REFINITIV

DELTA REPORT

10-Q

AUBN - AUBURN NATIONAL BANCORPOR

10-Q - MARCH 31, 2024 COMPARED TO 10-Q - SEPTEMBER 30, 2023

The following comparison report has been automatically generated

TOTAL DELTAS	8760
CHANGES	1068
DELETIONS	3605
ADDITIONS	4087

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

FORM
10-Q

(Mark One)
☒
Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended
September 30, 2023 March 31, 2024
☐
Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the transition period __________ to __________
Commission File Number:
0-26486

Auburn National Bancorporation, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of incorporation or organization)
63-0885779
(I.R.S. Employer
Identification No.)
100 N. Gay Street
Auburn
,
Alabama

36830
(
334
)
821-9200

(Address and telephone number of principal executive offices)

AUBURN NATIONAL BANCORPORATION, INC. AND AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

PAGE

Item 1

Financial Statement

Consolidated Balance Sheets (Unaudited) as of September 30, 2023 March 31, 2024 and December 31, 2022 2023
3

Consolidated Statements of Earnings (Unaudited) for the quarters the quarter ended March 31, 2024 and nine months ended September 30,
2023 and 2022
4

Consolidated Statements of Comprehensive Income (Loss) (Unaudited) for the quarter and nine months quarters ended March September 30, 31, 2024 and 2023 and 2022
5

Consolidated Statements of Stockholders' Equity (Unaudited) for the quarter and nine months quarters ended March 31, 2024 September 30, and 2023 and 2022
6

Consolidated Statements of Cash Flows (Unaudited) for the nine months quarters ended March 31, September 30, 2024 and 2023 and 2022
7

Notes to Consolidated Financial Statements (Unaudited)
8

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations
28 26

Table 1 – Explanation of Non-GAAP Non -GAAP Financial Measures
45 41

Table 2 – Selected Quarterly Financial Data
46 42

Table 3 – Selected Financial Data
47

Table 4 3 – Average Balances and Net Interest Income Analysis – for the quarter ended September 30, 2023 and 2022
48

Table 5 – Average Balances and Net Interest Income Analysis – for the nine quarters months ended March September 31, 2024 30, and 2023 and 2022
49

Table 6 – Allocation of Allowance for Loan Losses
50

Table 7 – Estimated Uninsured Time Deposits by Maturity
51 43

Item 3

[Quantitative and Qualitative Disclosures About Market Risk]

3

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Unaudited)

September 30, **March 31,**
December 31,
(Dollars in thousands, except share data)
2023 **2024**
2022 **2023**

Assets:

Cash and due from banks

$
16,350 18,444
$

5

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Unaudited)

Quarter ended September 30,
Nine months ended September 30, March 31,
(Dollars in thousands)
2023
2022 2024
2023
2022

Net earnings
$
1,488 1,371
$
1,998
$
5,380
$
5,880 1,964

Other comprehensive loss, (loss) income, net of tax:

Unrealized net loss on securities
(9,941)
(17,223)
(8,093)
(46,533)

Reclassification adjustment for net holding (loss) gain on securities net of recognized in net earnings tax benefit of $
— 734
(33) and tax expense of $
— 1,834
(33) , respectively
(2,184)
5,463

Other comprehensive loss (loss) income
(9,941) (2,184)
(17,256)
(8,093)
(46,566) 5,463

Comprehensive loss (loss) income
$
(8,453) (813)
$
(15,258)

7

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

Nine months Quarter ended September 30, March 31,

(Dollars in thousands)

2023 2024
2022 2023

Cash flows from operating activities:

Net earnings
$
5,380 1,371
$
5,880 1,964

Adjustments to reconcile net earnings to net cash provided by operating activities:

Provision for credit losses
(191) 334
— 66

Depreciation and amortization
1,278 434
1,098 423

Premium amortization and discount accretion, net
1,834 386
2,450

Net gain on securities available-for-sale
—
(44) 612

Net gain on sale of loans held for sale
(81) (57)

(315)
Net gain on other real estate owned
—
(162) (4)
Loans originated for sale
(3,417) (3,123)
(8,711) —

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Auburn National Bancorporation, Inc. (the "Company") provides a full range of banking services to individuals and commercial customers in Lee County, Alabama and surrounding areas through its wholly owned subsidiary, AuburnBank (the "Bank"). The Company does not have any segments other than banking that are considered material.

Basis of Presentation and Use of Estimates

The unaudited consolidated financial statements in this report have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The unaudited consolidated financial statements include, in the opinion of management, all adjustments necessary to present a fair statement of the financial position and the results of operations for all periods presented. All such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results of operations that the Company and its subsidiaries may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2022 December 31, 2023.

The unaudited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Significant intercompany transactions and accounts are eliminated in consolidation.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of allowance for credit losses on loans and investment securities and loans, securities, fair value of financial instruments, and the valuation of deferred tax

Revenue Recognition

On January 1, 2018, the Company implemented Accounting Standards Update ("ASU" or "updates") 2014-09, *Revenue from Contracts with Customers*, codified at *Accounting Standards Codification ("ASC")* 606. The Company adopted ASC 606 using the modified retrospective transition method. The majority of the Company's revenue stream is generated from interest income on loans and securities which are outside the scope of ASC 606.

The Company's sources of income that fall within the scope of ASC 606 include service charges on deposits, interchange fees and gains and losses on sales of other real estate, all of which are presented as components of noninterest income. The following is a summary of the revenue streams that fall within the scope of ASC 606:

- Service charges on deposits, investment services, ATM and interchange fees – Fees from these services are either (i) transaction-based, for which the performance obligations are satisfied when the individual transaction is processed, or (ii) set periodic service charges, for which the performance obligations are satisfied over the period the service is provided. Transaction-based fees are recognized at the time the transaction is processed, and periodic service charges are recognized over the service period.

•

Gains on sales of OREO

–

A gain on sale should be recognized when a contract for sale exists and control of the asset has been transferred to the buyer. ASC 606 lists several criteria required to conclude that a contract for sale exists, including a determination that the institution will collect substantially all of the consideration to which it is entitled. In addition to the loan-to-value ratio, where the seller provides the purchaser with financing, the analysis is based on various other factors, including the credit quality of the purchaser, the structure of the loan, and any other factors that we believe may affect collectability.

9

Subsequent Events

The Company has evaluated the effects of events and transactions through the date of this filing that have occurred subsequent to September 30, 2023 March 31, 2024. The Company does not believe there were any material subsequent events during this period that would have required further recognition or disclosure in the unaudited consolidated financial statements included in this report.

9

Correction of Error

The disclosure of loans by vintage in Note 5 – Loans and Allowance for Credit Losses in the Company's Annual Report on
Form 10-K for year ended December 31, 2023 contained incorrect information as it pertains to loans originated by vintage and revolving loans. All current period gross charge-off data, total loans by segment and total loans by credit quality indicator were correctly reported. The loans originated by vintage and revolving loans as of December 31, 2023 have been corrected in the comparative presentation in Note 5 – Loans and Allowance for Credit Losses in the Notes herein.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no material effect on the Company's previously reported net earnings or total stockholders' equity.

