Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This report is required by law: Section 5(c)(1) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)); section 10(b)(2) of the Home Owners' Loan Act (12 U.S.C. § 1467a(b)(2)); sections 102 (a)(1), 165, and 618 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. §§ 5311(a)(1), 5365, and 1850a(c)(1)); and sections 8(a) and 13(a) of the International Banking Act of 1978 (12 U.S.C. §§ 3106(a) and 3108(a)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, Jon J. Prescott
Name of the Holding Company Director and Official

President & CEO
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Signature of Holding Company Director and Official

03/20/2023
Date of Signature

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2022
Month / Day / Year

Reporter's Name, Street, and Mailing Address

Katahdin Bankshares Corp.
Legal Title of Holding Company

11 Main Street
(Mailing Address of the Holding Company) Street / P.O. Box

Patten	ME	04765
City	State	Zip Code

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Joseph Porter	VP, Controller
Name	Title

207-521-3228
Area Code / Phone Number / Extension

207-521-0456
Area Code / FAX Number

j.porter@katahdintrust.com
E-mail Address

www.katahdintrust.com
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? .... 0=No 1=Yes: 0

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report .... ☐
2. a letter justifying this request has been provided separately ... ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

For Federal Reserve Bank Use Only

RSSD ID ________
C.I. ________

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

Report Item 1: Annual Report to Shareholders

For holding companies not registered with the SEC, **indicate status of Annual Report to Shareholders:**

☒ is included with the FR Y-6 report

☐ will be sent under separate cover

☐ is not prepared

Checklist

The checklist below is provided to assist the holding company in filing all the necessary responses and verifying changes from the prior year to the various report items. The completed checklist should be submitted with the report. Please see section A of the General Instructions for additional guidance.

Verification of Changes

All Reporters must respond to the following questions by checking the Yes or No box below, as appropriate.

Did the holding company have changes to any reportable FR Y-6 items (2a, 2b, 3, or 4) from the prior year?

☒ Yes ☐ No

If checked Yes, complete the remaining checklist for Report Items 2a, 2b, 3, and 4. For each Report Item, indicate whether there are changes from the prior year by checking Yes or No below. See section A of the General Instructions for additional information.

Report Item 2a: Organization Chart

☐ Yes ☒ No

If checked Yes, the Reporter must submit the organization chart as specified in Report Item 2.a instructions.

Report Item 2b: Domestic Branch Listing

☐ Yes ☒ No

If checked Yes, the Reporter must submit the domestic branch listing as specified in Report Item 2.b instructions.

Report Item 3: Securities Holders

☐ Yes ☒ No

If checked Yes, the Reporter must submit the information as specified in Report Item 3 instructions.

Report Item 4: Insiders

☒ Yes ☐ No

If checked Yes, the Reporter must submit the information as specified in Report Item 4 instructions.

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

FR Y-6
For year-end December 31, 2022
Katahdin Bankshares Corp.
Main Street, P O Box 450
Patten, Maine 04765

Report Item 1a: Form 10-K filed with the Securities and Exchange Commission
None

Report Item 1b: Annual reports to shareholders
Enclosed

Report Item 3: Shareholders

(1) CEDE & Co.
New York, NY/USA
Country of Incorporation – United States of America
2,353,828 shares of Common Stock = 71.83%

Report Item 4: Principal Shareholders, Directors & Officers

Principal Shareholders:

1. Name & Address: **CEDE & Co.**, New York, NY/USA
2. Principal Occupation: Depository Trust Company
3. Title/Position: N/A
4. % of each class: 71.83% of stock in Katahdin Bankshares Corp., (beneficial interest)

Directors:

1. Name & Address: **Steven L. Richardson,** Patten, ME/USA
2. Principal Occupation: Businessman – Retail Store Owner
3. Title/Position: a. Chairman of the Board & Director of Katahdin Bankshares Corp., b. Chairman of the Board & Director of Katahdin Trust Company, c. Partner in Richardson's Hardware.
4. % of each class: a. Owner of 2.87% of stock in Katahdin Bankshares Corp., c. Owner of 75% of stock in Richardson's Hardware.

1. Name & Address: **Richard B. Harnum, Jr.** Bangor, ME/USA
2. Principal Occupation: Commercial Real Estate Development and Management
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Co-owner and Managing Member of Harnum Family, LLC,
e. Co-owner and Managing Member of M&H Family, LLC, f. owner and manager of RBH Enterprises, LLC, g. owner and manager of Lucerne Properties, LLC
4. % of each class: a. Owner of 0.09% of stock in Katahdin Bankshares Corp.; c. owner of 50% of stock in Harnum Family, LLC, e. owner of 50% of stock in M&H Family, LLC, f. owner of 100% of stock in RBH Enterprises, LLC, g. owner of 100% of stock in Lucerne Properties, LLC.

1. Name & Address: **Paul R. Powers,** Caribou, ME/USA
2. Principal Occupation: Contractor
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner of Powers Roofing & Sheet Metal, Inc. d. Owner of B.J.J. Powers Enterprises, LLC, e. Partner in Aroostook County Redevelopment Association, f. Partner in Northern Maine Brewing Company.
4. % of each class: a. Owner of 1.31% of stock in Katahdin Bankshares Corp. c. Owner of 30% stock in Powers Roofing & Sheet Metal, Inc., d. Owner of 100% of stock in B.J.J. Powers Enterprises; e. Owner of 6.0 % stock in Aroostook County Redevelopment Association; f. Owner of 16% stock in Northern Maine Brewing Company.

1. Name & Address: **Richard J. York,** Houlton, ME/USA
2. Principal Occupation: Businessman – Owner of Automobile Dealership
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner of York Ford Sales, d. Owner of York Leasing, Inc., e. Owner of Freshstart Finance Company, f. Owner of York Reinsurance Ltd. g. Owner of Nature's Circle Farm
4. % of each class a. Owner of 1.23% of stock in Katahdin Bankshares Corp., c. Owner of 26.2% of stock in York's of Houlton, d. Owner of 47.5% of stock in York Leasing Inc., e. Owner of 47.5% of stock in Freshstart Finance Company, f. Owner of 47.5% of stock in York Reinsurance Ltd., g. Owner of 65% of stock in Nature's Circle Farm.

1. Name & Address: **Kimberley A. Niles,** Atkinson, NH/USA
2. Principal Occupation: Business Owner
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Managing Director of State of Granite, LLC, d. Managing Director of MRMT, LLC
4. % of each class: a. Owner of 0.07% of stock in Katahdin Bankshares Corp.; c. Owner of 100% of stock in State of Granite, LLC. d. Owner of 100% stock in MRMT, LLC

1. Name & Address: **Marianna (Molly) Putnam Liddell,** Yarmouth, ME/USA
2. Principal Occupation: Attorney, Pierce Atwood LLP
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Partner Pierce Atwood LLP
4. % of each class: a. Owner of 0.07% of stock in Katahdin Bankshares Corp., c. Owner of <5% in Pierce Atwood LLP

1. Name & Address: **Keith P. Bourgoin** Hampden, ME/USA
2. Principal Occupation: CPA
3. Title/Position: a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner and Managing Partner Haverlock, Estey & Curran LLC, d. Owner and Managing Partner HEC – Hampden
4. % of each class: a. Owner of 0.08% of stock in Katahdin Bankshares Corp., c. Partnership Interest of 16.66% in Haverlock, Estey & Curran CPA's, d. Partnership Interest of 16.66% in HEC- Hampden.

1. Name & Address: **Jon J. Prescott,** Houlton, ME/USA
2. Principal Occupation: Bank Executive
3. Title/Position: a. President & CEO, and Director of Katahdin Bankshares Corp., b. Director, President & CEO of Katahdin Trust Company, c. Director of MMG Insurance & Holding Company, d. Director of Houlton Water Company
4. % of each class: a. Owner of 2.19% of stock in Katahdin Bankshares Corp.

Officers:

1. Name & Address:	**William P. Lucy**, Verona Island, ME/USA
2. Principal Occupation:	Banker
3. Title/Position:	No position with holding company, Executive Vice President, Commercial Services of Katahdin Trust Company.
4. % of each class:	Owner of .39% of stock in Katahdin Bankshares Corp.

1. Name & Address:	**Matthew M. Nightingale,** Houlton, ME/USA
2. Principal Occupation:	Banker
3. Title/Position:	a. Treasurer & Clerk of Katahdin Bankshares Corp., b. Executive Vice President, CFO, & Treasurer of Katahdin Trust Company c. Director Aroostook Partnership
4. % of each class:	a. Owner of .22% of stock of Katahdin Bankshares Corp.

1. Name & Address:	**Krista K. Putnam,** New Limerick, ME/USA
2. Principal Occupation:	Banker
3. Title/Position:	No position with holding company, Executive Vice President, Chief Marketing Officer of Katahdin Trust Company
4. % of each class:	Owner of .08% stock in Katahdin Bankshares Corp.

1. Name & Address:	**Angela T. Butler**, Bangor, ME/USA
2. Principal Occupation:	Banker
3. Title/Position:	No position with holding company, Executive Vice President, Retail and Business Banking of Katahdin Trust Company
4. % of each class:	Owner of .12% stock in Katahdin Bankshares Corp.

1. Name & Address:	**Natasha R. McCarthy**, New Limerick, ME/USA
2. Principal Occupation:	Banker
3. Title/Position:	No position with holding company, Executive Vice President, Chief Human Resources Officer of Katahdin Trust Company
4. % of each class:	Owner of .05% stock in Katahdin Bankshares Corp.

ANNUAL REPORT
2022

Katahdin Bankshares Corp.

DEAR FELLOW SHAREHOLDERS,

It is my pleasure to provide the annual update on the progress of our Company. I am proud to report that in the past year, we have achieved significant growth and success.

2022 Financial Recap

Our team has worked tirelessly to ensure that we are providing high-quality products and services to our customers, as reflected in our 2022 financial results.

Katahdin Bankshares Corp. and its subsidiary, Katahdin Trust Company, continued to demonstrate very good performance in 2022. Despite industry and economic challenges, performance eclipsed the prior year in many areas.

Net income for 2022 totaled $9,724,000 or $2.97 per share. This was an increase of 3.1% over 2021's earnings per share. Return on average assets was 1.02% and return on average equity was 12.39%. Both are solid numbers. Tangible book value per share equaled $22.70.

You may recall that in 2021 the bank realized $2,357,000 in income from the Small Business Administration's Paycheck Protection Program (PPP); this was income not repeated in 2022. However, net interest income still rose by $1,325,000 as the Federal Reserve hiked interest rates seven times. Loan yields rose faster than funding costs throughout 2022, but we expect this situation to reverse itself in 2023.

Non-interest income remained flat in most categories. Non-interest expense rose due to higher salaries in an extremely tight labor market, opening a new office in Scarborough, and upgrading some of our facilities. Additionally, overall inflationary impacts contributed to an increase in expenses. We predict costs will continue to remain elevated for most of 2023 as the Federal Reserve attempts to curb inflation.

Balance sheet growth was moderate, as total assets rose 4.6% or $43,039,000. Total loans increased $19,219,000 year over year. We have been selective on loan opportunities due to economic uncertainty and competitive rates or loans that we felt needed to meet our credit standards better. Our strong asset quality has continued, but we know that it will not indefinitely remain as pristine as we now see it. The bank currently maintains an adequate allowance for loan losses and strong capital levels to protect against future losses.

Deposit growth remained a priority and a challenge, as later in the year many customers responded to rising rates by shifting deposits into higher-yielding categories. This will continue in 2023, and our challenge is to grow earning assets at profitable yields while maintaining an adequate net interest margin. This is common throughout the industry, particularly for community banks. We are dedicated to growing core deposits and are actively calling on customers and prospects for new business.

Further detailed commentary on our financials appears in the Company Overview and Results of Operations section of this report.

Shareholder Meeting and Voting

We invite you to join us at the Annual Shareholders' Meeting on Monday, May 1, 2023, at 11:00 a.m. The meeting will be in person and held at a new location at the Houlton Higher Education Center on Military Street in Houlton, Maine. Even if you cannot attend the meeting, I urge each shareholder to cast their proxy votes on important Company decisions. Voting can be conveniently done online, by mail, or by telephone, and only takes a few minutes of your time.

Achievements

In addition to our financial success, I am also pleased to report that our Company received several notable recognitions over the past year. We were named one of the top 200 publicly traded community banks in the United States by *American Banker* Magazine for the third consecutive year. Our family-friendly policies, employee benefits package, and company culture helped us to receive the Best Place for Working Parents® designation, as well as being named one of the Best Places to Work in Maine for the fifth consecutive year.

We also made a significant investment in relocating and enhancing our retail and commercial presence in Scarborough. The new location has allowed us to provide additional services for our customers and grow in southern Maine.

Supporting our Team and Communities

We are pleased that we were able to continue helping our friends and neighbors in need. Katahdin employees and directors donated their time to support 153 unique organizations across Maine. The average number of hours volunteered per volunteer was 30 hours. The total number of volunteer hours increased from the prior year as we saw more events and activities return to normal.

As a Company, we were proud to partner with several local non-profit organizations to help enrich the communities we serve. Causes included helping to end hunger throughout Maine, improving access to emergency healthcare services, and supporting efforts that create new jobs, retain residents, and attract more visitors to Maine communities.

Moving Forward Together

In terms of our future, we remain focused on helping our customers with their personal and business financial goals. With the recent addition of Ben Carlisle and Julie Libby to our Board of Directors, I am confident we can continue to grow our market share and move our Company forward.

Thank you for your investment in and continued support of Katahdin Trust. I encourage you to connect and follow along with us on Facebook, Twitter, LinkedIn, and Instagram for the latest on employee highlights, bank news, photos, and updates.

As always, if you have questions regarding the Company or this report, feel free to contact us.

