. There is no assurance that future realized and unrealized losses will not be recognized from the Company's portfolio of investment securities.

The tangible common equity (TCE) ratio (non-GAAP) was 6.48% 5.89% and 5.90% 5.19% for the six nine months ended June 30, 2023 September 30, 2023 and 2022, respectively. At June 30, 2023 September 30, 2023 and 2022, the held-to-maturity securities portfolio had $24.8 million $36.2 million and $17.8 million $31.7 million in unrealized losses, net of deferred taxes. If the TCE ratio was adjusted to include the unrealized losses on held-to-maturity securities, the adjusted TCE ratio (non-GAAP) would have been 5.45% 4.41% and 5.16% 3.87% at June 30, 2023 September 30, 2023 and 2022. See reconciliation on page 39.

To help maintain a healthy capital position, the Company can issue stock to participants in the DRP and ESPP plans. The DRP affords the Company the option to acquire shares in open market purchases and/or issue shares directly from the Company to plan participants. During the first half nine months of 2023, the Company re-issued treasury shares to fulfill the needs of the DRP. Both the DRP and the ESPP plans have been a consistent source of capital from the Company's loyal employees and shareholders and their participation in these plans will continue to help strengthen the Company's balance sheet.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Under these guidelines, assets and certain off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets. The guidelines require all banks and bank holding companies to maintain a minimum ratio of total risk-based capital to total risk-weighted assets (Total Risk Adjusted Capital) of 8%, including Tier I common equity to total risk-weighted assets (Tier I Common Equity) of 4.5%, Tier I capital to total risk-weighted assets (Tier I Capital) of 6% and Tier I capital to average total assets (Leverage Ratio) of at least 4%. A capital conservation buffer, comprised of common equity Tier I capital, is also established above the regulatory minimum capital requirements of 2.50%. As of June 30, 2023 September 30, 2023 and December 31, 2022, the Company and the Bank exceeded all capital adequacy requirements to which it was subject.

The Company continues to closely monitor and evaluate alternatives to enhance its capital ratios as the regulatory and economic environments change. The following table depicts the capital amounts and ratios of the Company, on a consolidated basis, and the Bank as of June 30, 2023 September 30, 2023 and December 31, 2022:

	Actual		For capital adequacy purposes		For capital adequacy purposes with capital conservation buffer		To be well capitalized under prompt corrective action provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2023								
Total capital (to risk-weighted assets)								
Consolidated	$ 241,539	14.7 %	≥ $ 131,377	8.0 %	≥ $ 172,432	10.5 %	N/A	N/A
Bank	$ 240,569	14.7 %	≥ $ 131,370	8.0 %	≥ $ 172,423	10.5 %	≥ $ 164,212	10.0 %
Tier 1 common equity (to risk-weighted assets)								
Consolidated	$ 222,031	13.5 %	≥ $ 73,899	4.5 %	≥ $ 114,955	7.0 %	N/A	N/A
Bank	$ 221,061	13.5 %	≥ $ 73,895	4.5 %	≥ $ 114,949	7.0 %	≥ $ 106,738	6.5 %
Tier I capital (to risk-weighted assets)								
Consolidated	$ 222,031	13.5 %	≥ $ 98,533	6.0 %	≥ $ 139,588	8.5 %	N/A	N/A
Bank	$ 221,061	13.5 %	≥ $ 98,527	6.0 %	≥ $ 139,580	8.5 %	≥ $ 131,370	8.0 %
Tier I capital (to average assets)								
Consolidated	$ 222,031	9.1 %	≥ $ 97,852	4.0 %	≥ $ 97,852	4.0 %	N/A	N/A
Bank	$ 221,061	9.0 %	≥ $ 97,848	4.0 %	≥ $ 97,848	4.0 %	≥ $ 122,310	5.0 %