Accounting Standards Adopted in 2023 2024

On January 1, 2023 January 1, 2024, the Company adopted ASU 2016-13 Financial Instruments 2023-02, *Investments – Credit Equity Method and Joint Ventures Losses (Topic 326) (Topic 323): Accounting for Investments in Tax Measurement*
of Credit Losses on Financial Instruments (ASC 326). This standard replaced Structures Using the incurred loss methodology with an Proportional Amortization Method
expected loss methodology that is referred to as the current expected credit loss ("CECL"). methodology. CECL requires The amendments in this
Update permit reporting entities to elect to account for their equity investments made primarily an to receive income tax estimate of credit losses for the remaining estimated life credits and other income tax benefits, regardless of the financial asset using program from which the income tax credits or historical experience, current benefits are received,
using the proportional amortization method if certain conditions and reasonable and supportable forecasts and generally applies to are met. The new standard financial assets measured at amortized cost, is effective for fiscal years, and including loan receivables and held-to-maturity debt securities, and some off interim periods within those fiscal years, beginning after December 15, -balance sheet credit exposures such as unfunded commitments to extend credit. Financial assets measured at amortized 2023. cost will be presented at the net amount expected to be collected by using an allowance for credit losses.

In addition, CECL made changes to the accounting for available for sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available for sale debt securities if management does not intend to sell and does not believe that it is more likely than not, they will be required to sell.

The Company adopted ASC 326 ASU 2023-02
effective January 1, 2024 and all related subsequent amendments thereto effective January 1, 2023 using the modified retrospective approach for all financial assets measured at amortized cost and off-balance sheet credit exposures.

The transition adjustment upon the adoption of CECL on January 1, 2023 included an increase in the allowance for credit losses on loans of $
1.0
million, which is presented as a reduction to net loans outstanding, and an increase in the allowance for credit losses on unfunded loan commitments of $
0.1
million, which is recorded within other liabilities. The Company
recorded a net decrease to retained earnings of $

0.8

million as of January 1, 2023 for the cumulative effect of adopting
CECL, which reflects the transition adjustments noted above, net of the applicable deferred change tax assets
recorded. Results for in accounting standard adjustment which reduced reporting periods beginning after January
1, 2023 are presented under CECL while prior retained earnings by $0.3 million. period amounts continue to be
reported in accordance with previously applicable accounting standards.
The Company adopted ASC 326 will prospectively account for its investments in New Market
Tax Credits ("NMTCs") using the prospective transition approach proportional amortization method through
charges to the provision for debt income taxes. See
Note 3, Variable securities for which other-than-
temporary impairment had been recognized prior to January 1, 2023. As of December 31, 2022, the Company did

10

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at amortized cost. Amortized cost is the principal balance outstanding, net of purchase premiums and discounts and deferred fees and costs. Accrued interest receivable related to loans is recorded in other assets on the consolidated balance sheets. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using methods that approximate a level yield without anticipating prepayments.

The accrual of interest is generally discontinued when a loan becomes 90 days past due and is not well collateralized and in the process of collection, or when management believes, after considering economic and business conditions and collection efforts, that the principal or interest will not be collectible in the normal course of business. Past due status is based on contractual terms of the loan. A loan is considered to be past due when a scheduled payment has not been received 30 days after the contractual due date.

All accrued interest is reversed against interest income when a loan is placed on nonaccrual status. Interest received on such loans is accounted for using the cost-recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, there is a sustained period of repayment performance, and future payments are reasonably assured.

Allowance for Credit Losses – Loans

The allowance for credit losses is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Accrued interest receivable is excluded from the estimate of credit losses.

The allowance for credit losses represents management's estimate of lifetime credit losses inherent in loans as of the balance sheet date. The allowance for credit losses is estimated by management using relevant available information, from both internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts.

The Company's loan loss estimation process includes procedures to appropriately consider the unique characteristics of its respective loan segments (commercial and industrial, construction and land development, commercial real estate,
residential real estate, and consumer loans). These segments are further disaggregated into loan classes, the level at which credit quality is monitored. See Note 5, Loans and Allowance for Credit Losses, for additional information about our loan portfolio.

Credit loss assumptions are estimated using a discounted cash flow ("DCF") model for each loan segment, except consumer loans. The weighted average remaining life method is used to estimate credit loss assumptions for consumer loans.

The DCF model calculates an expected life-of-loan loss percentage by considering the forecasted probability that a borrower will default (the "PD"), adjusted for relevant forecasted macroeconomic factors, and LGD, which is the estimate of the amount of net loss in the event of default. This model utilizes historical correlations between default experience and certain macroeconomic factors as determined through a statistical regression analysis.

The forecasted Alabama
unemployment rate is considered in the model for commercial and industrial, construction and land development,

commercial real estate, and residential real estate loans. In addition, forecasted changes in the Alabama home price index is considered in the model for construction and land development and residential real estate loans; forecasted changes in the national commercial real estate ("CRE") price index is considered in the model for commercial real estate and multifamily loans; and forecasted changes in the Alabama gross state product is considered in the model for multifamily loans.

Projections of these macroeconomic factors, obtained from an independent third party, are utilized to predict quarterly rates of default based on the statistical PD models.

Expected credit losses are estimated over the contractual term of the loan, adjusted for expected prepayments and principal payments ("curtailments") when appropriate. Management's determination of the contract term excludes expected extensions, renewals, and modifications unless the extension or renewal option is included in the contract at the reporting date and is not unconditionally cancellable by the Company. To the extent the lives of the loans in the portfolio extend beyond the period for which a reasonable and supportable forecast can be made

11

The weighted average remaining life method was deemed most appropriate for the consumer loan segment because consumer loans contain many different payment structures, payment streams and collateral. The weighted average remaining life method uses an annual charge-off rate over several vintages to estimate credit losses. The average annual charge-off rate is applied to the contractual term adjusted for prepayments.

Additionally, the allowance for credit losses calculation includes subjective adjustments for qualitative risk factors that are believed likely to cause estimated credit losses to differ from historical experience. These qualitative adjustments may increase reserve levels and include adjustments for lending management experience and risk tolerance, loan review and audit results, asset quality and portfolio trends, loan portfolio growth, industry concentrations, trends in underlying collateral, external factors and economic conditions not already captured.

Loans secured by real estate with balances equal to or greater than $500 thousand and loans not secured by real estate with balances equal to or greater than $250 thousand that do not share risk characteristics are evaluated on an individual basis.

When management determines that foreclosure is probable and the borrower is experiencing financial difficulty, the expected credit losses are based on the estimated fair value of collateral held at the reporting date, adjusted for selling costs as appropriate.

Allowance for Credit Losses – Unfunded Commitments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit issued to meet customer financing needs. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for off-balance sheet loan commitments is represented by the contractual amount of those instruments. Such financial instruments are recorded when they are funded.

The Company records an allowance for credit losses on off-balance sheet credit exposures, unless the commitments to extend credit are unconditionally cancelable, through a charge to provision for credit losses in the Company's consolidated statements of earnings. The allowance for credit losses on off-balance sheet credit exposures is estimated by loan segment at each balance sheet date under the current expected credit loss model using the same methodologies as portfolio loans,

taking into consideration the likelihood that funding will occur as well as any third-party guarantees. The allowance for unfunded commitments is included in other liabilities on the Company's consolidated balance sheets.

On January 1, 2023, the Company recorded an adjustment for unfunded commitments of $77 thousand upon the adoption of ASC 326. At September 30, 2023, the liability for credit losses on off-balance-sheet credit exposures included in ... million.