Sincerely,

Jon J. Prescott
President & CEO

104 YEARS IN BUSINESS

1918–2022

FINANCIAL HIGHLIGHTS AS OF 12/31/22

KTHN STOCK
$22.05

TOTAL ASSETS
$983.5 MILLION

NET INCOME
$9.72 MILLION

RETURN ON AVG EQUITY
12.39%

EARNINGS PER SHARE
$2.97

TOTAL DEPOSITS
$857.6 MILLION

BOARD OF DIRECTORS

STEVEN L. RICHARDSON
CHAIRMAN
Partner,
Richardson's Hardware
Patten, Maine
Director since 1978

RICHARD J. YORK, SR.
VICE CHAIRMAN
Owner,
York's of Houlton
Houlton, Maine
Director since 1997

JON J. PRESCOTT
PRESIDENT & CEO
Katahdin Bankshares Corp.
and Katahdin Trust Company
Houlton, Maine
Director since 1997

KEITH P. BOURGOIN, CPA
Managing Partner,
Haverlock, Estey & Curran, LLC
Hampden, Maine
Director since 2018

RICHARD B. HARNUM, JR.
President,
Harnum Holdings
Hampden, Maine
Director since 2017

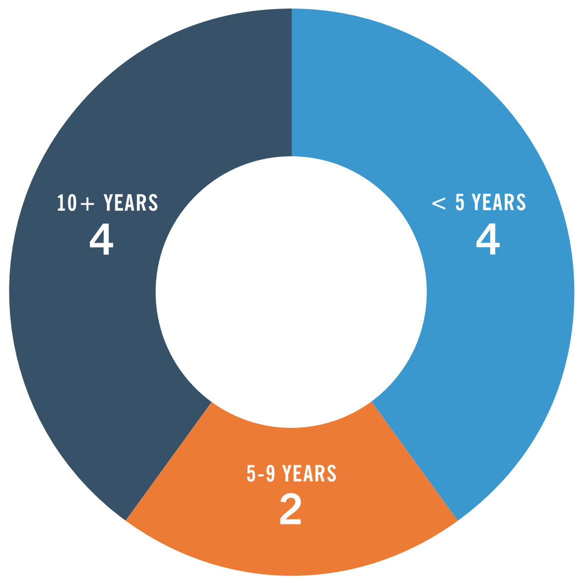
MARIANNA PUTNAM LIDDELL, ESQ.
Partner,
Pierce Atwood LLP
Yarmouth, Maine
Director since 2018

KIMBERLEY A. NILES
Owner and Director,
State of Granite, LLC
Atkinson, New Hampshire
Director since 2015

PAUL R. POWERS
Owner,
Powers Roofing & Sheet Metal, Inc.
Owner,
B.J.J. Powers Enterprises
Caribou, Maine
Director since 2000

ABOUT THE BOARD

On January 25, 2023, we welcomed Benjamin D. Carlisle of Bangor and Julie A. Libby of Presque Isle to our Board of Directors. Ben is the President of Prentiss & Carlisle and Julie is retired from the asset management industry. Our ten Directors are local leaders committed to the success of our Company. Each one cares deeply about the communities we serve because they live, work, and enjoy our region just like we do. Their diverse backgrounds help provide insight and leadership in the oversight of our Bank with an average tenure of 13 years.



THANK YOU, PETER

We offer a special thank you to Peter F. Briggs for 28 years of leadership and outstanding dedication to Katahdin Trust Company and Katahdin Bankshares Corp. Peter retired from our Board of Directors after serving from 1994 to 2022. During his tenure, Peter helped Katahdin Trust grow from only five branches to 16 and expand into the greater Bangor and Portland markets. We wish you continued happiness in your retirement, Peter!

OUR PROMISE

To provide community banking at its best and exceed customer expectations by offering personalized financial solutions to help individuals, businesses, and local communities manage their money and reach their goals.

WE ARE COMMITTED TO:

- Providing quality financial service by giving each and every customer courteous, personal and professional attention. Our employees will be well trained; knowledgeable and motivated at all times to fulfill our customers' financial needs.
- Continued growth and increased shareholder value at levels in line with maintaining a strong capital position.
- Helping businesses grow and prosper.
- Treating all people fairly and equally.
- Meeting the financial needs of the communities we serve, consistent with maintaining safe and sound banking practices.
- Remaining an independent, locally owned and managed community bank that adds to the quality of life of the communities we serve.

"We knew we wanted to deal with a local bank, so we chose to bank with Katahdin Trust. When we met with Katahdin, they helped us throughout the whole process. We've worked with employees at both Bangor locations and they've all been phenomenal and very down to earth.

We get all our loans through Katahdin Trust and it's really an easy process. At the beginning of our business, we didn't qualify for a lot of loans but they were creative and found a way to make it happen for us."

Larry and Kathy Hannon
Owners, Dairy Queen Bangor
Katahdin Trust Customers Since 2013

EXECUTIVE MANAGEMENT TEAM

JON J. PRESCOTT
President & CEO

ANGELA T. BUTLER
Executive Vice President
Retail & Business Banking

WILLIAM P. LUCY
Executive Vice President
Commercial Services

NATASHA R. McCARTHY, SHRM-CP
Executive Vice President
Chief Human Resources Officer

MATTHEW M. NIGHTINGALE
Executive Vice President
Treasurer & CFO

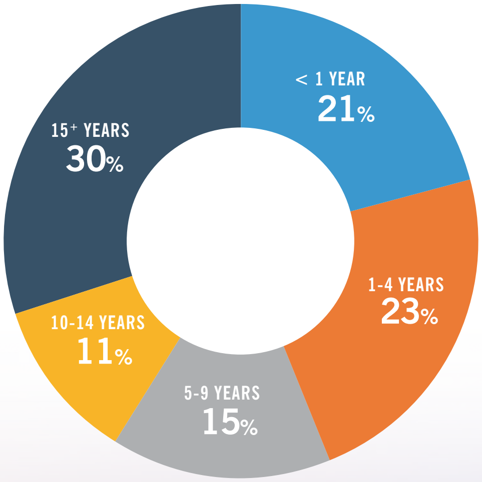
KRISTA K. PUTNAM, CFMP
Executive Vice President
Chief Marketing Officer

EMPLOYEE TENURE

Our 177 employees work together across various departments, including accounting, commercial, customer service, data processing, human resources, information technology, lending, marketing, retail, and operations. Each department strives for a common goal of helping our customers with their financial goals while achieving the highest level of customer satisfaction possible.

We are committed to supporting our employees' professional and personal needs by providing an excellent benefits package and family-friendly policies — and honored to be named one of the 2022 Best Places to Work in Maine and Best Place for Working Parents®.

We pride ourselves on the experience and knowledge of our staff, with 41% having been with us for 10 or more years.



Work with us | Bank with us

2018-2022 Best Places to Work in ME

177
Employees

BEST PLACE FOR WORKING PARENTS™ 2022

OFFICERS

NORTHERN MAINE

As of 12/31/22

Tori A. Barber, AVP
Training Manager

Annette J. Beaton, VP
Community Banking Officer

Bradley A. Berthiaume, SVP
Financial Consultant
Katahdin Financial Services

Adam Bither, VP
Financial Consultant
Katahdin Financial Services

Cindy L. Boot, AVP
Commercial Services Officer

Alexis Brown
Branch Manager &
Community Banking Officer
Houlton

David H. Cambridge, SVP
Commercial Services Officer

Samuel S. Clockedile, AVP
Marketing Officer

Albert "Joe" Clukey II, VP
Community Banking Officer

Melissa A. Dahlgren, AVP
Branch Manager &
Community Banking Officer
Fort Fairfield & Mars Hill

Janet M. Doak, AVP
Branch Manager &
Community Banking Officer
Ashland & Presque Isle

Sue A. Fox
Appraisal Department Manager

Angela M. Franck, AVP
Branch Manager &
Community Banking Officer
Eagle Lake & Fort Kent

Sarah J. Gardiner, AVP
Senior Credit Analyst

Leslie M. Gardner, VP
Retail Loans

Allissa M. Given, AVP
Branch Manager &
Community Banking Officer
Island Falls, Oakfield & Patten

Alison N. Gould, AVP
Commercial Services Officer

Billi B. Griffeth, RVP
Retail Banking

Patricia A. Hersey, VP
Cash Management &
Business Development Officer

Katherine H. Hill, VP
Bank Operations Manager

Teresa S. Lincoln
Executive Assistant

Susan B. Lunn, VP
Compliance Officer

Valerie J. Maynard
Senior Credit Administration
Assistant

Jean E. Noyes, VP
Information Security Officer

Kevin B. Plourde, SVP
Credit Administrator

Joseph M. Porter, VP
Controller

Barrett Potter, VP
Information Security &
Vendor Risk

Andrew L. Putnam, VP
Chief Information Officer

Scott A. Rossignol, AVP
System Administrator

Sarah S. Silliboy, AVP
BSA Officer

Peggy S. Smith, VP
Branch Manager &
Community Banking Officer
Caribou & Van Buren

Craig C. Staples, VP
Commercial Services Officer

Pamela J. Ward, VP
Credit Control

Jessica Weeks, AVP
Deposit Operations Manager

Miranda Wotton, AVP
Electronic Banking Manager

BANGOR & HAMPDEN

Cale L. Burger, VP
Commercial Services Officer

Justin K. Jamison, VP
Commercial Services Officer

Rebecca J. Kord, AVP
Branch Manager &
Community Banking Officer
Broadway & Springer Dr., Bangor

Eunice M. McAfee
Branch Manager &
Community Banking Officer
Hampden

Danelle L. Weston
Retail Underwriting Officer

SCARBOROUGH

Vicki L. Bessette, VP
Commercial Services Officer

Aaron J. Cannan, SVP
Commercial Services Officer

Lauren Carpenter
Branch Manager &
Community Banking Officer
Scarborough

Karyn L. MacLeod, VP
Commercial Services Officer

Craig Robinson, AVP
Commercial Services Officer

MAINE FINANCIAL GROUP

Susan L. McCarthy, VP
MFG Manager &
Commercial Services Officer

James P. Amabile, VP
Commercial Services Officer

Blake R. Hamel
Commercial Services Officer

2022 EMPLOYEE & COMMUNITY IMPACT

$303k
Total Giving

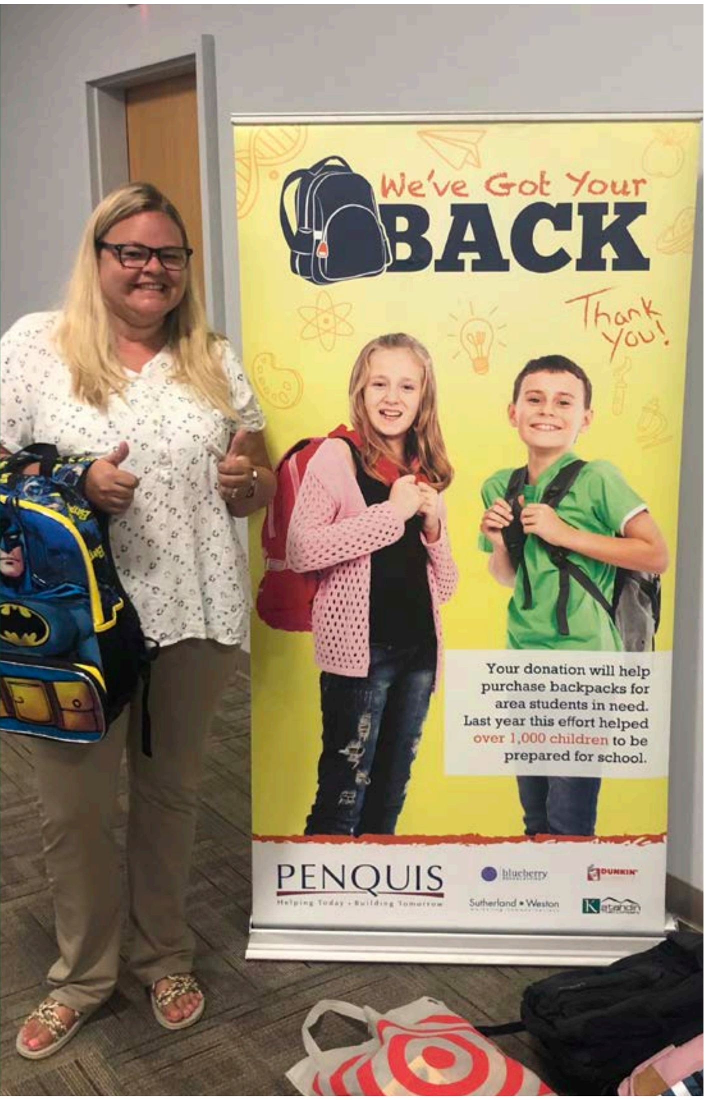
356
Local Non-Profit Organizations Supported

$2,400
Raised through employee donations for the Aroostook House of Comfort

$184k
Total Down Payment Assistance for 9 First-Time Homebuyers

3,800
Volunteer Hours

654
First-grade students benefited from the Summer Slide Reading Program



2022 COMMITMENT TO COMMUNITY

Top of the Mountain Award

Patricia (Patty) Hersey

Patty has been with Katahdin since 1999. She currently serves as Vice President, Cash Management & Business Development Officer. Patty spends her time volunteering with organizations such as the Houlton Regional Health Services Foundation and Houlton Lodge of Elks.

Congratulations, Patty, on receiving this award and for your commitment to making a positive impact in your local community!

SELECTED FINANCIAL DATA

The summary consolidated financial and other data should be read in conjunction with, and is qualified in its entirety by, the Company's current and prior years' annual reports and regulatory filings. Dollars in thousands, except share and per share data.