	Actual		For capital adequacy purposes		For capital adequacy purposes with capital conservation buffer		To be well capitalized under prompt corrective action provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2023								
Total capital (to risk-weighted assets)								
Consolidated	$ 245,784	14.8 %	≥ $ 133,184	8.0 %	≥ $ 174,805	10.5 %	N/A	N/A
Bank	$ 244,567	14.7 %	≥ $ 133,174	8.0 %	≥ $ 174,790	10.5 %	≥ $ 166,467	10.0 %
Tier 1 common equity (to risk-weighted assets)								
Consolidated	$ 226,039	13.6 %	≥ $ 74,916	4.5 %	≥ $ 116,536	7.0 %	N/A	N/A
Bank	$ 224,822	13.5 %	≥ $ 74,910	4.5 %	≥ $ 116,527	7.0 %	≥ $ 108,204	6.5 %
Tier I capital (to risk-weighted assets)								
Consolidated	$ 226,039	13.6 %	≥ $ 99,888	6.0 %	≥ $ 141,508	8.5 %	N/A	N/A
Bank	$ 224,822	13.5 %	≥ $ 99,880	6.0 %	≥ $ 141,497	8.5 %	≥ $ 133,174	8.0 %

Tier I capital (to average assets)												
Consolidated	$	226,039	9.2 %	≥ $	98,075	4.0 %	≥ $	98,075	4.0 %		N/A	N/A
Bank	$	224,822	9.2 %	≥ $	98,068	4.0 %	≥ $	98,068	4.0 %	≥ $	122,585	5.0 %

	Actual			For capital adequacy purposes			For capital adequacy purposes with capital conservation buffer			To be well capitalized under prompt corrective action provisions		
(dollars in thousands)		Amount	Ratio		Amount	Ratio		Amount	Ratio		Amount	Ratio
As of December 31, 2022												
Total capital (to risk-weighted assets)												
Consolidated	$	230,133	14.4 %	≥ $	128,325	8.0 %	≥ $	168,427	10.5 %		N/A	N/A
Bank	$	229,803	14.3 %	≥ $	128,308	8.0 %	≥ $	168,405	10.5 %	≥ $	160,385	10.0 %
Tier 1 common equity (to risk-weighted assets)												
Consolidated	$	212,935	13.3 %	≥ $	72,183	4.5 %	≥ $	112,285	7.0 %		N/A	N/A
Bank	$	212,605	13.3 %	≥ $	72,173	4.5 %	≥ $	112,270	7.0 %	≥ $	104,251	6.5 %
Tier I capital (to risk-weighted assets)												
Consolidated	$	212,935	13.3 %	≥ $	96,244	6.0 %	≥ $	136,346	8.5 %		N/A	N/A
Bank	$	212,605	13.3 %	≥ $	96,231	6.0 %	≥ $	136,328	8.5 %	≥ $	128,308	8.0 %
Tier I capital (to average assets)												
Consolidated	$	212,935	8.7 %	≥ $	97,960	4.0 %	≥ $	97,960	4.0 %		N/A	N/A
Bank	$	212,605	8.7 %	≥ $	97,951	4.0 %	≥ $	97,951	4.0 %	≥ $	122,439	5.0 %

The Company advises readers to refer to the Supervision and Regulation section of Management's Discussion and Analysis of Financial Condition and Results of Operation, of its 2022 Form 10-K for a discussion on the regulatory environment and recent legislation and rulemaking.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company's management, with the participation of its President and Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the President and Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and are effective. The Company made no changes in its internal controls over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, these controls during the last fiscal quarter ended June 30, 2023 September 30, 2023.

PART II - Other Information

Item 1. Legal Proceedings

The nature of the Company's business generates a certain amount of litigation involving matters arising in the ordinary course of business. However, in the opinion of the Company after consultation with legal counsel, no legal proceedings are pending, which, if determined adversely to the Company or the Bank, would have a material adverse effect on the Company's undivided profits or financial condition, operations or the results of such operations. No legal proceedings are pending other than ordinary routine litigation incidental to the business of the Company and the Bank. In addition, to management's knowledge, no governmental authorities have initiated or contemplated any material legal or regulatory actions against the Company or the Bank.

Item 1A. Risk Factors

Recent Negative Developments Affecting the Banking Industry, Including Recent Bank Failures or Concerns Regarding Liquidity, Have Eroded Customer Confidence in the Banking System and May Have a Material Adverse Effect on the Company.

During March and April 2023, three significant bank failures occurred (Silicon Valley Bank, Signature Bank, and First Republic Bank). This was and continues These failures continue to be accompanied by financial instability at various additional banks. These bank failures and bank instabilities have created and may continue to create market and other risks, for all financial institutions and banks, including the Corporation. These risks include, but are not limited to:

1. market risk and a loss of confidence in the financial services sector, and/or specific banks;
2. Deterioration of securities and loan portfolios;
3. Deposit volatility and reductions with higher volumes and occurring over shorter periods of time;
4. Increased liquidity demand and utilization of sources of liquidity; and
5. Interest rate volatility and abrupt, sudden and greater than usual rate changes.