Provision for Credit Losses

The composition of the provision for (recoveries of) credit losses for the respective periods is presented below

Quarter ended September 30,

Nine months ended September 30,

(Dollars in thousands)

2023

2022

2023

2022

Provision for credit losses:

Loans
$
158
$
250
$
(133)
$
—

12

NOTE 2: BASIC AND DILUTED NET EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the respective period. quarters ended March 31, 2024 and 2023, respectively. Diluted net earnings per share reflect the potential dilution that could occur upon exercise of securities or other rights for, or convertible into, shares of the Company's common Company's common stock. At September 30, 2023 March 31, 2024 and 2023, respectively, 2022, respectively, the Company had no such securities or rights issued or outstanding, and therefore, no dilutive effect to consider for the diluted net earnings per share calculation.

The basic and diluted net earnings per share computations for the respective periods are are presented below

Quarter ended September 30,
Nine months ended September 30, March 31,
(Dollars in thousands, except share and per share data)

NOTE 3: VARIABLE INTEREST ENTITIES

2023
2022 2024
2023
2022

Generally, a variable interest entity ("VIE") is a corporation, partnership, trust or other legal structure that does not have equity investors with substantive or proportional voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities.

Basic and diluted:

Net earnings
$
1,488 1,371
$
1,998
$
5,380
$
5,880 1,964
Weighted average common shares outstanding
3,496,411 3,493,663
3,507,318

3,499,518

3,513,068 3,502,143

Net earnings per share

$

0.43 0.39

$

0.57

$

1.54

$

1.67 0.56

10

At September 30, 2023 March 31, 2024, the Company did not have any consolidated VIEs to disclose but did have one nonconsolidated VIE, discussed below.

New Markets Tax Credit Investment

The New Markets Tax Credit ("NMTC") NMTC program provides federal tax incentives to investors to make investments in distressed communities and distressed communities and promotes economic improvement through the development of successful businesses in these communities. The NMTC is NMTCs are available to investors over seven years and is are subject to recapture if certain events occur during such period. At September 30, 2023 March 31, 2024 and December 31, 2022, December 31, 2023, respectively, the Company had one such investment in of $1.2 million and $1.7 million, the amounts of $1.8 million and $2.1 million, respectively, which was included in other assets in the consolidated balance sheets. The Company's equity investment was included in other assets in the NMTC entity meets Company's consolidated balance sheets as a VIE. While the definition of a VIE. While the Company's Company's investment exceeds 50% of the outstanding equity interests, interest in this VIE, the Company does not consolidate the VIE because it does not meet the characteristics of a primary beneficiary since the Company lacks the power to direct the Company lacks the power to direct the activities of the VIE, and therefore is not a primary beneficiary of the VIE.

On March 29, 2023, the FASB issued ASU 2023-02, which was effective beginning in 2024 for public business entities. We have adopted ASU 2023-02 as of January 1, 2024 with respect to accounting for our NMTC investment. The proportional amortization method results in the tax credit investment being amortized in proportion to the allocation of tax credits and other tax benefits in each period and a net presentation within the income tax line item. The cumulative effects of the change in accounting standard resulted in a $0.4 million pre-tax decrease in the Company's NMTC investment at January 1, 2024. See Note 1: Summary of Significant Accounting Policies – Accounting Standards Adopted in 2024.

(Dollars in thousands)

Type:	Maximum Loss Exposure	Asset Recognized	Classification
New Markets Tax Credit investment	$ 1,807 1,175	$ 1,807 1,175	Other assets

13

NOTE 4: SECURITIES

At September 30, 2023 March 31, 2024 and December 31, 2022 December 31, 2023, respectively, all securities within the scope of ASC 320,
Investments – Debt

or-sale. The fair value and amortized cost for securities available- available-for-
...aturity at September 30, 2023 March 31, 2024 and December December 31, 2023,
2, respectively, are presented below.

Securities with aggregate fair values of $ 224.6 204.8 million and $ 208.3 211.8 million at September 30, 2023 March 31, 2024 and December 31, 2022 December 31, 2023, respectively, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, Federal Home Loan Bank of Atlanta ("FHLB of Atlanta") advances, and for other purposes required or or permitted by law.

(Dollars in thousan
December 31, 2022 2023
or less years
years years
Value
Agency obligations (a)
$
4,935 331
50,746 10,339
Cost
69,936 43,209
September 30, 2023 March 31, 2024
Agency obligations (a)
125,617 53,879

$—

15,826 8,195

$9,036 14,416

141,443 162,074

Agency MBS (a)

— 132,750 52,751

7,130 15,109

27,153 22,090

183,877 161,058

218,160 198,289

Agency MBS (a)

33,146 27,838

251,306 226,127

States and political subdivisions

300,— 17 154,380

642,— 57 190,224

Other

11

Included in other assets on the accompanying consolidated balance sheets include non-marketable equity investments. The carrying carrying amounts of non-marketable equity investments were $

1.4

million at September 30, 2023 March 31, 2024 and $ December 31, 2023,

Gross Unrealized Losses and Fair Value

1.2

The fair values and gross unrealized losses on securities at September 30, March 31, 2024 2023 and December 31, 2022 December 31, 2023, respectively,

2022, respectively. Non-marketable equity investments include FHLB of Atlanta tock, stock, Federal Reserve segregated by those securities that have been in an unrealized loss position for less than 12 months and 12

nancial institution.

Less than 12 Months

Unrealized

Fair

December 31, 2022: 2023:

Agency obligations

Unrealized

$

(Dollars in thousands)

55,931 —

4,161 —

69,686 53,879

11,665 8,195

Value

$

Losses

125,617 53,879 **2023: March 31, 2024:**

15,826 8,195

Agency obligations

Agency MBS

$

70,293 66

5,842 1

147,867 198,223

27,304 27,837

218,160 198,289

33,146 27,8381
State and political subdivisions
44,777 793 S
2,176 2
13,043 14,408
3,505 2,729 ,209
57,820 15,201
5,681 2,731 ,224
Total 30,229
State and political subdivisions
171,001 .859
12,179 3
230,596 266,510
42,474 38,761
$7,039 16,469
401,597 267,369
54,653
38,764

14

For the securities in the previous table, the Company assesses whether considers the severity of the unrealized loss as well the Company's intent to hold the securities to maturity or not it intends to the recovery of the cost basis. Unrealized losses have not been recognized into income as the decline in fair value is largely due to changes in interest rates and other market conditions. For the securities in the previous table as of March 31, 2024, management does not intend to sell or and it is more likely than that management will not that be the Company will be required to sell the securities before recovery prior to their recovery.

Agency Obligations

Investments in agency obligations are guaranteed of full and timely payments by the issuing agency. Based on management's analysis and judgement, there were no credit losses attributable to the Company's investments in agency obligations at March 31, 2024.

ts in agency mortgage backed securities ("MBS") are issued by Ginnie Mae, Fannie Mae, and Freddie Mac.

ach of these agencies provide a guarantee of full and timely payments of principal and interest by the issuing

12

ased on management's analysis and judgement, there were no credit losses attributable to the Company's investments in agency MBS at March 31, 2024.

Realized Gains and Losses

State and Political Subdivisions

The following table presents the gross Company had no realized gains and or losses on sales sale of securities.