As of or for the Years Ended December 31,	2022	2021	2020	2019	2018
Balance Sheet Data					
Total assets	$ 983,538	$ 940,499	$ 937,007	$ 850,909	$ 803,119
Total investments (1)	147,736	111,739	95,973	103,173	96,319
Total loans	749,522	730,303	746,593	701,016	660,475
Allowance for loan losses	(7,428)	(7,803)	(7,454)	(6,293)	(5,856)
Total deposits	857,566	820,187	809,024	714,418	657,074
Shareholders' equity	79,664	83,604	76,202	68,879	71,057
Summary of Operations					
Interest and dividend income	$ 36,163	$ 34,735	$ 36,373	$ 36,314	$ 33,172
Interest expense	4,169	4,066	6,443	8,872	6,906
Net interest income	31,994	30,669	29,930	27,442	26,266
(Credit) Provision for loan losses	(500)	135	1,260	460	180
Net interest income after the provision for loan losses	32,494	30,534	28,670	26,982	26,086
Non-interest income	4,786	5,099	5,833	5,089	4,408
Amortization of investments in limited partnerships (11)	236	236	1,166	107	–
Non-interest expense	25,233	23,856	22,803	21,969	21,520
Income before income taxes	11,811	11,541	10,534	9,995	8,974
Income taxes (11)	2,087	2,068	1,015	1,836	1,777
Net income	$ 9,724	$ 9,473	$ 9,519	$ 8,159	$ 7,197
Less dividends on preferred stock	-	-	-	474	875
Net income available to common shareholders	$ 9,724	$ 9,473	$ 9,519	$ 7,685	$ 6,322
Per Common Shares and Common Shares Outstanding					
Net income, basic (2)	$ 2.97	$ 2.88	$ 2.88	$ 2.31	$ 1.89
Net income, diluted (2)	2.97	2.88	2.88	2.31	1.89
Book value (3)	24.49	25.41	23.16	20.77	18.29
Tangible book value (3)	22.70	23.63	21.43	19.05	16.59
Weighted average common shares outstanding: (4)					
Basic	3,276,837	3,290,788	3,299,905	3,326,912	3,345,012
Diluted	3,276,837	3,290,788	3,299,905	3,326,912	3,345,012
Common shares outstanding at period end	3,276,492	3,323,450	3,332,638	3,369,207	3,404,367
Adjusted common shares outstanding at period end (5)	3,253,289	3,290,605	3,290,151	3,316,671	3,339,734
Selected Performance Ratios					
Return on average assets	1.02%	1.00%	1.02%	0.99%	0.91%
Return on average common shareholders' equity	12.39	11.75	13.26	11.73	10.85
Net interest spread (6)	3.50	3.22	3.18	3.44	3.40
Net interest margin (7)	3.63	3.52	3.45	3.51	3.50
Efficiency ratio (8)	69.09	66.70	63.78	67.87	70.16
Asset Quality Ratios					
Allowance for loan losses to period end loans	0.99%	1.07%	1.00%	0.90%	0.89%
Allowance for loan losses to non-performing loans (9)	351.11	278.39	155.43	117.05	92.72
Non-performing loans to period end loans (9)	0.28	0.38	0.64	0.77	0.96
Non-performing assets to total assets (10)	0.22	0.30	0.52	0.64	0.79
Capital Ratios (Katahdin Trust Company)					
Total risk-based capital ratio	15.45%	15.67%	14.98%	13.75%	13.40%
Tier 1 risk-based capital ratio	14.42	14.50	13.81	12.75	12.42
Common equity tier 1 risk-based capital ratio	14.42	14.50	13.81	12.75	12.42
Tier 1 capital ratio (Leverage ratio)	10.99	10.14	9.52	9.65	9.42
Other Data					
Number of full and limited service banking offices	16	16	16	16	16
Number of full-time equivalent employees	165	162	161	171	173
Katahdin Financial Services Assets Under Management	$ 195,446	$ 191,140	$ 159,970	$ 135,063	$ 106,190

(1) Consists of investment securities and FHLB stock. (2) Computed based on the weighted average number of common shares outstanding during each period. (3) Book Value and Tangible Book Value are calculated using Adjusted Common Shares Outstanding at period end. (4) Weighted Average Common Shares Outstanding less weighted average unallocated ESOP shares. Used for calculating Earnings per Common Share. (5) Common Shares Outstanding at period end less unallocated ESOP shares at period end. Since unearned ESOP shares are deducted from capital, this adjustment deducts the unallocated shares from shares outstanding for calculating Book Value and Tangible Book Value. (6) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. (7) Net interest margin is the net interest income divided by the average interest-earning assets. (8) Efficiency ratio is non-interest expense (excluding Amortization of Investments in Limited Partnerships) divided by the sum of net interest income and non-interest income. (9) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. (10) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable. (11) The Bank invested in federal historic tax credits which were recognized as a reduction of federal tax expense. Amortization of the corresponding investment was accounted for in other expenses through Amortization of Investments in Limited Partnerships.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Katahdin Bankshares Corp. ("KBS" or the "Company") is a bank holding company incorporated under the laws of the State of Maine in 1986 for the purpose of becoming the parent holding company of Katahdin Trust Company (the "Bank"), which was established in 1918. The Bank serves individuals and businesses throughout Maine and online at KatahdinTrust.com.

The Bank conducts commercial and retail banking business that includes accepting deposits from the public and utilizing those funds to originate commercial loans, commercial and residential real estate loans, and consumer loans.

Securities and insurance products are made available to the Bank's customers through Katahdin Financial Services (a service of Cetera Investment Services LLC, a registered broker-dealer and unaffiliated with Katahdin Trust Company), with assets under management of approximately $195.4 million as of December 31, 2022.

Following is an overview of the results of 2022 operations.

Assets

Total assets reached $983.5 million, up $43.0 million over the prior year. Cash and cash equivalents ended the year at $30.5 million, down $32.4 million from year end 2021. These balances shifted to the investment portfolio which grew $36.0 million, ending the year at $147.7 million.

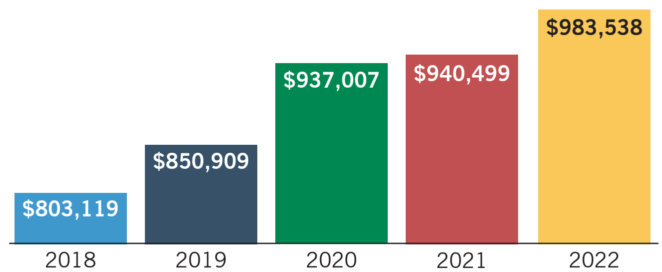
Due to the sharp increase in interest rates in 2022, the investment portfolio market value was reduced significantly, causing a reduction in shareholder equity by $15.0 million, net-of-tax. The investment portfolio market value will continue to fluctuate as rates move and cash flows are reinvested. Offsetting a portion of reduced investment valuation is our interest rate swap derivatives that hedge against movements in interest rates. The net unrealized gain on derivative investments, net of tax, increased shareholder equity by $4.2 million in 2022.

Loans

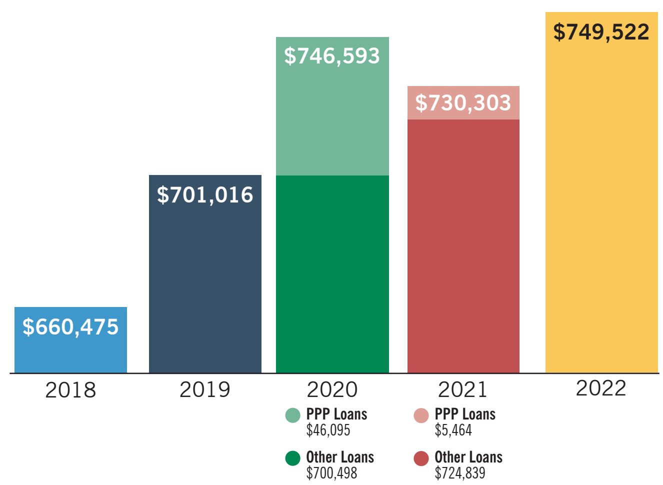
Total loan balances ended the year at $749.5 million, representing an increase of $19.2 million for 2022. Market rates increased substantially in 2022 as the Federal Reserve increased the Fed Funds rate by 4.25%. Our loan portfolio yield has increased throughout this time, moving from a December 2021 portfolio yield of 3.93% to 4.98% as of December 2022. This helped offset rising funding costs throughout the year.

Real estate lending consisted of the largest growth split between 1-4 residential properties growing $3.7 million and commercial real estate growing $19.0 million in 2022. Commercial and industrial loans were down by $4.9 million. Municipal lending grew by $1.4 million in 2022.

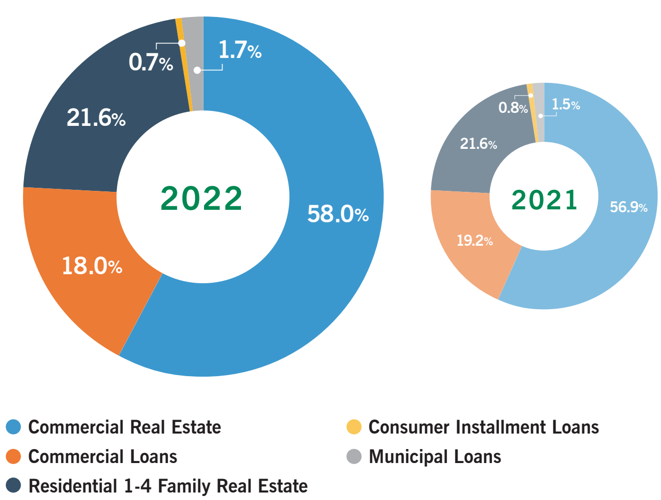
ASSETS ($000)



TOTAL LOANS ($000)



LOAN MIX



Securities and insurance products are offered through Cetera Investment Services LLC, member FINRA/SIPC. Advisory services are offered through Cetera Investment Advisers LLC. Cetera is not affiliated with the financial institution where investment services are offered. Individuals affiliated with Cetera firms are either Registered Representatives who offer only brokerage services and receive transaction-based compensation (commissions), Investment Adviser Representatives who offer only investment advisory services and receive fees based on assets, or both Registered Representatives and Investment Adviser Representatives, who can offer both types of services. Investments: **1) Are not FDIC/NCUSIF insured 2) May lose value 3) Are not financial institution guaranteed 4) Are not a deposit 5) Are not insured by any federal government agency.** Cetera registered offices: 12 North St., Presque Isle, ME 04769 and 65 North St., Houlton, ME 04730.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Loans (cont.)

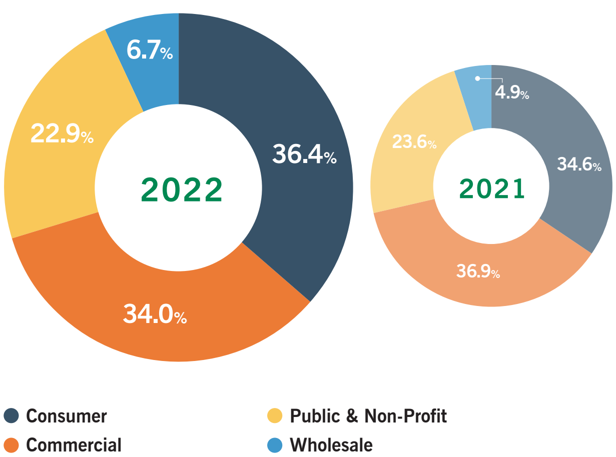
Approximately 77.7% of the Bank's loan portfolio consists of municipal, commercial, and commercial real estate loans. Loan officers continue to explore new loan opportunities across our market area, with a focus on building profitable relationships. We were pleased with the new relationships developed through all areas of the Company in 2022.

Deposits

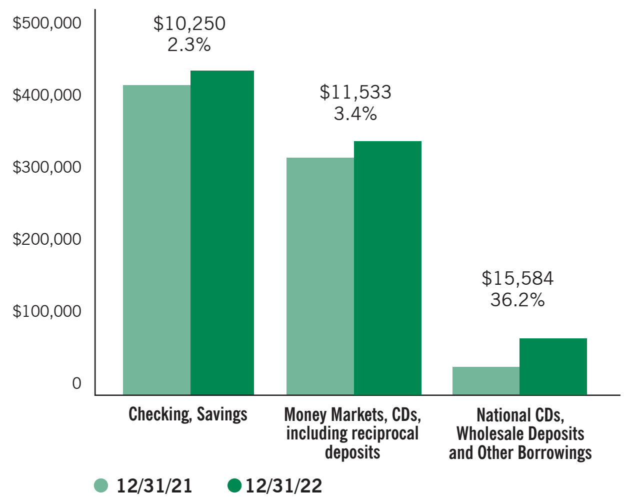
Deposits, including both customer and wholesale, grew to $857.6 million, an increase of $37.4 million. Customer deposits grew $21.8 million in 2022. This helped reduce our reliance on wholesale funding sources. Customer checking and savings grew by $10.3 million while money markets and certificate of deposits grew by $11.5 million year over year.

As rates have risen, we have seen our funding costs increase throughout 2022. We expect this to continue in 2023. Growing deposit relationships is a top priority. Should deposit levels diminish due to higher rates in 2023, the Bank is well-positioned with excess liquidity, both on- and off-balance sheet, to continue asset growth.

DEPOSIT SOURCES



DEPOSIT TREND ($000)



Net Interest Income

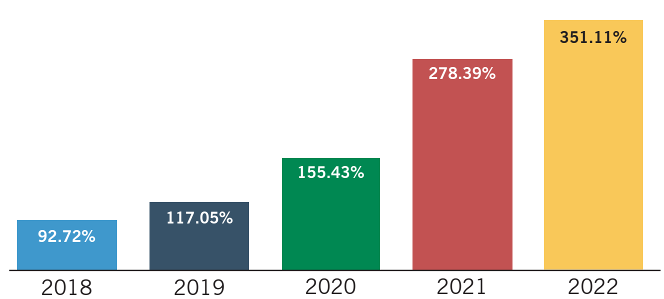
Net interest income in 2022 reached $31,994,000, exceeding the prior year by $1,325,000 or 4.3%. Net interest income reflects revenue generated from income on earning assets, plus loan fees, less interest paid on interest-bearing deposits and borrowings. While asset growth added to net interest income, the larger contributor in 2022 was from interest rate increases. By managing our cost of funds during the year and increasing yields on the asset side, our net interest spread grew from 3.22% to 3.50% year over year. We expect maintenance of the level of spread in 2023 to be challenging, as customers react to higher interest yielding options for their money.

Provision for Loan Losses and Asset Quality

Asset quality continued to be exceptional in 2022. Past due balances and non-performing loans have remained at the lowest levels we've seen over the last 5 years. Non-performing loans to total period end loans dropped from 0.38% at the end of 2021 to 0.28% as of year-end 2022. Non-performing assets to total assets dropped from 0.30% to 0.22% year-over-year.

As a result of solid asset quality, management decided to reduce the allowance for loan loss in the 4th quarter of 2022 by $500,000. The $500,000 was added to the allowance at the beginning of the Covid -19 pandemic but was never needed. There was no provision for loan loss expense in 2022. With this adjustment, our allowance for loan losses to period end loans

ALLOWANCE FOR LOAN LOSSES TO NON-PERFORMING LOANS



COMPANY OVERVIEW AND RESULTS OF OPERATIONS

ratio moved to 0.99% compared to 1.07% at year-end 2021. Further, the allowance to non-performing loan coverage ratio reached 351% by year end 2022 as compared to 278% at the end of 2021.