These factors individually, or in any combination, could materially and adversely affect our:

1. Financial condition;
2. Operations and results thereof; and
3. Stock price.

In addition, the previously mentioned bank failures and instabilities, or future bank failures and instability, may result in an increase of FDIC deposit insurance premiums and/or result in special FDIC deposit insurance assessments, which also may adversely affect the Company's financial condition, operations, results thereof or stock price.

The Company cannot predict the impact, timing or duration of such events.

Management of the Company does not believe there have been any other material changes to the risk factors that were disclosed in the 2022 Form 10-K filed with the Securities and Exchange Commission on March 20, 2023.

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

Period	(a) Total number of shares (or units) purchased	(b) Average price paid per share (or unit)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
April 1, 2023 to April 30, 2023	-	$ -	-	$ 3,739,242
May 1, 2023 to May 31, 2023	-	-	-	3,739,242
June 1, 2023 to June 30, 2023	-	-	-	3,739,242
Total	-	$ -	-	$ 3,739,242

On May 18, 2022, the Company announced that the Board of Directors approved a plan to purchase, in open market and privately negotiated transactions, up to 3% of its outstanding common stock in accordance with all applicable securities laws and regulations, including Rule 10b-18 of the Exchange Act. The plan is expected to terminate on August 9, 2023. None

Item 3. Default Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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Item 6. Exhibits

The following exhibits are filed herewith or incorporated by reference as a part of this Form 10-Q:

3(i) Amended and Restated Articles of Incorporation of Registrant. Incorporated by reference to Annex B of the Proxy Statement/Prospectus included in Registrant's Amendment 4 to its Registration Statement No. 333-90273 on Form S-4, filed with the SEC on April 6, 2000.

3(ii) Amended and Restated Bylaws of Registrant. Incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed with the SEC on April 16, 2020.

2.1 Agreement and Plan of Reorganization by and among Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank, MNB Corporation and Merchants Bank of Bangor dated as of December 9, 2019. Incorporated by reference to Annex A of the Registrant's Registration Statement No. 333-236453 on Form S-4, filed with the Commission on February 14, 2020. (Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Registrant agrees to furnish supplementally to the SEC a copy of any omitted schedule upon request.)

2.2 Agreement and Plan of Reorganization by and among Fidelity D & D Bancorp, Inc., NEPA Acquisition Subsidiary, LLC, The Fidelity Deposit and Discount Bank, Landmark Bancorp, Inc. and Landmark Community Bank dated as of February 25, 2021. Incorporated by reference to Annex A of the Registrant's Registration No. 333-255479 on Form S-4, filed with the Commission on April 23, 2021. (Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Registrant agrees to furnish supplementally to the SEC a copy of any omitted schedule upon request.)

****10.1 Registrant's 2012 Dividend Reinvestment and Stock Repurchase Plan***. Incorporated by reference to Exhibit 4.1 to Registrant's Registration Statement No. 333-183216 on Form S-3 filed with the SEC on August 10, 2012 as amended February 3, 2014.

****10.2 Registrant's 2002 Employee Stock Purchase Plan.*** Incorporated by reference to Appendix A to Definitive proxy Statement filed with the SEC on March 28, 2002.

****10.3 Amended and Restated Executive Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Daniel J. Santaniello, dated March 23, 2011.*** Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 29, 2011.

****10.4 2012 Omnibus Stock Incentive Plan.*** Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

****10.5 2012 Director Stock Incentive Plan.*** Incorporated by reference to Appendix B to Registrant's Definitive Proxy Statement filed with the SEC on March 30, 2012.

****10.6 Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Salvatore R. DeFrancesco, Jr. dated as of March 17, 2016.*** Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 18, 2016.

****10.7 Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Eugene J. Walsh dated as of March 29, 2017.*** Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on April 4, 2017.

****10.8 Form of Supplemental Executive Retirement Plan*** – Applicable to Daniel J. Santaniello and Salvatore R. DeFrancesco, Jr. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on April 4, 2017.

****10.9 Form of Supplemental Executive Retirement Plan*** – Applicable to Eugene J. Walsh. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on April 4, 2017.