Quarter securities during the quarters ended September 30,

Nine months ended September 30, portfolio was rated AA or higher, cost basis, which may be maturity. with no securities

(Dollars in thousands)

March 31, 2024 and 2023, investment grade at March 31, 2024.

2022 use the Company currently does not intend to sell those securities that have an Based on management's

2023 lysis and judgement, there were no credit losses attributable unrealized loss at September 30, 2023

2022 it is not more-likely-than-not that the Company will be required to sell the security before recovery of their

Gross realized gains, which may be maturity, the Company has determined that no provision for credit loss is

$ necessary. In addition,

The Company evaluates whether any portion of the decline in fair value of available-for-sale securities is the result

44 credit deterioration, which would require the recognition of a provision to increase the allowance for credit

$ losses. Such

evaluations consider the extent to which the amortized cost of the security exceeds its fair value, changes in credit

44 ratings and any other known adverse conditions related to the specific security. Company's investments The

Realized gains, net associated with available-for- in sale securities state and political subdivisions at September 30,

$023 are driven by changes in market interest rates and are not due to the credit quality of the securities, and imarily
—cordingly, no allowance for credit losses is considered necessary for available-for-sale securities at
44 ptember 30, 2023. These securities will continue to be monitored as a part of the Company's ongoing atic method
$ valuation of credit quality. Management evaluates the financial performance of the issuers on a quarterly basis to
— etermine if it is probable that the issuers can make all contractual principal and interest payments. March 31,
44 respectively.

commercial real estate, residential real estate, and consumer installment. Where appropriate, the Company's loan portfolio segments are further disaggregated into classes. A class is generally determined based on the initial measurement attribute, risk characteristics of the loan, and an entity's method for monitoring and determining credit risk.

$
80,212 73,374
Construction and land development
76,129 58,909
66,479 68,329
Commercial real estate:
Owner occupied
66,237 63,826
61,125 66,783
Hotel/motel
36,992 38,822
33,378 39,131
Multi-family
47,634 45,634
41,084 45,841
Other
131,101 152,202
128,986 135,552
Total commercial real estate
281,964 300,484
264,573 287,307
Residential real estate:
Consumer mortgage
60,024 59,813
45,370 60,545
Investment property
57,126 58,427
52,278 56,912
Total residential real estate
117,150 118,240

The following describes the risk characteristics relevant to each of the portfolio segments and classes.

Commercial and industrial ("C&I") —
includes loans to finance business operations, equipment purchases, or other needs for small and medium-sized commercial customers. Also included in this category are loans to finance agricultural production. Generally, the primary source of repayment is the cash flow from business operations and activities of the borrower.

Construction and land development ("C&D") —
includes both loans and credit lines for the purpose of purchasing, carrying, and developing land into commercial developments or residential subdivisions. Also included are loans and credit lines for construction of residential, multi-family, and commercial buildings. Generally, the primary source of repayment is dependent upon the sale or refinance of the real estate collateral.

Commercial real estate ("CRE") —
includes loans in these classes:

- *Owner occupied* – includes loans secured by business facilities to finance business operations, equipment and owner-occupied facilities primarily for small and medium-sized commercial customers. Generally, the primary source of repayment is the cash flow from business operations and activities of the borrower, who owns the property.

●

Hotel/motel

– includes loans for hotels and motels. Generally, the primary source of repayment is dependent upon income generated from the hotel/motel securing the loan. The underwriting of these loans takes into consideration the occupancy and rental rates, as well as the financial health of the borrower.

13

●

Multi-family

– primarily includes loans to finance income-producing multi-family properties. These include loans for 5 or more unit residential properties and apartments leased to residents. Generally, the primary source of repayment is dependent upon income generated from the real estate collateral. The underwriting of these loans takes into consideration the occupancy and rental rates, as well as the financial health of the respective borrowers.

●

Other

– primarily includes loans to finance income-producing commercial properties other than hotels/motels and multi-family properties, and which are not owner occupied. Loans in this class include loans for neighborhood retail centers, medical and professional offices, single retail stores, industrial buildings, and warehouses leased to local and other businesses. Generally, the primary source of repayment is dependent upon income generated from the real estate collateral. The underwriting of these loans takes into consideration the occupancy and rental rates, as well as the financial health of the borrower.

Residential real estate ("RRE") —

includes loans in these two classes:

- *Consumer mortgage* – primarily includes first or second lien mortgages and home equity lines of credit to consumers that are secured by a primary residence or second home. These loans are underwritten in in accordance with the Bank's general loan policies and procedures which require, among other things, proper documentation of each borrower's financial condition, satisfactory credit history, and property value.
- *Investment property* – primarily includes loans to finance income-producing 1-4 family residential properties. Generally, the primary source of repayment is dependent upon income generated from leasing the property securing the loan. The underwriting of these loans takes into consideration the rental rates and property values, as well as the financial health of the borrowers.

Consumer installment — includes loans to individuals, which may be secured by personal property or are unsecured. Loans include personal lines of credit, automobile loans, and other retail loans. These loans are underwritten in accordance with the Bank's general loan policies and procedures which require, among other things, proper documentation of each borrower's financial condition, satisfactory credit history, and, if applicable, property values.

16 14

The following is a summary of current, accruing past due, and nonaccrual loans by portfolio segment and class as of March eptember 30, 2023 31, 2024 and December 31, 2022 December 31, 2023.

s
an
ccruing
on-
Total

December 31, 2022: 2023:

(Dollars in thousands)

Commercial and industrial

Current

$

Past Due

17 15

Credit Quality Indicators

The credit quality of the loan portfolio is summarized no less frequently than quarterly using categories similar to the standard asset classification system used by the federal banking agencies. The following table presents credit quality indicators for the loan portfolio segments and classes by year of origination as of September 30, 2023. These categories are utilized to develop the associated allowance for credit losses using historical losses adjusted for qualitative and environmental factors and are defined as follows:

- Pass – loans which are well protected by the current net worth and paying capacity of the obligor (or guarantors, if any) or by the fair value, less cost to acquire and sell, of any underlying collateral.
- Special Mention – loans with potential weakness that may, if not reversed or corrected, weaken the credit or inadequately protect the Company's position at some future date. These loans are not adversely classified and do not expose an institution to sufficient risk to warrant an adverse classification.
-

Substandard accrual and nonaccrual loans are often collectively referred to as "classified." The following tables presents credit quality indicators for the loan portfolio segments and classes by year of origination as of March 31, 2024 and December 31, 2023. The December 31, 2023

Substandard Accruing – loans that exhibit a well-defined weakness which presently jeopardizes debt repayment, even though they are currently performing. These loans are characterized by the distinct possibility that the Company may incur a loss in the future if these weaknesses are not corrected.

table has been revised to correct revolving loans and properly allocate loans by year of origination. See Note 1: Summary of Significant Accounting Policies – Correction of Error.ccrual – includes loans where management has determined that full payment of principal and interest is not expected.

16

18 17

18

19

20

Allowance for Credit Losses

The Company adopted ASC 326 on January 1, 2023, which introduced the CECL methodology for estimating all expected losses over the life of a financial asset. Under the CECL methodology, the allowance for credit losses is measured on a collective basis for pools of loans with similar risk characteristics, and for loans that do not share similar risk characteristics with the collectively evaluated pools, evaluations are performed on an individual basis.