Management closely monitors the Bank's reserve for loan losses compared to asset quality to match our reserves with a reasonable estimate of risk. Detailed information regarding our allowance for loan loss can be found in footnote 4 of the audited financial statements.

Non-Interest Income and Expense

Non-interest income totaled $4,786,000, down from 2021 by $313,000. Non-interest income consists largely of service charges on loans, deposits, and electronic banking activity. The lower fee income can be attributed to fewer loan originations in 2022, while most other fee income sources remained on par with the prior year.

Non-interest expense reached $25,469,000 in 2022, representing expense growth of $1,377,000 or 5.7% year-over-year. Expense growth was primarily increases in salaries and benefits throughout the year, expenses associated with our new branch office in Scarborough, and overall inflationary pressures. The Efficiency Ratio ended at 69.1% as of year-end 2022 from 66.7% last year. Results have ended below 70% for the last four years. Management continues to look for opportunities to both grow revenue and operate more efficiently.

Net Income

Net Income available to common shareholders totaled $9,724,000, an increase of $251,000 over 2021. Net income in 2020 and 2021 was significantly enhanced by administering PPP loans, while 2022 was greatly impacted by how interest rate increases took effect during the year.

Earnings per common share totaled $2.97, up 9 cents from 2021. Return on Average Assets ended at 1.02% compared to 1.00% in 2021. Return on Average Common Shareholders' Equity was 12.39% compared to 11.75% in 2021.

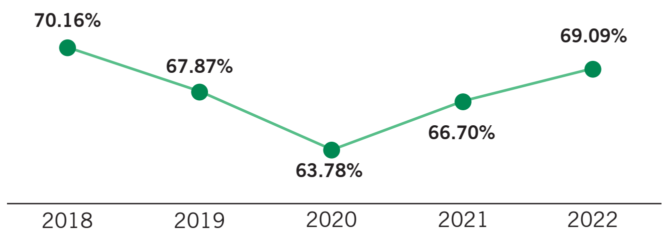
Capital

While the additional earnings have contributed to Capital, Total Shareholders' Equity decreased by $3.9 million to $79,664,000. This is a result of the previously described accounting of the unrealized negative fair market value reduction within our investment portfolio due to market rates.

Capital ratios for the Bank remained solid in 2022 and continued to remain well above the minimums to be well-capitalized per regulatory capital requirements. The Bank's leverage ratio at year-end 2022 was 10.99%, compared to 10.14% at the end of 2021. Total risk-based capital stood at 15.45% compared to 15.67% in 2021.

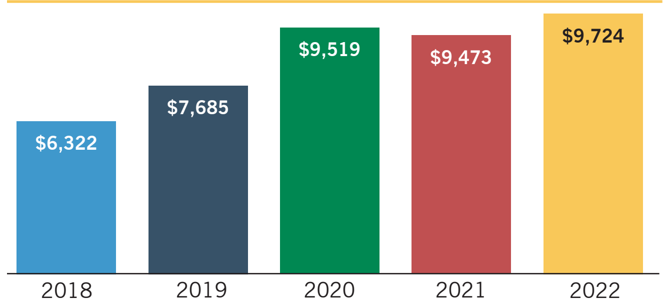
Tangible book value was $22.70, a decrease of $0.93 from year end 2021. The Company paid out common stock dividends of $0.552 per share, representing an 18.6% payout ratio. During the year, the Company repurchased 56,700 shares at an average price of $23.55 per share.

EFFICIENCY RATIO

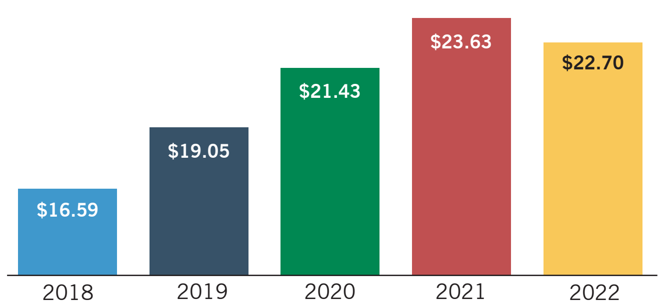


NET INCOME ($000)

Available to common shareholders



TANGIBLE BOOK VALUE



INDEPENDENT AUDITOR'S REPORT

Berry Dunn

Board of Directors and Shareholders
Katahdin Bankshares Corp. and Subsidiary

Opinion

We have audited the accompanying consolidated financial statements of Katahdin Bankshares Corp. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Katahdin Bankshares Corp. and Subsidiary as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with U.S. generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.

Auditor's Responsibilities
for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with U.S. generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with U.S. generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
February 6, 2023

CONSOLIDATED BALANCE SHEETS

December 31, 2022 and 2021

ASSETS	2022	2021
Cash and cash equivalents		
Cash and due from banks	$ 7,184,000	$ 7,159,000
Interest bearing deposits in banks	23,327,000	55,756,000
Total cash and cash equivalents	30,511,000	62,915,000
Securities available-for-sale	146,809,000	110,524,000
Other investments, at fair value	378,000	507,000
Securities held-to-maturity	2,000	3,000
Federal Home Loan Bank stock, at cost	547,000	705,000
Loans receivable, net of allowance for loan losses of $7,428,000 in 2022 and $7,803,000 in 2021	742,094,000	722,500,000
Bank premises and equipment, net	17,220,000	11,418,000
Goodwill	5,559,000	5,559,000
Other assets	40,418,000	26,368,000
	$ 983,538,000	$ 940,499,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2022	2021
Deposits		
Demand deposits	$ 219,565,000	$ 221,355,000
NOW and money market deposits	412,912,000	389,825,000
Savings deposits	105,502,000	98,804,000
Certificates of deposit	119,587,000	110,203,000
Total deposits	857,566,000	820,187,000
Advances from Federal Home Loan Bank	1,519,000	1,530,000
Accrued expenses and other liabilities	23,329,000	13,793,000
Senior notes 5.375%, net of unamortized debt issuance costs	14,243,000	14,168,000
Junior subordinated debentures	7,217,000	7,217,000
Total liabilities	903,874,000	856,895,000
Shareholders' equity		
Common stock, $.10 par value; 20,000,000 shares authorized, 3,276,492 and 3,323,450 shares issued and outstanding on December 31, 2022 and 2021, respectively	328,000	332,000
Surplus	6,512,000	7,528,000
Undivided profits	83,707,000	75,791,000
Accumulated other comprehensive (loss) income		
Net unrealized (depreciation) appreciation on securities available-for-sale, net of deferred income taxes	(15,033,000)	35,000
Net unrealized gain on derivative instruments, net of deferred income taxes	4,895,000	730,000
Unearned ESOP shares	(406,000)	(554,000)
Unearned compensation – restricted stock	(339,000)	(258,000)
Total shareholders' equity	79,664,000	83,604,000
	$ 983,538,000	$ 940,499,000

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

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2022 and 2021

	2022	2021
Interest and dividend income		
Loans	$ 32,583,000	$ 32,687,000
Investment securities	3,301,000	2,000,000
Other interest-earning assets	279,000	48,000
Total interest and dividend income	36,163,000	34,735,000
Interest expense		
Deposits	3,067,000	2,689,000
Borrowed funds and junior subordinated debentures	1,102,000	1,377,000
Total interest expense	4,169,000	4,066,000
Net interest income	31,994,000	30,669,000
(Credit) provision for loan losses	(500,000)	135,000
Net interest income after (credit) provision for loan losses	32,494,000	30,534,000
Noninterest income		
Service charges and fees on deposit accounts	1,179,000	1,141,000
Net realized gain on securities available-for-sale	–	117,000
Other	3,607,000	3,841,000
Total noninterest income	4,786,000	5,099,000
Noninterest expenses		
Salaries and employee benefits	15,319,000	14,877,000
Occupancy and equipment expense	3,073,000	2,753,000
Data processing	2,680,000	2,499,000
Marketing and donations	957,000	878,000
FDIC and state assessments	313,000	305,000
Amortization of investments in limited partnerships	236,000	236,000
Other general and administrative	2,891,000	2,544,000
Total noninterest expenses	25,469,000	24,092,000
Income before income taxes	11,811,000	11,541,000
Income tax expense	2,087,000	2,068,000
Net income	$ 9,724,000	$ 9,473,000
Basic earnings per common share	$ 2.97	$ 2.88
Diluted earnings per common share	$ 2.97	$ 2.88

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2022 and 2021

	2022	2021
Net Income	$ 9,724,000	$ 9,473,000
Other comprehensive (loss) income, net of related tax effects		
Unrealized depreciation on available-for-sale securities		
Unrealized depreciation on available-for-sale securities arising during period	(19,074,000)	(2,522,000)
Reclassification adjustment for gains realized in net income	–	(154,000)
Reclassification adjustment for losses realized in net income	–	37,000
Tax effect	4,006,000	554,000
Net change in unrealized depreciation on available-for-sale securities, net of tax	(15,068,000)	(2,085,000)
Unrealized gain on derivative instruments, net of tax	4,165,000	1,773,000
Total other comprehensive loss	(10,903,000)	(312,000)
Comprehensive (loss) income	$ (1,179,000)	$ 9,161,000

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2022 and 2021

	Common Stock	Surplus	Undivided Profits	Net Unrealized Appreciation (Depreciation) on Securities	Net Unrealized (Loss) Gain on Derivative Instruments	Unearned ESOP Shares	Unearned Compensation - Restricted Stock	Total
Balance, December 31, 2020	$ 333,000	$ 7,669,000	$ 67,963,000	$ 2,120,000	$ (1,043,000)	$ (697,000)	$ (143,000)	$ 76,202,000
Net income	–	–	9,473,000	–	–	–	–	9,473,000
Change in net unrealized appreciation on securities available-for-sale, net of deferred income taxes of ($554,000)	–	–	–	(2,085,000)	–	–	–	(2,085,000)
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of $471,000	–	–	–	–	1,773,000	–	–	1,773,000
Total comprehensive income (loss)	–	–	9,473,000	(2,085,000)	1,773,000	–	–	9,161,000
Cash dividends declared on common stock, $0.50 per share	–	–	(1,645,000)	–	–	–	–	(1,645,000)
Common stock purchased and retired under the Company buyback program (22,771 shares)	(3,000)	(501,000)	–	–	–	–	–	(504,000)
Issuance of 10,677 shares of restricted stock	1,000	196,000	–	–	–	–	(197,000)	–
Restricted stock award compensation	–	–	–	–	–	–	82,000	82,000
Director stock compensation (2,906 shares)	1,000	61,000	–	–	–	–	–	62,000
Common stock held by ESOP committed to be released (9,642 shares)	–	103,000	–	–	–	143,000	–	246,000
Balance, December 31, 2021	$ 332,000	$ 7,528,000	$ 75,791,000	$ 35,000	$ 730,000	$ (554,000)	$ (258,000)	$ 83,604,000
Net income	–	–	9,724,000	–	–	–	–	9,724,000
Change in net unrealized appreciation on securities available-for-sale, net of deferred income taxes of ($4,006,000)	–	–	–	(15,068,000)	–	–	–	(15,068,000)
Change in net unrealized loss on derivative instruments, at fair value, net of taxes of $1,107,000	–	–	–	–	4,165,000	–	–	4,165,000
Total comprehensive income (loss)	–	–	9,724,000	(15,068,000)	4,165,000	–	–	(1,179,000)
Cash dividends declared on common stock, $0.552 per share	–	–	(1,808,000)	–	–	–	–	(1,808,000)
Common stock purchased and retired under the Company buyback program (56,700 shares)	(6,000)	(1,333,000)	–	–	–	–	–	(1,339,000)
Issuance of 8,506 shares of restricted stock	1,000	216,000	–	–	–	–	(217,000)	–
Restricted stock award compensation	–	–	–	–	–	–	136,000	136,000
Director stock compensation (1,236 shares)	1,000	31,000	–	–	–	–	–	32,000
Common stock held by ESOP committed to be released (9,642 shares)	–	70,000	–	–	–	148,000	–	218,000
Balance, December 31, 2022	$ 328,000	$ 6,512,000	$ 83,707,000	$ (15,033,000)	$ 4,895,000	$ (406,000)	$ (339,000)	$ 79,664,000

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2022 and 2021

	2022	2021
Cash flows from operating activities		
Net income	$ 9,724,000	$ 9,473,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,153,000	1,117,000
Net amortization of premiums and discounts on securities	232,000	443,000
Noncash lease expense	238,000	124,000
(Credit) provision for loan losses	(500,000)	135,000
Amortization of investments in limited partnerships	296,000	285,000
Impairment of investment securities	–	20,000
Restricted stock award compensation	136,000	82,000
Director stock compensation	32,000	62,000
Loss (gain) on sale of bank premises and equipment	70,000	(19,000)
Unrealized loss (gain) on other investments	129,000	(9,000)
Gain on sale of securities available-for-sale	–	(137,000)
Deferred income tax expense (benefit)	297,000	(28,000)
Increase in cash value of life insurance	(394,000)	(391,000)
Gain on sale of other real estate and property owned	–	(8,000)
ESOP compensation expense	218,000	246,000
(Increase) decrease in other assets	(372,000)	495,000
Increase (decrease) in accrued expenses and other liabilities	282,000	(247,000)
Net cash provided by operating activities	11,541,000	11,643,000
Cash flows from investing activities		
Additions to premises and equipment	(3,429,000)	(794,000)
Loan originations and principal collections, net	(19,094,000)	16,462,000
Purchase of securities available-for-sale	(77,702,000)	(57,659,000)
Maturities of securities available-for-sale	22,111,000	27,948,000
Maturities of securities held-to-maturity	1,000	1,000
Proceeds from sales of securities available-for-sale	–	10,469,000
Investment in limited partnerships	(211,000)	(225,000)
Proceeds from sales of other real estate and property owned	–	88,000
Proceeds from sales of bank premises and equipment	–	19,000
Redemption of Federal Home Loan Bank stock	575,000	519,000
Purchase of Federal Home Loan Bank stock	(417,000)	–
Net cash used by investing activities	(78,166,000)	(3,172,000)
Cash flows from financing activities		
Net increase in deposits	37,379,000	11,163,000
Net decrease in short-term borrowings	(11,000)	(11,000)
Repayment of long-term debt	–	(11,500,000)
Purchase of common stock under Company buyback program	(1,339,000)	(504,000)
Cash dividends paid on common stock	(1,808,000)	(1,645,000)
Net cash (used) provided by financing activities	34,221,000	(2,497,000)
Net (decrease) increase in cash and cash equivalents	(32,404,000)	5,974,000
Cash and cash equivalents, beginning of year	62,915,000	56,941,000
Cash and cash equivalents, end of year	$ 30,511,000	$ 62,915,000
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	$ 4,091,000	$ 4,138,000
Income taxes paid	1,381,000	1,199,000
Noncash transactions		
Transfer from loans to other real estate and property owned	–	42,000
Unfunded commitment in Low Income Housing Tax Credit Partnership	339,000	–
Right-of-use assets	3,708,000	1,795,000
Lease liabilities	(3,708,000)	(1,795,000)
Increase (decrease) in fair value of interest rate swap assets	9,372,000	(3,226,000)
Increase (decrease) in fair value of interest rate swap liabilities	5,207,000	(4,999,000)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022 and 2021

Nature of Business

Katahdin Bankshares Corp. (the Company) is a bank holding company. Its subsidiary, Katahdin Trust Company (the Bank), is a state-chartered commercial bank with deposits insured by the Federal Deposit Insurance Corporation (FDIC). As a locally owned and managed community bank, the Bank's primary mission is to provide a broad range of banking services to individuals and small businesses throughout Maine while adding to the quality of life in the communities they serve. The Bank has 16 full-service branches throughout northern Maine and the greater Bangor and Portland regions. Maine Financial Group (MFG), a consolidated affiliate of the Bank, provides heavy equipment financing in the trucking, construction, forest products, and marine industries located around northern New England. The Company and its subsidiary are subject to regulation and periodic examination by the FDIC, the Maine Bureau of Financial Institutions, and the Federal Reserve System.