****10.10 Form of Split Dollar Life Insurance Agreement*** – Applicable to Daniel J. Santaniello, Salvatore R. DeFrancesco, Jr. and Eugene J. Walsh. Incorporated by reference to Exhibit 99.3 to Registrant's Current Report on Form 8-K filed with the SEC on April 4, 2017.

***10.11 Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Michael J. Pacyna dated as of March 20, 2019.** Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 21, 2019.*

10.12 Form of Supplemental Executive Retirement Plan for Michael J. Pacyna. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 21, 2019.

10.13 Form of Split Dollar Life Insurance Agreement for Michael J. Pacyna. Incorporated by reference to Exhibit 99.3 to Registrant's Current Report on Form 8-K filed with the SEC on March 21, 2019.

10.14 2022 Omnibus Stock Incentive Plan. Incorporated by reference to Appendix A to Registrant's Definitive Proxy Statement filed with the SEC on March 23, 2022.

31.1 Rule 13a-14(a) Certification of Principal Executive Officer, filed herewith.

31.2 Rule 13a-14(a) Certification of Principal Financial Officer, filed herewith.

***32.1 Certification of Principal Executive Officer** pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith herewith..*

***32.2 Certification of Principal Financial Officer** pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.*

101 Interactive data files: The following, from Fidelity D&D Bancorp, Inc.'s. Quarterly Report on Form 10-Q for the quarter ended June 30, 2023 September 30, 2023, is formatted in Inline XBRL (eXtensible Business Reporting Language): Consolidated Balance Sheets as of June 30, 2023 September 30, 2023 and December 31, 2022; Consolidated Statements of Income for the three and six nine months ended June 30, 2023 September 30, 2023 and 2022; Consolidated Statements of Comprehensive Income for the three and six nine months ended June 30, 2023 September 30, 2023 and 2022; Consolidated Statements of Changes in Shareholders' Equity for the three and six nine months ended June 30, 2023 September 30, 2023 and 2022; Consolidated Statements of Cash Flows for the six nine months ended June 30, 2023 September 30, 2023 and 2022 and the Notes to the Consolidated Financial Statements. **

104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

***** Management contract or compensatory plan or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the interactive data files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

Signatures

FIDELITY D & D BANCORP, INC.

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.

Fidelity D & D Bancorp, Inc.

Date: August 11, 2023 November 13, 2023

/s/ Daniel J. Santaniello

Daniel J. Santaniello,
President and Chief Executive Officer

Fidelity D & D Bancorp, Inc.

Date: August 11, 2023 November 13, 2023

/s/ Salvatore R. DeFrancesco, Jr.

Salvatore R. DeFrancesco, Jr.,

Treasurer and Chief Financial Officer

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Exhibit 31.1

CERTIFICATION

I, Daniel J. Santaniello, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fidelity D & D Bancorp, Inc.;

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

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

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

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

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

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

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

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

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

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

Date: August 11, 2023 November 13, 2023

/s/ Daniel J. Santaniello

Daniel J. Santaniello,

President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Salvatore R. DeFrancesco, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Fidelity D & D Bancorp, Inc.;

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

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

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

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

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

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

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

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

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

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

Date: August 11, 2023 November 13, 2023	/s/ Salvatore R. DeFrancesco, Jr.
	Salvatore R. DeFrancesco, Jr.,
	Treasurer and Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADDED BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Fidelity D & D Bancorp, Inc. (the "Company") for the period ended June 30, 2023 September 30, 2023, as filed with the Securities and Exchange Commission (the "Report"), I, Daniel J. Santaniello, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as added by §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 Exchange Act of 1934; and

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

Date: August 11, 2023 November 13, 2023

By: /s/ Daniel J. Santaniello

Daniel J. Santaniello

President and Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADDED BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Fidelity D & D Bancorp, Inc. (the "Company") for the period ended June 30, 2023 September 30, 2023, as filed with the Securities and Exchange Commission (the "Report"), I, Salvatore R. DeFrancesco, Jr., Treasurer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as added by §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 Exchange Act of 1934; and

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

Date: August 11, 2023 November 13, 2023

By: /s/ Salvatore R. DeFrancesco, Jr.

Salvatore R. DeFrancesco, Jr.,

Treasurer and Chief Financial Officer

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