The composition of the provision for credit losses for the respective periods is presented

Quarter ended March 31,

(Dollars in thousands)

2024

2023

The following table is a summary of details the Company's nonaccrual changes in the allowance for credit losses for loans, by major categories as of September 30, 2023 portfolio segment for the respective periods

85

0

Reserve for unfunded commitments

Total provision for credit losses

The following table presents the amortized cost basis of collateral dependent loans, which are individually evaluated to determine expected credit losses: losses as of March 31, 2024 and December 31, 2023:

(Dollars in thousands)

Allowance for Credit Losses

The Company adopted ASC 326 on January 1, 2023, which introduced the CECL methodology for estimating all expected losses over the life of a financial asset. Under the CECL methodology, the allowance for credit losses is measured on a collective basis for pools of loans with similar risk characteristics, and for loans that do not share similar risk characteristics with the collectively evaluated pools, evaluations are performed on an individual basis.

Commercial and industrial

Beginning balance

Total

Loans with

Loans with an

Nonaccrual

Nonaccrual

No Allowance

Allowance

162

$

162

March 31, 2024:

Commercial real estate

801

$

765

801

Commercial and industrial Beginning balance

20

The following table details the changes in the allowance for credit losses by portfolio segment for the respective

eptember 30, 2023
Dollars in thousands)
onstruction
line months ended:
l estate
28
eginning balance
eptember 30, 2022
ommercial and industrial 326
onstruction
Nine months ended:
Beginning balance
$ al estate
857 dential
real estate
518 sumer
2,739 ment
739 rge-offs
86 uarter ended:
Beginning balance
$
4,939
Charge-offs
(17)
2,523
Recoveries
Recoveries
103
4,716
Charge-offs
(13)

21

The following table presents an analysis of the allowance for loan losses and recorded investment in loans by portfolio segment and impairment methodology as of September 30, 2022 as determined, prior to the adoption of ASC 326:

Collectively evaluated (1)
Individually evaluated (2)
Total
Allowance
Recorded
Allowance
Recorded
Allowance
Recorded
for loan investment
for loan investment
for loan investment
(In thousands)
losses in loans losses
in loans losses
in loans

September 30, 2022:

Commercial and industrial
$
732
70,685
—
—
732
70,685
Construction and land development
789
54,773
—
—
789
54,773 December 31, 2023:
Commercial real estate
2,561
249,860
—
170

22

Impaired loans

The following tables present impaired loans at December 31, 2022 as determined under ASC 310 prior to the adoption of
ASC 326. Loans that have been fully charged-off are not included in the following tables. The related allowance generally represents the following components that correspond to impaired loans:

- Individually evaluated impaired loans equal to or greater than $500 thousand secured by real estate (nonaccrual construction and land development, commercial real estate, and residential real estate loans).
- Individually evaluated impaired loans equal to or greater than $250 thousand not secured by real estate (nonaccrual commercial and industrial and consumer installment loans).

December 31, 2022

(Dollars in thousands)	**Unpaid principal balance (1)**	**Charge-offs and payments applied (2)**	**Recorded investment (3)**	**Related allowance**
With no allowance recorded:				
Commercial and industrial 783	$ 210	(1)	209	$ —
Commercial real estate:				
Owner occupied	858	(3)	855	
Total commercial real estate	858	(3)	855	

23 21

Pursuant to the adoption of ASU 2022-02, effective January 1, 2023, the Company prospectively discontinued the recognition and measurement guidance previously required for troubled debt restructurings (TDRs). As of September 30, 2023, the Company had no loans that would have previously required disclosure as TDRs.

onaccrual loans if any, by portfolio segment, major categories as of March 31, 2024 and the amount of
terest income recognized on impaired loans after impairment by portfolio segment and class during the

SC 326. December 31, 2023.

NOTE 6: MORTGAGE SERVICING RIGHTS, NET

Mortgage servicing rights ("MSRs") are recognized based on the fair value of the servicing rights on the date the corresponding mortgage loans are sold. An estimate of the fair value of the Company's MSRs is determined determined using assumptions that market participants would use in estimating future net servicing income, including estimates of prepayment speeds, discount rates, rate, default rates, costs cost to service, escrow account earnings, contractual servicing contractual servicing fee income, ancillary income, and late fees.

Subsequent to the date of transfer, the Company has elected to measure its MSRs under the amortization method. Under the amortization method, MSRs are amortized in proportion to, and over the period the period of, estimated net servicing income.

Increases in market interest rates generally increase the fair value of MSRs by reducing prepayments and refinancings and therefore reducing the prepayment speed.

The Company has recorded MSRs related to loans sold to Fannie Mae. The Company generally sells without recourse, conforming, fixed-rate, fixed-rate, closed-end, residential mortgages to Fannie Mae, where the Company services the mortgages sold and records MSRs. Mae. MSRs are included in other assets on the accompanying accompanying consolidated balance sheets.

The Company evaluates MSRs for impairment on a quarterly basis. Impairment is determined by stratifying MSRs into groupings based on predominant risk characteristics, such as interest rate and loan type. If, by individual stratum, the carrying amount of the MSRs exceeds fair value, a valuation allowance is established. The valuation allowance is adjusted as the fair value changes. Changes in the valuation allowance are recognized in earnings as a component of of mortgage lending income.

Quarter ended September 30, 2022 (CECL)
Nine months ended September 30, 2022 Nonaccrual loans
Average Nonaccrual loans
Total interest
Average
Total interest re
income recognized
income
(Dollars in thousands)
investment with no Allowance
recognized with an Allowance
investment Nonaccrual Loans
recognized
impaired loans: March 31, 2024
Commercial real estate
Other estate
$
173 765
—
$
199
—
Total commercial real estate
173
—
199
— 765
Residential real estate:
Investment property
—
—
6
—
Total residential real estate
—
97
97
Consumer
—
6 16
— 16
Total
$
24 22

The following table details the changes change in amortized MSRs and the related valuation allowance for the quarters the respective periods ended March 31, 2024 and 2023 are presented below.

NOTE 7: FAIR VALUE

Fair Value Hierarchy

“Fair value” is defined by ASC 820, *Fair Value Measurements and Disclosures*, and focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for an asset or liability at the measurement date.

GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1—inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets.

Level 2—inputs to the valuation methodology include 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.

Level 3—inputs to the valuation methodology are unobservable and reflect the Company’s own assumptions about the inputs market participants would use in pricing the asset or liability.

Level changes in fair value measurements

Transfers between levels of the fair value hierarchy are generally recognized at the end of each reporting period. The Company monitors the valuation techniques utilized for each category of financial assets and liabilities to ascertain when transfers between levels have been affected. The nature of the Company’s financial assets assets and liabilities generally is such that transfers in and out of any level are expected to be infrequent. For the nine quarter ended months ended September 30, 2023, March 31, 2024, there were no transfers between levels and no changes in valuation techniques for the Company’s financial assets and liabilities.