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Katahdin Bankshares Corp. and its wholly-owned subsidiary, Katahdin Trust Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Pursuant to the criteria established by U.S. generally accepted accounting principles (GAAP), the Company has not consolidated the trusts which it formed for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The trusts are considered affiliates (see Note 9).

Use of Estimates

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and 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 relate to the determination of the allowance for loan losses and the valuation of other real estate and property owned. In connection with the determination of the allowance for loan losses and the carrying value of other real estate and property owned, management obtains independent appraisals for significant properties.

While management uses all available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in the economy. In addition, regulatory agencies, as a part of their examination process, periodically review the Bank's loan portfolio and may require the Bank to make additions to the allowance for loan losses based on judgments about information available to them at the time of the examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks and interest-bearing deposits in banks.

The Company's due from bank accounts and interest-bearing deposits in banks, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Debt securities not classified as held to maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income or loss. Other investments are carried at estimated fair value with changes in fair value and realized gains or losses reported in noninterest income.

Purchase premiums and discounts are recognized in interest income using a method approximating the interest method over the terms of the securities. Declines in the fair value of individual debt securities that are deemed to be other-than-temporary are reflected in earnings when identified. For individual debt securities where the Company does not intend to sell the security and it is more-likely-than-not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings and 2) other factors are recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more-likely-than-not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay off are stated at the amount of unpaid principal, increased by net deferred loan costs and reduced by an allowance for loan losses.

All loans past due more than 30 days are considered delinquent. Management is responsible to initiate immediate collection efforts to minimize delinquency and any eventual adverse impact on the Company. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely.

Interest on loans is calculated by applying the simple interest method to daily balances of the principal amount outstanding. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income on nonaccrual loans is recognized only to the extent that interest payments are received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees and certain direct loan origination costs are deferred and amortized as an adjustment to income over the lives of the related loans.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance for loan losses when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses consists of general, allocated and unallocated components, as further described below.

1. Summary of Significant Accounting Policies (cont.)

General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following portfolio segments: commercial, commercial real estate, residential real estate, and consumer. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each portfolio segment. Management deems seven years to be an appropriate time frame on which to base historical losses for each portfolio segment. This historical loss factor is adjusted by various qualitative factors for each portfolio segment, including but not limited to performance of the portfolio segment, lender experience, new loan products or strategies, and economic factors. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit.

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

Commercial – Loans in this segment are made to businesses and municipalities and are generally secured by assets of the entity. For loans made to businesses, repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality of these loans. For loans made to municipalities, repayment is primarily dependent on taxes or other funds collected by the municipalities. Management considers there to be minimal risk surrounding the credit quality of these loans.

Commercial real estate – Loans in this segment are primarily income-producing properties or properties occupied by businesses. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates or a general slowdown in business which, in turn, will have an effect on the credit quality of this segment.

Residential real estate – Loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Consumer – Repayment of loans in this segment is generally dependent on the credit quality of the individual borrower.

Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The Bank recognizes the change in present value attributable to the passage of time as provision for loan losses. Large groups of smaller balance homogenous loans are collectively evaluated for impairment, and the allowance resulting therefrom is reported as the general component, as described above.

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

The Bank periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are classified as impaired and measured using the present value of expected future cash flows, or the fair value of the collateral less cost to sell if the TDR is collateral dependent.

Unallocated Component

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

There were no changes in the Bank's accounting policies or methodology pertaining to the allowance for loan losses during 2022 or 2021.

Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements and letters-of-credit. Such financial instruments are recorded when they are funded.

Loan Servicing

The Company capitalizes mortgage servicing rights at their fair value upon sale of the related loans. Capitalized servicing rights are reported in other assets and are amortized into other general and administrative expenses in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost.

Other Real Estate and Property Owned (OREO)

Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at fair value at the date of foreclosure or repossession. Subsequent to foreclosure or repossession, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate and property owned.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation computed on the straight-line and declining balance methods over the estimated useful lives of the assets.

Bank Owned Life Insurance (BOLI)

The Bank purchased life insurance policies insuring the lives of certain officers of the Bank. Consent was obtained from the employees prior to the purchase. The fee income stream related to the BOLI assets is reported in other noninterest income and the cash surrender value of the life insurance policies is reported in other assets.

Goodwill

Goodwill, related to branch acquisitions and MFG, is not amortizable and is reviewed for impairment annually, or more frequently upon the occurrence of certain events.

1. Summary of Significant Accounting Policies (cont.)

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. The Company releases income tax effects from accumulated other comprehensive income when the associated transaction is recognized in earnings.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2019 through 2022.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and derivative investments, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Employee Stock Ownership Plan

Shares of the Company's common stock purchased by the Katahdin Trust Company Employee Stock Ownership Plan (ESOP) are held in a suspense account until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Company recognizes compensation expense equal to the fair value of the ESOP shares committed to be released during the period. To the extent that the fair value of the ESOP shares differs from the cost of such shares, the difference is charged or credited to equity as surplus. Allocated and committed-to-be-released ESOP shares are considered outstanding for earnings per share calculations based on debt service payments. Other ESOP shares are excluded from earnings per share. The cost of unearned shares to be allocated to ESOP participants for future services not yet performed is reflected as a reduction of stockholders' equity.

Earnings Per Share

Basic and diluted earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year, which excludes the unallocated shares of the ESOP. Common stock related to unvested restricted stock awards is considered in the calculation of weighted average shares outstanding for basic and diluted earnings per share.

Derivative Financial Instruments Designated as Hedges

Fair values for interest rate swap agreements are based upon the amounts required to settle the contracts.

The Company utilizes interest rate swap agreements to provide an effective hedge against changes in the London Interbank Offered Rates (LIBOR) and federal funds rate swap curves. Interest rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

At the inception of a derivative contract, the Company designates the derivative as one of two types based on the Company's intentions and belief as to likely effectiveness as a hedge. These two types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), or (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives not designated or that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Accrued settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Accrued settlements on derivatives not designated or that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

The Company is exposed to losses if a counterparty fails to make its payments under a contract in which the Company is in the net receiving position. The Company anticipates that the counterparty will be able to fully satisfy its obligations under the agreements. All the contracts to which the Company is a party settle monthly or quarterly. In addition, the Company obtains collateral above certain thresholds of the fair value of its derivatives with the counterparty based upon its credit standing.

Revenue from Contracts with Customers

All of the Company's revenue from contracts with customers in the scope of ASC Topic 606 is recognized within noninterest income. A description of the Company's revenue streams accounted for under ASC Topic 606 follows:

1. Summary of Significant Accounting Policies (cont.)

Service charges and fees on deposit accounts: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH/wire transfer fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request, or the fee has been earned. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges and fees on deposits are withdrawn from the customer's account balance.

Interchange income: The Company earns interchange fees from debit cardholder transactions conducted through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Interchange income is included in other noninterest income and was $1,568,000 and $1,527,000 in 2022 and 2021, respectively.

Investment brokerage fees: The Company earns investment brokerage fees from its contracts with trust and brokerage customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Company provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management at month-end. Fees that are transaction-based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided include financial planning services and the fees the Company earns, which are based on a fixed fee schedule, are recognized when the services are rendered. Investment brokerage fees are included in other noninterest income and was $819,000 and $731,000 in 2022 and 2021, respectively.

Recently Issued Accounting Pronouncements

In June 2016, FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks, and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available-for-sale. The ASU is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Management is evaluating the potential impact of the ASU and anticipates that it may have a material impact on the Company's consolidated financial statements. The Company has formed an implementation committee for ASU No. 2016-13. To date, a third-party vendor has been selected and the committee is working through modeling and calculations and anticipates having fully adopted the new guidance by March 2023.

In March 2020, FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting,* and has issued subsequent amendments thereto, which provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying GAAP to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2024. The Company adopted ASU No. 2020-04 as of January 1, 2021 and has applied the ASU to its transition away from LIBOR for its financial instruments.

In March 2022, FASB issued ASU No. 2022-02, *Financial Instruments-Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,* which eliminates the accounting guidance for TDRs, while enhancing disclosure requirements for certain loan refinancing and restructurings by creditors when a borrower is experiencing financial difficulty. ASU No. 2022-02 is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Management does not expect the ASU to have a material effect on the Company's consolidated financial statements.

2. Cash and Due from Banks

The Bank may be required to maintain certain reserves of vault cash or deposits per Federal Reserve Bank policy. The Bank had no reserve requirement as of December 31, 2022 and 2021.

3. Securities

Securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost and fair value of debt securities, with gross unrealized gains and losses, follow:

2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury	$ 1,934,000	–	$ (126,000)	$ 1,808,000
State and municipal	18,416,000	73,000	(1,799,000)	16,690,000
Corporate bonds	2,200,000	–	(320,000)	1,880,000
Mortgage-backed and collateralized mortgage obligations (CMOs)	143,289,000	51,000	(16,909,000)	126,431,000
Total securities available-for-sale	$165,839,000	$ 124,000	$(19,154,000)	$146,809,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 2,000	$ –	$ –	$ 2,000
Total securities held-to-maturity	$ 2,000	$ –	$ –	$ 2,000
2021				
Securities Available-for-Sale				
State and municipal	$ 9,401,000	$ 378,000	$ (3,000)	$ 9,776,000
Corporate bonds	1,200,000	–	(85,000)	1,115,000
Mortgage-backed and CMO's	99,878,000	887,000	(1,132,000)	99,633,000
Total securities available-for-sale	$ 110,479,000	$1,265,000	$ (1,220,000)	$ 110,524,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 3,000	$ –	$ –	$ 3,000
Total securities held-to-maturity	$ 3,000	$ –	$ –	$ 3,000

3. Securities (cont.)

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2022:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury	$ 1,808,000	$ (126,000)	$ –	$ –	$ 1,808,000	$ (126,000)
State and municipal	10,426,000	(808,000)	2,647,000	(991,000)	13,073,000	(1,799,000)
Corporate bonds	891,000	(109,000)	989,000	(211,000)	1,880,000	(320,000)
Mortgage-backed and CMO's	63,810,000	(5,685,000)	55,898,000	(11,224,000)	119,708,000	(16,909,000)
Total temporarily impaired securities	$ 76,935,000	$ (6,728,000)	$59,534,000	$ (12,426,000)	$ 136,469,000	$ (19,154,000)

At December 31, 2022, unrealized losses within the U.S. Treasury category relate to two individual securities of which none had continuous losses for more than one year. Unrealized losses within the mortgage-backed and CMOs category relate to 144 individual securities of which 53 had continuous losses for more than one year. Unrealized losses within the state and municipal bond category relate to 30 bonds of which eight had a continuous loss position for more than one year. Unrealized losses within the corporate bond category relate to four bonds of which two had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2021:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State and municipal	$ 1,318,000	$ (3,000)	$ –	$ –	$ 1,318,000	$ (3,000)
Corporate bonds	674,000	(26,000)	441,000	(59,000)	1,115,000	(85,000)
Mortgage-backed and CMO's	63,115,000	(1,132,000)	–	–	63,115,000	(1,132,000)
Total temporarily impaired securities	$ 65,107,000	$ (1,161,000)	$ 441,000	$ (59,000)	$ 65,548,000	$ (1,220,000)

At December 31, 2021, unrealized losses within the mortgage-backed and CMOs category relate to 39 individual securities of which none had continuous losses for more than one year. Unrealized losses within the state and municipal bond category relate to three bonds of which none had a continuous loss position for more than one year. Unrealized losses within the corporate bond category relate to two bonds of which one had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the period the investment has been in an unrealized loss position. As of December 31, 2022 and 2021, management has determined that the current unrealized losses on these securities are consistent with changes in the overall bond markets caused by an increase in market yields and spread levels and the securities are not other-than-temporarily impaired. The exception to this is a mortgage-backed security at Banc of America Funding Corporation (BAFC). Management performed an internal analysis on the market value of its investment at BAFC as of December 31, 2022 and 2021, and recognized OTTI write-downs related to credit loss of the security of $20,000 for the year ended December 31, 2021. No OTTI write-down was recognized for the year ended December 31, 2022. OTTI write-downs are presented within net realized gain on securities available-for-sale on the consolidated statements of income.

The following table presents gross realized gains and losses on available-for-sale securities during the years ended December 31:

	2022	2021
Proceeds from sales	$ –	$ 10,469,000
Gross realized gains	$ –	$ 154,000
Gross realized losses	$ –	$ (37,000)
Net realized gain	$ –	$ 117,000

At December 31, 2022 and 2021, securities with a fair value of $52,871,000 and $53,776,000, respectively, were pledged to secure certain borrowings and municipal deposits as required or permitted by law.

The amortized cost and fair value of securities by contractual maturity at December 31, 2022 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	$ 3,662,000	$ 3,617,000	$ –	$ –
Over 1 year through 5 years	25,105,000	24,055,000	2,000	2,000
Over 5 years through 10 years	26,515,000	24,703,000	–	–
Over 10 years	110,557,000	94,434,000	–	–
	$165,839,000	$146,809,000	$ 2,000	$ 2,000

Mortgage-backed securities and CMOs are allocated among the above maturity groupings based on their final maturity dates.

The Bank's investment in Federal Home Loan Bank (FHLB) stock is stated at cost, subject to adjustments for any observable market transactions on the same or similar instruments of the investee.

Other Investments

The following table summarizes the cost and estimated fair value of the Company's other investments at December 31, 2022:

	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Other investments	$ 500,000	$ –	$ (122,000)	$ 378,000

The following table summarizes the cost and estimated fair value of the Company's other investments at December 31, 2021:

	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Other investments	$ 500,000	$ 7,000	$ –	$ 507,000

For the years ended December 31, 2022 and 2021, the Company recognized unrealized losses of $122,000 and unrealized gains of $9,000, respectively, due to the change in the fair value of its other investments. These losses and gains have been presented within other noninterest income on the consolidated statements of income.

4. Loans

A summary of the loan balances are as follows:

	2022	2021
Mortgage loans on real estate		
Residential 1-4 family	$ 161,499,000	$ 157,814,000
Commercial	434,165,000	415,116,000
	595,664,000	572,930,000
Commercial		
Commercial and industrial	134,329,000	139,309,000
Municipal loans	12,621,000	11,207,000
Business credit cards	579,000	496,000
	147,529,000	151,012,000
Consumer	5,480,000	5,680,000
Subtotal	748,673,000	729,622,000
Less: Allowance for loan losses	7,428,000	7,803,000
Add: Net deferred loan costs	849,000	681,000
Loans, net	$ 742,094,000	$ 722,500,000

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was enacted to provide emergency assistance for individuals, families and businesses affected by the COVID-19 pandemic. Amongst other programs, the CARES Act created the Paycheck Protection Program (PPP) designed to incentivize small businesses to keep their workers on the payroll. In January 2021, the PPP was reopened under the Consolidated Appropriations Act (CAA). During 2021 and 2020, the Bank had received approval from the U.S. Small Business Administration (SBA) for 341 and 585 applications, for PPP loans under the CARES Act and CAA with respect to $24,770,000 and $73,300,000 in loans, respectively. As of December 31, 2022, $98,026,000 of the Bank's PPP loans had been forgiven by the SBA with $44,000 in principal remaining outstanding. PPP loans are classified as commercial and industrial loans.

The SBA paid the Bank a 1% to 5% origination fee on the principal balance of PPP loans depending on the size of loan. As of December 31, 2022 and 2021, the Bank had PPP deferred loan origination fees of $2,000 and $189,000, respectively, recorded in accrued expenses and other liabilities on the consolidated balance sheets. In 2022 and 2021, the Bank recognized in income $187,000 and $2,024,000 of PPP loan origination fees, respectively. This income is recorded in loans interest income on the consolidated statements of income.

The following tables present the allowance for loan losses and select loan information for the years ended December 31, 2022 and 2021:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2022 Total
Allowance for loan losses						
Beginning balance	$ 1,381,000	$ 4,739,000	$ 463,000	$ 22,000	$1,198,000	$ 7,803,000
Provision for (reduction of) loan losses	(119,000)	(571,000)	418,000	22,000	(250,000)	(500,000)
Loans charged off	–	–	–	(8,000)	–	(8,000)
Recoveries of loans previously charged off	57,000	73,000	1,000	2,000	–	133,000
Ending balance	$ 1,319,000	$ 4,241,000	$ 882,000	$ 38,000	$ 948,000	$ 7,428,000
Individually evaluated for impairment	$ 15,000	$ 79,000	$ 19,000	$ –	$ –	$ 113,000
Collectively evaluated for impairment	$ 1,304,000	$ 4,162,000	$ 863,000	$ 38,000	$ 948,000	$ 7,315,000
Loans						
Ending balance	$147,529,000	$434,165,000	$161,499,000	$ 5,480,000	$ –	$748,673,000
Individually evaluated for impairment	$ 623,000	$ 978,000	$ 503,000	$ 21,000		$ 2,125,000
Collectively evaluated for impairment	$ 146,906,000	$ 433,187,000	$ 160,996,000	$ 5,459,000		$ 746,548,000

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2021 Total
Allowance for loan losses						
Beginning balance	$ 1,445,000	$ 4,666,000	$ 261,000	$ 26,000	$1,056,000	$ 7,454,000
Provision for (reduction of) loan losses	(226,000)	81,000	145,000	(7,000)	142,000	135,000
Loans charged off	–	(72,000)	(1,000)	–	–	(73,000)
Recoveries of loans previously charged off	162,000	64,000	58,000	3,000	–	287,000
Ending balance	$ 1,381,000	$ 4,739,000	$ 463,000	$ 22,000	$1,198,000	$ 7,803,000
Individually evaluated for impairment	$ 70,000	$ 218,000	$ –	$ –	$ –	$ 288,000
Collectively evaluated for impairment	$ 1,311,000	$ 4,521,000	$ 463,000	$ 22,000	$1,198,000	$ 7,515,000
Loans						
Ending balance	$ 151,012,000	$ 415,116,000	$ 157,814,000	$ 5,680,000		$ 729,622,000
Individually evaluated for impairment	$ 769,000	$ 1,301,000	$ 775,000	$ 43,000		$ 2,888,000
Collectively evaluated for impairment	$ 150,243,000	$ 413,815,000	$ 157,039,000	$ 5,637,000		$726,734,000

Management's judgment of the likelihood of a loss is demonstrated by the internal risk rating assigned to each loan in both the Commercial and Consumer portfolios.

Commercial: Commercial and Commercial Real Estate

The commercial portfolio is closely monitored for quality and the likelihood of loss. Based on the current information surrounding the facts and circumstances of the loan, an internal credit rating is assigned. Credit ratings 1-5 are deemed to be a performing loan with no significant likelihood of loss, and is considered pass. The ratings are further measured with a 6 – special mention, 7 – substandard, 8 – doubtful, and 9 – loss. Each of these ratings are supported by the facts and circumstances surrounding the loan that would cause a higher probability of some loss and thus as the rating progresses down the scale a higher reserve for loan loss is allocated to the particular group mentioned.

Loans rated 1: Loans in this category include municipalities or other government establishments primarily engaged in providing general support for government or administration of education programs.

Loans rated 2: Loans in this category include borrowers of unquestioned credit standing and a consistently strong financial condition as evidenced by earnings, liquidity, leverage, and cash flow. Additionally, loans secured by cash collateral or properly margined marketable securities are considered rated 2.

Loans rated 3: These loans include borrowers that have most of the characteristics of a loan rated 2, but either the financial condition, management, or industry is not quite as strong.

Loans rated 4: These loans include borrowers that have a reasonable financial condition. While loans in this category are sound, they do carry a higher risk. The borrower is generally profitable with occasional moderate losses.

Loans rated 5: These loans are considered "watch list." These loans are those commercial loans that, while creditworthy, exhibit some characteristics which require special attention by the loan officer. This is the lowest permissible rating for a new loan. Loans rated 5 must be closely monitored as any deterioration may be cause for prompt re-rating to 6 or lower. Principal areas of concern may be management problems, industry stress, financial deterioration,

4. Loans (cont.)

operating losses, inadequate cash flow, highly cyclical industries, or any other area that would negatively affect the borrower's ability to repay the obligation in full on a timely basis.

Loans rated 6: Loans in this category are considered "special mention." These loans are considered protected but may have potential weaknesses, which may weaken the asset or inadequately protect the Bank's credit position at some future date.

Loans rated 7: Loans in this category are considered "substandard." These loans might be inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified often have well-defined weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated 8: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses may make collection or liquidation in full highly questionable and improbable based on currently existing facts, conditions, and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage of strengthening of the asset, its rating as 9 is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loans rated 9: Loans in this category are considered "loss" or uncollectible. For these loans it is not practical or desirable to defer writing off the basically worthless loan even though partial recovery may be affected in the future.

Consumer: Consumer and Residential 1–4 Family

These loans are broken out as either pass or substandard. A loan is typically marked as substandard when it becomes 90 days past due or under certain circumstances such as bankruptcy or excessive tax liens. Higher reserves are allocated to substandard consumer loans as there would be a higher probability of loss.

The following tables summarize credit risk indicators by portfolio as of December 31, 2022 and 2021:

Commercial Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2022	Commercial	Commercial Real Estate
Pass	$ 144,592,000	$ 419,890,000
Special mention	2,061,000	12,381,000
Substandard	876,000	1,894,000
Doubtful	–	–
Loss	–	–
2022 Total	$ 147,529,000	$ 434,165,000
2021		
Pass	$ 148,588,000	$ 391,528,000
Special mention	1,116,000	20,846,000
Substandard	1,308,000	2,742,000
Doubtful	–	–
Loss	–	–
2021 Total	$ 151,012,000	$ 415,116,000

Consumer Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2022	Residential Real Estate	Consumer
Pass	$ 160,962,000	$ 5,475,000
Substandard	537,000	5,000
2022 Total	$ 161,499,000	$ 5,480,000
2021		
Pass	$ 157,239,000	$ 5,660,000
Substandard	575,000	20,000
2021 Total	$ 157,814,000	$ 5,680,000

The following presents an aging analysis of past due loans as of December 31, 2022 and 2021:

2022	31–60 Days Past Due	61–90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans on Nonaccrual	Recorded Investment Loans > 90 Days and Accruing
Commercial	$ 236,000	$ 6,000	$ 38,000	$ 280,000	$ 147,249,000	$ 147,529,000	$ 98,000	$ –
Commercial real estate	–	3,000	–	3,000	434,162,000	434,165,000	202,000	–
Residential real estate	41,000	39,000	50,000	130,000	161,369,000	161,499,000	205,000	–
Consumer	1,000	–	–	1,000	5,479,000	5,480,000	–	–
2022 Total	$ 278,000	$ 48,000	$ 88,000	$ 414,000	$ 748,259,000	$ 748,673,000	$ 505,000	$ –
2021								
Commercial	$ 25,000	$ –	$ 42,000	$ 67,000	$ 150,945,000	$ 151,012,000	$ 148,000	$ –
Commercial real estate	–	–	8,000	8,000	415,108,000	415,116,000	497,000	–
Residential real estate	28,000	56,000	268,000	352,000	157,462,000	157,814,000	427,000	–
Consumer	–	–	–	–	5,680,000	5,680,000	5,000	–
2021 Total	$ 53,000	$ 56,000	$ 318,000	$ 427,000	$ 729,195,000	$ 729,622,000	$ 1,077,000	$ –

4. Loans (cont.)

The Bank takes a conservative approach in credit risk management and remains focused on community lending and reinvesting, working closely with borrowers experiencing credit problems to assist in loan repayment or term modifications when appropriate. TDRs consist of loans where the Bank, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal that the Bank would not normally make for other borrowers with similar risk characteristics. Once such an obligation has been restructured, it will continue to remain in restructured status until paid in full. Current balances of loan modifications qualifying as TDRs during the years ended December 31, 2022 and 2021 were $78,000 and $2,000, respectively. Loans restructured due to credit difficulties that are now performing were $1,395,000 and $1,599,000 at December 31, 2022 and 2021, respectively.

At December 31, 2022 and 2021, the allowance related to TDRs was $94,000 and $235,000, respectively. The specific reserve component was determined by using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows from the borrower. There were no commitments to lend additional funds to borrowers with loans classified as TDRs at December 31, 2022 and 2021.

A loan is considered to be in payment default once it is greater than 30 days contractually past due under the modified terms. There were no TDRs restructured within the previous twelve months that subsequently defaulted during the years ended December 31, 2022 and 2021.

The following is a summary of new TDRs (accruing and non-accruing) by portfolio segment during the years ended December 31, 2022 and 2021:

2022	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Commercial	1	$ 83,000	$ 83,000	$ 78,000
2022 Total	1	$ 83,000	$ 83,000	$ 78,000
2021				
Commercial	1	$ 3,000	$ 3,000	$ 2,000
2021 Total	1	$ 3,000	$ 3,000	$ 2,000

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment as of December 31, 2022 and 2021:

2022	Number of Contracts	Current Balance	Related Allowance
Commercial	14	$ 586,000	$ 15,000
Commercial real estate	17	999,000	79,000
Residential real estate	3	434,000	–
Consumer	1	22,000	–
2022 Total	35	$ 2,041,000	$ 94,000
2021			
Commercial	22	$ 722,000	$ 70,000
Commercial real estate	19	1,085,000	165,000
Residential real estate	3	479,000	–
Consumer	2	29,000	–
2021 Total	46	$ 2,315,000	$ 235,000

Impaired loans mainly consist of non-accrual loans and TDRs. All impaired loans are allocated a portion of the allowance to cover potential losses.

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2022 and 2021:

2022	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 579,000	$ 579,000	$ –	$ 38,000
Commercial real estate	891,000	891,000	–	56,000
Residential real estate	484,000	484,000	–	16,000
Consumer	21,000	21,000	–	2,000
With an allowance recorded:				
Commercial	$ 44,000	$ 44,000	$ 15,000	$ –
Commercial real estate	87,000	87,000	79,000	–
Residential real estate	19,000	19,000	19,000	1,000
Consumer	–	–	–	–
2022 Total:				
Commercial	$ 623,000	$ 623,000	$ 15,000	$ 38,000
Commercial real estate	978,000	978,000	79,000	56,000
Residential real estate	503,000	503,000	19,000	17,000
Consumer	21,000	21,000	–	2,000

2021	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 698,000	$ 698,000	$ –	$ 41,000
Commercial real estate	724,000	724,000	–	39,000
Residential real estate	775,000	775,000	–	30,000
Consumer	43,000	43,000	–	4,000
With an allowance recorded:				
Commercial	$ 71,000	$ 71,000	$ 70,000	$ –
Commercial real estate	577,000	577,000	218,000	17,000
Residential real estate	–	–	–	–
Consumer	–	–	–	–
2021 Total:				
Commercial	$ 769,000	$ 769,000	$ 70,000	$ 41,000
Commercial real estate	1,301,000	1,301,000	218,000	56,000
Residential real estate	775,000	775,000	–	30,000
Consumer	43,000	43,000	–	4,000

The following is a summary of information pertaining to impaired loans:

	2022	2021
Impaired loans without a valuation allowance	$ 1,975,000	$ 2,240,000
Impaired loans with a valuation allowance	150,000	648,000
Total impaired loans	$ 2,125,000	$ 2,888,000
Valuation allowance related to impaired loans	$ 113,000	$ 288,000
Average investment in impaired loans	$ 2,474,000	$ 3,772,000

As of December 31, 2022 and 2021, there were one and three mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $14,000 and $250,000, respectively.