Quarter ended September 30,
Nine months ended September 30, March 31,
(Dollars in thousands)
2023
2022 2024
2023
2022
MSRs, net:
Beginning balance
$
1,050
$
1,259 992
$
1,151
$
1,309
Additions, net
7 12
13
110 —
Amortization expense
(46) (39)
(64)
(156)
(211) (55)
Ending balance
$
1,011 965
$
1,208
$
1,011
$

23

Assets and liabilities measured at fair value on a recurring basis

Securities available-for-sale

Fair values of securities available for sale were primarily measured using Level 2 inputs. For these securities, the Company

obtains pricing data from third party pricing services. These third party pricing services consider observable data that may include broker/dealer quotes, market spreads, cash flows, benchmark yields, reported trades for similar securities, market consensus prepayment speeds, credit information, and the securities' terms and conditions. On a quarterly basis,

management reviews the pricing data received from the third party pricing services for reasonableness given current market conditions. As part of its review, management may obtain non-binding third party broker/dealer quotes to validate the fair value measurements. In addition, management will periodically submit pricing information provided by the third party pricing services to another independent valuation firm on a sample basis. This independent valuation firm will compare the prices provided by the third party pricing service with its own

The following table presents the balances of the assets and liabilities measured at fair value on a recurring basis as of March

September 30, 2023 31, 2024 and December 31, 2022 December 31, 2023, respectively, by caption, on the

aluation hierarchy (as described above).

Assets and liabilities measured at fair value on a nonrecurring basis

Collateral Dependent Loans

Collateral dependent loans are measured at the fair value of the collateral securing the loan less estimated selling costs. The

fair value of real estate collateral is determined based on real estate appraisals which are generally based on recent sales of comparable properties which are then adjusted for property specific factors. Non-real estate collateral is valued based on various sources, including third party asset valuations and internally determined ~~values based on cost adjusted for depreciation and other judgmentally determined discount factors. Collateral~~ dependent loans are classified within Level 3 of the hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower's underlying financial condition.

Quoted Prices in
Significant
Active Markets
Other
Significant
for
Observable
Unobservable
Identical Assets
Inputs
Inputs
(Dollars in thousands)
Amount
(Level 1)

Mortgage servicing rights, net

MSRs, net, included in other assets on the accompanying consolidated balance sheets, are carried at the lower of cost or estimated fair value. MSRs do not trade in an active market with readily observable prices. To determine the fair value of

MSRs, the Company engages an independent third party. The independent third party's valuation model calculates the present value of estimated future net servicing income using assumptions that market participants would use in estimating future net servicing income, including estimates of mortgage prepayment speeds, discount rates, default rates, costs to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Periodically, the

Company will review broker surveys and other market research to validate validate significant assumptions used in the model. The

significant unobservable inputs include mortgage prepayment speeds or the constant prepayment rate ("CPR") and the weighted average discount rate. Because the valuation of MSRs requires the use of significant

assets and liabilities measured at fair value on a nonrecurring basis as of

eptember 30, 2023 March 31, 2024 and December 31, 2022 December 31, 2023, respectively, by caption, on the

ASB ASC 820 valuation valuation hierarchy (as described above):

Quantitative Disclosures for Level 3 Fair Value Measurements

At September 30, 2023 March 31, 2024 and December 31, 2022 December 31, 2023, the Company had no Level 3 assets measured measured at fair value on a recurring basis.

For Level 3 assets measured at fair value on a non-recurring basis at September March 31, 2024 30, 2023 and and December 31, December 31, 2023, the

resented below.

Active M
Other
Significant
nputs
nputs
Level 3)

September 30, 2023: March 31, 2024:

Range of
Weighted
Loans held for sale
Carrying
$
Significant
175
Unobservable
Average
(Dollars in thousands)
175
Amount
Valuation Technique
Loans, net
Unobservable Input
Inputs
969 765

September 30, 2023: March 31, 2024:

Collateral dependent loans

$ 969 765

Fair Value of Financial Instruments

ASC 825, *Financial Instruments*, requires disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, where it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow analyses. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Company's financial instruments, but rather are good-faith estimates of the fair value of financial instruments held by the Company. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments:

Loans, net

Fair values for loans were calculated using discounted cash flows. The discount rates reflected current rates at which similar loans would be made for the same remaining maturities. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments. The fair value of loans was measured using an exit price notion.

Loans held for sale

Fair values of loans held for sale are determined using quoted secondary market prices for similar loans.

Time Deposits

Fair values for time deposits were estimated using discounted cash flows. The discount rates were based on rates currently offered for deposits with similar remaining maturities.

The carrying value, related estimated fair value, and placement in the fair value hierarchy of the Company's financial instruments at September 30, 2023 March 31, 2024 and December 31, 2022 December 31, 2023 are presented below. This table excludes financial instruments for for which the carrying amount approximates fair value. Financial assets for which fair value approximates carrying value included cash and cash equivalents. Financial liabilities for which fair value approximates carrying value included noninterest-bearing demand deposits, interest-bearing demand deposits, and savings deposits. Fair value approximates carrying value in these financial liabilities due to these products having no stated maturity. Additionally, financial liabilities for which fair value approximates carrying value included overnight borrowings such as federal funds purchased and securities sold

The following table summarizes our fair value estimates:

Fair Value Hierarchy
Carrying
Estimated

28 26

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Auburn National Bancorporation, Inc. (the “Company”) is a bank holding company registered with the Board of Governors of the Federal Reserve System (the “Federal Reserve”) under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was incorporated in Delaware in 1990, and in 1994 it succeeded its Alabama predecessor as the bank holding company controlling AuburnBank, an Alabama state member bank with its principal office in Auburn, Alabama (the “Bank”). The Company and its predecessor have controlled the Bank since 1984. As a bank holding company, the Company may diversify into a broader range of financial services and other business activities than currently are permitted to the Bank under applicable laws and regulations. The holding company structure also provides greater financial and operating flexibility than is presently permitted to the Bank.

The Bank has operated continuously since 1907 and currently conducts its business primarily in East Alabama, including Lee County and surrounding areas. The Bank has been a member of the Federal Reserve System since April 1995. The Bank’s primary regulators are the Federal Reserve and the Alabama Superintendent of Banks (the “Alabama Superintendent”). The Bank has been a member of the FHLB of Atlanta since 1991. Certain of the statements made in this discussion and analysis and elsewhere, including information incorporated herein by reference to other documents, are “forward-looking statements” as more fully described under “Special Cautionary Notice Regarding Forward-Looking Statements” below.

The following discussion and analysis is intended designed to provide a better understanding of various factors related to the results of operations and financial condition of the Company and the Bank. This discussion is intended to supplement and highlight information contained in the accompanying unaudited condensed consolidated financial statements and related notes for the quarters ended March 31, 2024 and nine months ended September 30, 2023 and 2022, 2023, as well as the information contained in our annual report Annual Report on Form 10-K for the year ended December 31, 2022 and our interim reports on Form 10-Q for the quarters ended March 31, 2023 and June 30, 2023 December 31, 2023.