The Bank was servicing for others mortgage loans of approximately $18,144,000 and $20,147,000 at December 31, 2022 and 2021, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022 and 2021

4. Loans (cont.)

The balance of mortgage servicing rights included in other assets at December 31, 2022 was $113,000. Mortgage servicing rights of $4,000 were capitalized and mortgage servicing rights of $51,000 were amortized during 2022. The balance of mortgage servicing rights included in other assets at December 31, 2021 was $160,000. Mortgage servicing rights of $59,000 were capitalized and mortgage servicing rights of $51,000 were amortized during 2021.

5. Bank Premises and Equipment

A summary of the cost and accumulated depreciation of bank premises and equipment follows:

	2022	2021
Land	$ 3,106,000	$ 2,937,000
Buildings	11,777,000	11,594,000
Construction in process	–	128,000
Right-of-use assets	5,141,000	1,671,000
Equipment	15,966,000	15,039,000
Leasehold improvements	3,193,000	1,112,000
	39,183,000	32,481,000
Accumulated depreciation	(21,963,000)	(21,063,000)
	$ 17,220,000	$ 11,418,000

6. Leases

The Company has operating leases pertaining to bank premises with remaining lease terms of 8 to 29 years. Leases are classified as operating or finance leases at the lease commencement date. The Company does not have any finance leases. Lease expense for the operating leases are recognized on a straight-line basis over the lease term. Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term, including renewal options that are reasonably certain to be exercised.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors. The weighted average discount rate for operating leases at December 31, 2022 and 2021 was 3.00%.

Right-of-use assets and lease liabilities by lease type, and the associated balance sheet classifications, as of December 31 were as follows:

	Balance Sheet Classification	2022	2021
Right-of-use assets:			
Operating leases	Bank premises and equipment	$ 5,141,000	$ 1,671,000
Lease liabilities:	Accrued expenses		
Operating leases	and other liabilities	$ 5,226,000	$ 1,685,000

The components of lease expense were as follows for the years ended December 31:

	2022	2021
Operating lease cost	$ 453,000	$ 224,000

The weighted average remaining lease term for operating leases was 24.67 and 9.13 years at December 31, 2022 and 2021, respectively.

Future lease payments for operating leases with initial terms of one year or more as of December 31, 2022 are as follows:

2023	$ 304,000
2024	305,000
2025	306,000
2026	309,000
2027	348,000
Thereafter	5,986,000
Total undiscounted lease payments	7,558,000
Less: Imputed interest	2,332,000
Net lease liability	$ 5,226,000

7. Deposits

At December 31, 2022, the scheduled maturities of certificates of deposit are as follows:

2023	$ 85,072,000
2024	15,778,000
2025	7,375,000
2026	4,476,000
2027	6,885,000
Thereafter	1,000
	$ 119,587,000

Certificates of deposit accounts in denominations that met or exceeded the insured limit were $23,334,000 and $24,608,000 at December 31, 2022 and 2021, respectively.

8. Advances from FHLB and Other Borrowings

Pursuant to collateral agreements with the FHLB, advances are collateralized by all stock in the FHLB, qualifying first mortgages and securities available-for-sale.

Fixed-rate advances of $1,519,000 and $1,530,000 at December 31, 2022 and 2021, respectively, mature through August 2023. At December 31, 2022 and 2021, respectively, the interest rates on fixed rate advances ranged from 0.00 to 1.00 percent. At December 31, 2022 and 2021, the weighted-average interest rates on fixed-rate advances was 0.92 percent. The fixed-rate advances contractually mature in 2023.

At December 31, 2022 and 2021, the Company also had $1,000,000 available under a long-term line of credit with the FHLB. There were no advances outstanding on this line of credit as of December 31, 2022 and 2021.

At December 31, 2022 and 2021, the Company also had $27,000,000, respectively, available under lines of credit with other banks which were in addition to the FHLB line of credit. There were no advances outstanding under these lines of credit with other banks as of December 31, 2022 or 2021.

The Bank also has a line of credit with the Federal Reserve Bank's Borrower-In-Custody Program (the Program). The Program offers overnight collateralized advances secured by certain loan assets. At December 31, 2022 and 2021, the amounts of available borrowing were $36,034,000 and $37,300,000, respectively. There were no funds outstanding on the Program as of December 31, 2022 and 2021.

9. Capital Trust Securities

On October 14, 2003, the Company sponsored the creation of Katahdin Capital Trust II (the Trust II), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust II. On October 16, 2003, the Trust II issued $3,000,000 of London Interbank Offered Rate (LIBOR) floating rate plus 3.05% margin Capital Securities (the Capital Securities II, and with the common securities, the Trust Securities II), the proceeds from which were used by the Trust II, along with the Company's $93,000 capital contribution for the Common Securities II, to acquire $3,093,000 aggregate principal amount of the Company's LIBOR floating rate plus 3.05% Junior Subordinated Deferrable Interest Debentures due October 7, 2033 (the Debentures), which constitute the sole assets of the Trust II. The Company has, through the Declaration of Trust which established the Trust II, the Common Securities II and Capital Securities II Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust II's obligations under the Trust Securities II.

On December 20, 2005, the Company sponsored the creation of Katahdin Capital Trust III (the Trust III), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust III. On December 22, 2005, the Trust III issued $4,000,000 of LIBOR floating rate plus 1.50% margin Capital Securities (the Capital Securities III, and with the common securities, the Trust Securities III), the proceeds from which were used by the Trust III, along with the Company's $124,000 capital contribution for the Common Securities III, to acquire $4,124,000 aggregate principal amount of the Company's LIBOR floating rate plus 1.50% Junior Subordinated Deferrable Interest Debentures due January 7, 2036 (the Debentures), which constitute the sole assets of the Trust III. The Company has, through the Declaration of Trust which established the Trust III, the Common Securities III and Capital Securities III Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust III's obligations under the Trust Securities III.

10. Income Taxes

Allocation of federal and state income taxes between current and deferred portions is as follows:

	2022	2021
Current tax provision		
Federal	$ 1,606,000	$ 1,916,000
State	184,000	180,000
	1,790,000	2,096,000
Deferred federal tax benefit	297,000	(28,000)
	$ 2,087,000	$ 2,068,000

The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	2022	2021
Computed tax expense	$ 2,480,000	$ 2,424,000
Increase (reduction) in income taxes resulting from:		
Tax exempt interest	(153,000)	(102,000)
State taxes, net of federal benefit	146,000	142,000
Income from life insurance	(82,000)	(82,000)
Preferred stock dividends	(2,000)	(2,000)
Tax credits	(372,000)	(363,000)
Fair value adjustment of unearned ESOP shares	15,000	22,000
Other	55,000	29,000
	$ 2,087,000	$ 2,068,000

Items which give rise to deferred income tax assets and liabilities are as follows:

	2022	2021
Deferred tax assets		
Other-than-temporary impairment of investment securities	$ 52,000	$ 52,000
Allowance for loan losses	1,560,000	1,639,000
Employee benefit plans	790,000	728,000
Net unrealized loss on other investments	26,000	–
Net unrealized loss on securities available-for-sale	3,997,000	–
Restricted stock awards	54,000	25,000
Other	7,000	9,000
	6,486,000	2,453,000
Deferred tax liabilities		
Depreciation	747,000	422,000
Amortization of goodwill	1,167,000	1,165,000
Prepaid expenses	154,000	149,000
Mortgage servicing rights	24,000	34,000
Net unrealized gain on derivative instruments	1,301,000	194,000
Investment in pass-through entities	90,000	79,000
Net unrealized gain on securities available-for-sale	-	9,000
Other	29,000	30,000
	3,512,000	2,082,000
Net deferred tax asset	$ 2,974,000	$ 371,000

No valuation allowance is deemed necessary for the deferred income tax asset. The net deferred income tax asset is included in other assets on the consolidated balance sheets.

The Company invests in qualified affordable housing projects. At December 31, 2022 and 2021, the balance of the investment for qualified affordable housing projects was $880,000 and $440,000, respectively, and is included in other assets on the consolidated balance sheets. The Company amortizes these investments using the proportional amortization method and recognized amortization expense of $60,000 and $49,000 in 2022 and 2021, respectively, which was included within income tax expense on the consolidated statements of income. Additionally, during the years ended December 31, 2022 and 2021, the Company recognized tax credits from its investments in affordable housing tax projects of $66,000 and $53,000, respectively. As of December 31, 2022, the Company was committed to making additional contributions of $339,000. These commitments are recorded in accrued expenses and other liabilities on the consolidated balance sheets. The Company was not committed to making any additional contributions as of December 31, 2021.

The Company also invests in limited partnerships that generate historic tax credits. At December 31, 2022 and 2021, the balance of the investment in these limited partnerships was $491,000 and $753,000, respectively, and is included in other assets on the consolidated balance sheets. The Company amortizes these investments on an effective yield basis resulting in amortization expense of $236,000 in 2022 and 2021, which was included as amortization of investments in limited partnerships on the consolidated statements of income. Additionally, during the years ended December 31, 2022 and 2021, the Company recognized tax credits from its investment in these limited partnerships of $306,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022 and 2021

11. Earnings Per Share

The following sets forth the computation of basic and diluted earnings per common share for 2022 and 2021:

	2022	2021
Net income available to common shareholders, as reported	$ 9,724,000	$ 9,473,000
Weighted-average common shares outstanding	3,276,837	3,290,788
Effect of possible sources of options or conversions	–	–
Diluted weighted-average common shares outstanding	3,276,837	3,290,788
Basic earnings per common share	$ 2.97	$ 2.88
Diluted earnings per common share	$ 2.97	$ 2.88

12. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and commercial letters-of-credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk more than the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. The contractual or notional amounts of financial instruments reflect the extent of involvement the Company has in particular classes of financial instruments. See Note 24 for further discussion of derivative financial instruments.

At December 31, 2022 and 2021, the contractual amounts of the Company's financial instruments were as follows:

	Contract Amount	
	2022	2021
Lending-related instruments:		
Home equity lines-of-credit	$ 34,193,000	$ 30,931,000
Other lines-of-credit	91,379,000	89,975,000
Credit card arrangements	3,928,000	2,882,000
Letters-of-credit	3,504,000	3,384,000
Derivative financial instruments:		
Notional amounts of interest rate swaps	218,660,000	235,281,000

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. The commitments for lines-of-credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements.

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are uncollateralized, usually do not contain a specified maturity date, and may not be drawn upon to the total extent to which the Company is committed.

Commercial letters-of-credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. Substantially all letters-of-credit issued have expiration dates within one year. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

13. Significant Group Concentrations of Credit Risk

A large portion of the Company's loan portfolio consists of single-family residential loans and commercial real estate loans in Maine. The local economy depends heavily on Maine industries including the agricultural and forest industries, which are subject to annual variations. Accordingly, the collectability of a substantial portion of the Company's loan portfolio is dependent on the health of Maine's economy.

The Company's policy for requiring collateral is to obtain security in excess of the amount borrowed. The amount of collateral obtained is based on management's credit evaluation of the borrower. The Company requires appraisals of real property held as collateral. For consumer loans, the Company will accept security which has a title certificate. Collateral held for commercial loans may include accounts receivable, inventory, property and equipment, and income-producing properties. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The contractual amount of credit-related financial instruments such as commitments to extend credit and letters-of-credit represents the amount of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

14. Legal Contingencies

Various legal claims arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company's consolidated financial statements.

15. Minimum Regulatory Capital Requirements

The Bank is 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, 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.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and common equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined).

Regulatory capital requirements limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% above its minimum risk-based capital requirements. As of December 31, 2022, the Bank had a capital conservation buffer of 7.5% of risk-weighted assets, which was in excess of the regulatory requirement of 2.5%. As of

December 31, 2022 and 2021

15. Minimum Regulatory Capital Requirements (cont.)

December 31, 2021, the Bank had a capital conservation buffer of 7.7% of risk-weighted assets, which was in excess of the regulatory requirement of 2.5%. Management believes, as of December 31, 2022 and 2021, that the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2022, the Bank is well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios as set forth in the following tables. The Bank's actual capital amounts and ratios as of December 31, 2022 and 2021 are also presented in the table.

As of December 31, 2022	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets Bank	$111,736,000	15.5%	$ 57,853,000	8.0%	$ 72,317,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	104,275,000	14.4	43,390,000	6.0	57,853,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	104,275,000	14.4	32,543,000	4.5	47,006,000	6.5
Tier 1 Capital to Average Assets Bank	104,275,000	11.0	37,941,000	4.0	47,427,000	5.0
As of December 31, 2021						
Total Capital to Risk-Weighted Assets Bank	$104,157,000	15.7%	$ 53,153,000	8.0%	$ 66,441,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	96,321,000	14.5	39,865,000	6.0	53,153,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	96,321,000	14.5	29,898,000	4.5	43,187,000	6.5
Tier 1 Capital to Average Assets Bank	96,321,000	10.1	37,978,000	4.0	47,473,000	5.0

The actual and minimum capital amounts and ratios for the Company do not materially differ from those presented for the Bank in the table above.

Dividends paid by the Bank are the primary source of funds available to the Company for payment of dividends to its shareholders. The Bank is subject to certain requirements imposed by federal banking laws and regulations, which among other things, establish minimum levels of capital and restrict the amount of dividends that may be distributed by the Bank to the Company.