Special Cautionary Notice Regarding Forward-Looking Statements

Various of the statements made herein under the captions “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Quantitative and Qualitative Disclosures about Market Market Risk”, “Risk Factors” “Description of Property” and elsewhere, are “forward-looking statements” within the meaning and protections of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions and future performance, and involve involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause the actual results, performance, achievements or financial condition of the Company to be materially different from future results, performance, achievements or financial condition expressed or implied by such forward-looking statements. You should not expect us to update any forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as “may,” “will,” “anticipate,” “assume,” “should,” “indicate,” “would,” “believe,” “contemplate,” “expect,” “estimate,” “continue,” “designed”, “plan,” “point to,” “project,” “could,” “intend,” “seeks,” “model,” “simulations,” “target”, “view”, and other similar words and expressions of the future. These forward-looking statements may not be realized due to a variety of factors, including, without limitation:

- the effects of future economic, business and market conditions and changes, foreign, domestic and local, including locally, including inflation, seasonality, natural disasters or climate change, such as rising sea and water levels, hurricanes and and tornados, COVID-19 or other health crises, epidemics or pandemics including supply chain disruptions, inventory volatility, and changes changes in consumer behaviors;
- the effects of war or other conflicts, acts of terrorism, trade restrictions, sanctions or other events that may affect general economic conditions;

29

•

governmental monetary and fiscal policies, including the amount and costs of borrowing by the federal government and its agencies, the continuing effects of COVID-19 of fiscal and monetary stimuli, in and subsequent response to the COVID-19 crisis, followed by changes in monetary policies beginning in March 2022 in response to inflation, including increases in the Federal Reserve's Reserve's target federal funds rate and reductions in the Federal Reserve's
Reserve's holdings of securities; securities through quantitative tightening; and the duration that the Federal Reserve will keep its targeted federal funds rates at or above current rates to meet its long term inflation target of 2%;

•

legislative and regulatory changes, including changes in banking, securities and tax laws, regulations and rules and their application by our regulators, including capital and liquidity requirements, and changes changes in the scope and cost of FDIC insurance, including insurance;

•

changes in various capital, liquidity accounting pronouncements and other rule proposals, interpretations, including the required use, beginning January 1,
2023,of Financial Accounting Standards Board's ("FASB") Accounting Standards Update (ASU) 2016-13,
"Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," as well as changes in supervisory and examination focus, in light of three regional bank failures in California and the updates issued since June 2016 (collectively, New York in FASB March ASC Topic 326) on Current Expected Credit
Losses("CECL"), and May 2023; ASU 2022-02, Troubled Debt Restructurings and Vintage Disclosures, which eliminates troubled debt restructurings ("TDRs") and related guidance;

27

•

the failure of assumptions and estimates, including those used in the Company’s CECL models to establish our allowance for credit losses and estimate asset impairments, as well as differences in, and changes to, economic,
market and credit conditions, including changes in borrowers’ credit risks and payment behaviors from from those used in our CECL models and loan portfolio reviews;

●

the risks of inflation, changes in market interest rates and the shape of the yield curve on customer behaviors; the levels, composition composition and costs of deposits, and borrowings, the values of our securities and loans, loan demand and mortgage loan originations; the originations, and the values and liquidity of loan collateral, our securities portfolio and interest-sensitive assets and liabilities, liabilities;
and the risks and uncertainty of the amounts realizable on collateral;

●

the risks of further increases in market interest rates creating additional unrealized losses on our securities available
available for sale, which adversely affect our stockholders' equity (including for financial reporting purposes and our tangible stockholders' equity) for financial reporting purposes; equity;

●

changes in borrower liquidity and credit risks, and savings, deposit and payment behaviors;

●

changes in the availability and cost of credit and capital in the financial markets, and the types of instruments that may be included as capital for regulatory purposes;

●

changes in the prices, values and sales volumes of residential and commercial real estate;

●

the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services, including the disruptive effects of of financial technology and other competitors who are not subject to the same regulations regulation, including capital, and supervision and examination, as the Company
and the Bank and credit unions, which are not subject to federal income taxation;

●

the failure of assumptions and estimates underlying the establishment of allowances for credit losses, including asset impairments, losses valuations of assets and liabilities and other estimates;

●

the timing and amount of rental income from third parties following the June 2022 opening of our new headquarters;

●

the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;

●

changes in technology or products that may be more difficult, costly, or less effective than anticipated;

●

cyber-attacks and data breaches that may compromise our systems, our our vendors' systems or customers'
information;

●

the risks that our deferred tax assets ("DTAs") included in "other assets" on our consolidated balance sheets, if any, could be reduced if estimates of future taxable income from our operations and tax planning strategies are less than currently estimated, and sales of our capital stock could trigger a reduction in the amount of net operating loss carry-forwards that we may be able to utilize for income tax purposes;

●

the risks that our dividends, share repurchases and discretionary bonuses are limited by regulation to the maintenance of a capital conservation buffer of 2.5% and our future earnings and "eligible retained earnings" over rolling four calendar quarter periods;

●

other factors and risks described under “Risk Factors” herein, in our Annual Report on Form 10-K as of and for the year ended December 31, 2024 filed with the United States Securities and Exchange Commission (the
“Commission” or “SEC”), and in any of our subsequent reports that we make with the SEC under the Exchange
Act.
All written or oral forward-looking statements that are we make or are attributable to us are expressly qualified in their entirety by this cautionary notice.
We
have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

28

30

●

other factors and risks described herein and under “Risk Factors” in our annual report on Commission Form 10-K as of and for the year ended December 31, 2022 or in any of our subsequent reports that we make with the Securities and Exchange Commission (the “Commission” or “SEC”) under the Exchange Act.
All written or oral forward-looking statements that are we make or are attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

Summary of Results of Operations

Quarter ended September 30,
Nine months ended September 30, March 31,
(Dollars in thousands, except per share amounts) data)
2024
2023
2022
2023
2022

Net interest income (a)
$
6,380 6,677
$
7,360

$
20,591
$
20,034 7,217
Less: tax-equivalent adjustment
108 20
117
322
339 108
Net interest income (GAAP)
6,272 6,657
7,243

At September 30, 2023 March 31, 2024, the Company's allowance for credit losses was $6.8 million, $7.2 million, or 1.24% 1.27% of total loans, compared to $6.9 $5.8 million, or 1.14% 1.23% of total loans, at December 31, 2022 December 31, 2023, and $5.0 million $6.8 million, or 1.35% 1.05% of total loans, at September 30, 2022. The implementation of CECL required pursuant to Accounting Standards Codification ("ASC") 326, which was effective January 1, 2023, increased our allowance for credit losses by $1.0 million, or 0.20% of total loans, as a day one transition adjustment. March 31, 2023.

The Company recorded a negative provision for credit losses during the first three months of nine months 2024 of 2023 of $0.2 million, $0.3 million, compared to none $0.1 million during the first nine three months of 2022. 2023. The provision for credit losses under CECL is reflective reflects the Company's evaluation of the Company's its credit risk profile and the its future economic outlook and forecasts. Our CECL model is largely influenced by economic factors including, most notably, the anticipated unemployment rate. The negative increase in the provision for credit losses during losses in the first nine months quarter of 2024, as compared to the first quarter of 2023, was primarily related to changes in the resolution of a collateral dependent nonperforming loan, composition of, with a recorded investment of $1.3 million and a corresponding allowance of $0.5 million, that was collected increases in, full during loans as well as the second quarter of 2023. This was partially offset by an increase continued uncertainty in the calculation of current expected economic environment credit losses due which impacts the projected to loan growth during the first nine months of 2023.

macroeconomic factors used in our CECL modeling.

31

Noninterest income was $2.4 million $0.9 million in the first nine three months of 2023, 2024, compared to $2.6 million $0.8 million in the first nine three months of 2022. The decrease in noninterest income was primarily due to a decrease in mortgage lending income of $0.2 million as a result of higher market interest rates for mortgage loans. 2023.

Noninterest expense was $16.8 million $5.7 million in the first nine three months of 2023, 2024, compared to $15.4 million $5.6 million for the first nine three months of 2022. 2023. The increase in noninterest expense was primarily due to an increase in net occupancy routine increases in salaries and equipment expense of $0.4 million related to the Company's new headquarters, which opened in June 2022, professional fees expense of $0.2 million, and other noninterest expense of $0.9 million. benefits expense.

Income tax expense was $0.7 million $0.2 million for the first nine three months of 2023 2024 compared to $1.0 million $0.3 million for the first nine three months of 2022. of 2023. This decrease was due to a decline in the level of earnings before taxes and the Company's effective tax rate. The

Company's effective tax rate for the first nine three months of 2023 2024 was 12.05% 10.68%, compared to 15.14% 11.97% in the first nine three months of
2022. of 2023. The Company's effective income tax rate is affected principally affected by tax-exempt earnings from the Company's investment in municipal securities, bank-owned life insurance ("BOLI"), and New Markets Tax Credits ("NMTCs").

29

The Company paid cash dividends of $0.81 $0.27 per share in the first nine three months of 2024 and 2023 an increase of 2% from the same period of 2022. The Company repurchased 10,108 shares for $0.2 million during the first nine months of 2023. . At March 31, 2024, the
September 30, 2023, the Bank's regulatory capital ratios were well above the minimum amounts required to be "well capitalized" under current regulatory standards with a total risk-based capital ratio of 15.98% 15.69%, a tier 1 leverage ratio of
10.26% 10.34% and a common equity tier 1 ("CET1") ratio of 15.01% 14.62% at September 30, March 31, 2024. 2023. At September 30, 2023, the
Company's equity to total assets ratio was 5.96%, compared to 6.65% at December 31, 2022, and 5.74% at September 30, 2022.

For the third quarter of 2023, net earnings were $1.5 million, or $0.43 per share, compared to $2.0 million, or $0.57 per share, for the third quarter of 2022. Net interest income (tax-equivalent) was $6.4 million for the third quarter of 2023 compared to $7.4 million for the third quarter of 2022. This decrease was primarily due to decline in the Company's net interest margin. The Company's net interest margin (tax-equivalent) was 2.73% in the third quarter of 2023 compared to 3.00% in the third quarter of 2022. The decrease was primarily due to increased cost of funds and changes in our deposit mix, which was partially offset by a more favorable asset mix and higher yields on interest earning assets. The Company recorded a provision for credit losses during the third quarter of 2023 of $0.1 million, compared to $0.3 million for the third quarter 2022. Noninterest income was $0.9 million for both the third quarter of 2023 and 2022. Noninterest expense was $5.4 million in the third quarter of 2023 and 2022. Income tax expense was $0.2 million for the third quarter of 2023, compared to $0.4 million for the third quarter of 2022. This decrease was due to a decline in the level of earnings before taxes and the Company's effective tax rate. The Company's effective tax rate for the third quarter of 2023 was 10.90%, compared to 17.78% in the third quarter of 2022. The Company's effective income tax rate is principally impacted by tax-exempt earnings from the Company's investment in municipal securities, bank-owned life insurance, and New Markets Tax Credits.

CRITICAL ACCOUNTING POLICIES

The accounting principles we follow and our methods of applying these principles conform with U.S. GAAP and with general practices within the banking industry. The accounting policies which we believe to be most critical in preparing our

32

RESULTS OF OPERATIONS

Average Balance Balance Sheet and Interest Rates

Nine months Quarter ended September 30, March 31,

2023 2024
2022 2023
Average
Yield/
Average
Yield/
(Dollars in thousands)
Balance
Rate
Balance
Rate

Interest-earning assets:

Loans and loans held for sale
$
514,706 560,942
4.71% 5.01%
$
442,613 502,158
4.42% 4.65%
Securities - taxable
344,136 257,229
2.13% 2.21%
371,595 344,884
1.69% 2.19%
Securities - tax-exempt
54,615 10,377

30

The cost of total interest-bearing liabilities increased by 70 91 basis points to 1.02% 1.62% in the first nine three months of 2023 compared 2024 compared to 0.32% 0.71% in the first nine three months of 2022. 2023. Our deposit costs may continue to increase as the Federal Reserve maintains or increases its target federal funds rate, market interest rates increase, and as customer behaviors change as a result of inflation and higher market interest rates, and we compete for deposits against other banks, banks, money market mutual funds, funds, Treasury securities and other interest bearing alternative investments.

The Company continues to deploy various asset liability management strategies to manage its risks from interest rate fluctuations. Deposit and loan pricing remain competitive in our markets. We believe this challenging rate environment will continue throughout 2023. 2024. Our ability to compete and manage our deposit costs until our interest-earning assets reprice and we generate new fixed rate loans with current market interest rates will be important to our net interest margin during during the monetary tightening cycle that we believe will continue throughout 2023 and into 2024.

33

Provision for Credit Losses

On January 1, 2023, we adopted ASC 326 and its CECL methodology, which introduces the current expected credit losses (CECL) methodology and requires us to estimate all expected credit losses over the remaining life of our loans. Accordingly, Accordingly, the provision for credit losses represents a charge to earnings necessary to establish an allowance for credit losses that, in management's evaluation,

is adequate to provide coverage for all expected credit losses. The Company recorded a negative provision for credit losses during the first three months of 2024 of $0.3

million, compared to $0.1 million during the first nine three months of 2023 of $0.2 million, compared to none during the first nine months of 2022. 2023. Provision

expense is affected by organic loan growth in our loan portfolio, our internal assessment of the credit quality of the loan portfolio, portfolio, our expectations about future economic conditions and net charge-offs. Our CECL model is largely influenced by economic factors including, most notably, most notably, the anticipated unemployment rate, which may be affected by monetary policy. The negative increase in the provision for credit losses during in the first nine months quarter of 2024, as compared to the first quarter of 2023, was primarily related to changes in the resolution composition of, a collateral dependent nonperforming loan, with a recorded investment of $1.3 and increases in, loans as well as the continued uncertainty in the economic environment million and a corresponding allowance of which impacts the projected

$0.5 million, that was collected macroeconomic factors used in full during the second quarter of 2023. This was partially offset by an increase in the calculation of current expected credit losses due to loan growth during the first nine months of 2023. our CECL modeling. Our allowance for credit losses reflects an amount we believe appropriate, based on our allowance assessment methodology, to adequately cover all expected credit losses as of the date the allowance is determined. At September 30, March 31, 2024,

2023, the Company's allowance for credit for credit losses was $6.8 million $7.2 million, or 1.24% 1.27% of total loans, compared to $5.8 million, $6.9 million, or 1.23% of

1.14% total loans, at December 31, 2023, and $6.8 million, or 1.35% of total loans, at December 31, 2022, and $5.0 million, or 1.05% of total loans, at September March 31, 2023. 30, 2022. The

implementation of CECL, as of January 1, 2023, increased our allowance for credit losses by $1.0 million, or 0.20% of total loans, as a day one transition adjustment to ASC 326.

Noninterest Income

Quarter ended September 30,

Nine months ended September 30, March 31,

(Dollars in thousands)

2023

2022 2024

2023

2022

Service charges on deposit accounts