16. Employee Benefit Plans

The Company has a safe harbor 401(k) plan whereby substantially all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes safe harbor matching contributions equal to 100% of the first 3% of an employee's compensation plus 50% of the next 2% of an employee's compensation. The Company may also contribute discretionary profit sharing and additional matching contributions. For the years ended December 31, 2022 and 2021, expense attributable to the plan amounted to $422,000 and $393,000, respectively.

The Company has established a nonqualified supplemental executive retirement plan for the benefit of key employees. The amount of each benefit is guaranteed contingent upon employee vesting schedules. As of December 31, 2022, and 2021, the accrued liability of the plan was $3,763,000 and $3,468,000, respectively, and is recorded in accrued expenses and other liabilities. The present value of these benefits is expensed over the employment service period. The benefit expense amounted to $403,000 and $395,000 for 2022 and 2021, respectively. Life insurance policies were acquired for the purpose of serving as the primary funding source. The cash value of these policies was $14,911,000 and $14,517,000 at December 31, 2022 and 2021, respectively, and is included in other assets.

17. Restricted Stock Plan

The Company established a restricted stock plan during 2010 with 100,000 shares currently authorized by the Board of Directors for the compensation committee of the Board to administer. The holders of restricted stock, regardless of vesting status, shall have all the rights of a shareholder, including, but not limited to, the right to vote such shares and the right to receive all cash dividends and other distributions paid thereon. On January 1, 2022 and 2021, the compensation committee granted 8,507 and 10,677 shares with a fair value on the grant date of $25.55 and $18.49, respectively. A total of 39,930 shares have been issued under the restricted stock plan since inception, 11,897 of which are vested.

The unvested restricted stock shares will cliff-vest as follows:

2023	3,165
2024	–
2025	7,806
2026	9,471
2027	7,591
Total	28,033

18. Other Noninterest Income and Expenses

The components of other noninterest income and expenses which are in excess of 1% of total revenues (total interest and dividend income and noninterest income) and not shown separately on the consolidated statements of income are as follows for the years ended December 31:

	2022	2021
Other noninterest income		
Interchange income	$ 1,568,000	$ 1,527,000
Investment brokerage fees	819,000	731,000
Other general and administrative noninterest expenses		
Legal, audit, examination and consulting	676,000	564,000
Account servicing	731,000	631,000

19. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates amounting to $20,394,000 and $20,427,000 at December 31, 2022 and 2021, respectively. Deposits from related parties held by the Company at December 31, 2022 and 2021 amounted to $10,570,000 and $9,306,000, respectively.

20. Employee Stock Ownership Plan

Any employee who is not 1) an independent contractor; 2) a leased employee; 3) an employee covered by a collective bargaining agreement; or 4) a nonresident alien who receives no U.S. income is eligible to participate in the ESOP. An employee is eligible on his or her first day of employment, with enrollment dates on a quarterly basis. The Bank's ESOP borrowed from the Company to purchase 84,800 shares of Katahdin Bankshares Corp. common stock at net share prices varying from $11.25 to $16.38.

20. Employee Stock Ownership Plan (cont.)

The loans are secured by the shares purchased by the ESOP. Participants' benefits become fully vested after five years of service. The Bank's contributions are the primary source of funds for the ESOP's repayment of the loans. Shares are released and allocated to participants' accounts as the ESOP repays the loans. Contributions for the years ended December 31, 2022 and 2021 totaled $173,000. ESOP expense was $236,000 and $267,000 for the years ended December 31, 2022 and 2021, respectively. Dividends paid by the Bank on allocated and unallocated shares are allocated to participant accounts.

Shares held by the ESOP include the following at December 31:

	2022	2021
Allocated	61,597	51,955
Unallocated	23,203	32,845
	84,800	84,800

The fair value of the unallocated shares as of December 31, 2022 and 2021 was approximately $512,000 and $839,000, respectively.

21. Fair Value

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

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

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon model-based techniques incorporating various assumptions including interest rates, prepayment speeds, and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities available-for-sale: Fair values for securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The fair values of securities available-for-sale are classified as Level 2.

Other investments: Other investments consist of preferred stock. Other investments are reported at fair value utilizing the closing price reported in the active market in which the individual securities are traded.

Derivatives: The fair value of the Company's and Bank's interest rate swaps is determined using inputs that are observable in the market place obtained from third parties including yield curves, publicly available volatilities, and floating indexes and, accordingly, are classified as Level 2 inputs. The valuation of interest rate swap agreements executed with commercial banking customers is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at December 31, 2022 and 2021, Using		
December 31, 2022	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
U.S. Treasury	$ 1,808,000	$ –	$ 1,808,000	$ –
State and municipal	16,690,000	–	16,690,000	$ –
Corporate bonds	1,880,000	–	1,880,000	–
Mortgage-backed and CMO's	126,431,000	–	126,431,000	–
Total securities available-for-sale	146,809,000	–	146,809,000	–
Other investments	378,000	378,000	–	–
Derivative instruments	16,216,000	–	16,216,000	–
Total assets	$163,403,000	$ 378,000	$163,025,000	$ –
Liabilities				
Derivative instruments	$ 10,019,000	$ –	$ 10,019,000	$ –
December 31, 2021				
Assets				
Securities available-for-sale				
State and municipal	$ 9,776,000	$ –	$ 9,776,000	$ –
Corporate bonds	1,115,000	–	1,115,000	–
Mortgage-backed and CMO's	99,633,000	–	99,633,000	–
Total securities available-for-sale	110,524,000	–	110,524,000	–
Other investments	507,000	507,000	–	–
Derivative instruments	5,736,000	–	5,736,000	–
Total assets	$116,767,000	$ 507,000	$116,260,000	$ –
Liabilities				
Derivative instruments	$ 4,812,000	$ –	$ 4,812,000	$ –

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022 and 2021

21. Fair Value (cont.)

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

Impaired loans: A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. The fair value of collateral-dependent impaired loans is primarily based upon the fair value of the underlying collateral as determined by appraisals of the collateral by third-party appraisers and brokers' opinions by third-party brokers. The appraisals and opinions are based upon comparable prices for similar assets in active markets for residential real estate loans, and less active markets for commercial loans. The fair values of collateral-dependent impaired loans are classified as Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

	Fair Value Measurements at December 31, 2022 and 2021, Using			
December 31, 2022	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans (market approach)	$ 36,000	$ –	$ 36,000	$ –
December 31, 2021				
Assets				
Impaired loans (market approach)	$ 58,000	$ –	$ 58,000	$ –

Certain impaired loans were written down to their value of $36,000 and $58,000 at December 31, 2022 and 2021, respectively, resulting in an impairment charge through the allowance for loan losses.

Fair Value of Financial Instruments

GAAP requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

This summary excludes financial assets and liabilities for which carrying value approximates fair values and financial instruments that are recorded at fair value on a recurring basis. Financial instruments for which carrying values approximate fair value include cash equivalents (Level 1), interest bearing deposits in banks (Level 2), FHLB stock (Level 2), accrued interest (Level 2), junior subordinated debentures (Level 2), and demand, savings, NOW and money market deposits (Level 1). The estimated fair value of demand, savings, NOW and money market deposits is the amount payable on demand at the reporting date. Carrying value is used because the accounts have no stated maturity and the customer has the ability to withdraw funds immediately.

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

Securities held-to-maturity: Fair values for securities held-to-maturity are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of collateral-dependent impaired loans is primarily based upon the fair value of the underlying collateral as determined by appraisals of the collateral by third-party appraisers and brokers' opinions by third-party brokers. The appraisals and opinions are based upon comparable prices for similar assets in active markets for residential real estate loans, and less active markets for commercial loans.

Certificates of deposit: Fair values for maturity deposits are based on a replacement cost of funds approach, discounted to an 11 district FHLB average advances yield curve for the as of date in conjunction with the other cash flows associated with each account.

Advances from FHLB: The fair values of these borrowings are based on a replacement cost of funds approach. The borrowings are discounted to an 11 district FHLB average advances yield curve for the as of date.

Senior Notes: The fair value of the senior notes is estimated by indicative bid prices generally based upon market pricing observations in the current market.

The estimated fair values, and related carrying amounts, of these financial instruments are as follows:

	Fair Value Measurement at December 31, 2022				
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 2,000	$ 2,000	$ –	$ 2,000	$ –
Loans receivable, net:					
Commercial	146,190,000	144,763,000	–	29,000	144,734,000
Commercial real estate	429,866,000	421,312,000	–	7,000	421,305,000
Residential real estate	160,596,000	142,651,000	–	–	142,651,000
Consumer	5,442,000	5,328,000	–	–	5,328,000
Loan receivable, net	742,094,000	714,054,000	–	36,000	714,018,000
Financial liabilities					
Certificates of deposit	119,587,000	115,306,000	–	115,306,000	–
Advances from FHLB	1,519,000	1,491,000	–	1,491,000	–
Senior Notes	14,243,000	13,558,000	–	13,558,000	–

December 31, 2022 and 2021

21. Fair Value (cont.)

	Carrying Amount	Fair Value	Fair Value Measurement at December 31, 2021: Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 3,000	$ 3,000	$ –	$ 3,000	$ –
Loans receivable, net:					
Commercial	149,524,000	151,127,000	–	–	151,127,000
Commercial real estate	410,082,000	411,476,000	–	58,000	411,418,000
Residential real estate	157,239,000	156,108,000	–	–	156,108,000
Consumer	5,655,000	5,617,000	–	–	5,617,000
Loan receivable, net	722,500,000	724,328,000	–	58,000	724,270,000
Financial liabilities					
Certificates of deposit	110,203,000	110,291,000	–	110,291,000	–
Advances from FHLB	1,530,000	1,560,000	–	1,560,000	–
Senior Notes	14,168,000	15,298,000	–	15,298,000	–

22. Senior Notes

On June 13, 2019, the Company entered into a Senior Note Purchase Agreement (the Agreement) by and among the Company and several purchasers of Senior Notes (collectively, the Purchasers), pursuant to which the Company agreed to sell to the Purchasers, severally and not jointly, $14,500,000 in aggregate principal Senior Notes. Debt issuance costs of $521,000 were incurred in conjunction with the issuance of the Senior Notes which are being amortized over 84 months. Amortization expense was $74,000 for the years ended December 31, 2022 and 2021.

The Senior Notes bear interest at 5.375% per annum and will mature on June 15, 2026, unless earlier made payable in accordance with the terms of the Agreement. Interest on the Senior Notes is payable semi-annually in arrears on each annual and semi-annual anniversary of the date of the Senior Notes. The Company used the proceeds to redeem preferred stock and for general corporate purposes. The obligations under the Agreement are unsecured.

23. Preferred Stock

The Company has authorized the issuance of up to 20,000 shares of preferred stock at any one time. As of December 31, 2022 and 2021, there were no issued and outstanding shares of preferred stock.

24. Derivative Financial Instruments

The Company utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

The derivative instruments contain provisions that require the Company to post collateral with the counterparty for its contracts that are in a net loss position based on their fair value and the Company's credit rating. At December 31, 2022 and 2021, the Company had posted $4,979,000 and $6,611,000, respectively, in cash and securities collateral for the benefit of the counterparty.

Cash Flow Hedges: Interest rate swaps with notional amounts totaling $47,000,000 as of December 31, 2022 and 2021, were designated as cash flow hedges of variable rate deposits and borrowings and were determined to be effective during all periods presented. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swaps is recorded in other assets with changes in fair value recorded in other comprehensive income. The Company expects the hedges to remain fully effective during the remaining terms of the swaps. Interest income (expense) recorded on these swap transactions totaled $263,000 and ($363,000) during 2022 and 2021, respectively, and is reported as a component of interest expense on deposits and borrowings.

Derivatives Not Designated As Hedges: The Bank also enters into interest rate swaps with its loan customers. The notional amounts of interest rate swaps with its loan customers as of December 31, 2022 and 2021 were $85,830,000 and $94,140,000, respectively. The Bank enters into corresponding offsetting derivatives with third parties. While these derivatives represent economic hedges, they do not qualify as hedges for accounting purposes. Because the derivatives have mirror-image contractual terms, their changes in fair value offset one another in the consolidated statements of income.

The Company presents derivative positions gross on the balance sheet. The following table reflects the derivatives recorded on the consolidated balance sheets as of December 31:

	2022 Notional Amount	2022 Fair Value	2021 Notional Amount	2021 Fair Value
Included in other assets:				
Derivatives designated as hedges:				
Interest rate swaps related to variable rate deposits and borrowings	$ 47,000,000	$ 6,197,000	$ 22,000,000	$ 1,239,000
Derivatives not designated as hedges instruments:				
Interest rate swaps related to customer loans	85,830,000	10,019,000	94,140,000	4,497,000
Total included in other assets		$ 16,216,000		$ 5,736,000
Included in other liabilities:				
Derivatives designated as hedges:				
Interest rate swaps related to variable rate deposits and borrowings	$ –	$ –	$ 25,000,000	$ 315,000
Derivatives not designated as hedges instruments:				
Interest rate swaps related to customer loans	85,830,000	10,019,000	94,140,000	4,497,000
Total included in other liabilities		$ 10,019,000		$ 4,812,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2022 and 2021

24. Derivative Financial Instruments (cont.)

The effect of cash flow hedge accounting on accumulated other comprehensive income for the years ended December 31, net of tax, are as follows:

2022	Amount of Gain Recognized in OCI on Derivative	Location of Gain (Loss) Reclassified from OCI into Income	Amount of Gain (Loss) Reclassified from OCI into Income
Interest rate contracts	$ 4,165,000	N/A	$ –
2021			
Interest rate contracts	$ 1,773,000	N/A	$ –

At December 31, 2022, the Company does not expect any of the unrealized gain to be reclassified as a reduction of interest expense during 2023.

On September 9, 2021, the Company amended the variable index received on one of its interest rate swap arrangements from 1-month LIBOR to the federal funds rate. As a result of the amendment, the counterparty paid $59,000 to the Company for the anticipated difference in the variable indexes. This payment was recorded as a reduction of deposits interest expense on the consolidated statements of income.

In September 2021, the Company early terminated two interest rate swap agreements with notional amounts of $12,500,000 each. Early termination payments of $185,000 were made to the counterparty. Given these interest rate swap agreements were designated as cash flow hedges of variable rate deposits, the early termination payments were recorded as deposits interest expense on the consolidated statements of income.

25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about the conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. Management has evaluated subsequent events occurring through February 6, 2023, the date the financial statements were available to be issued.

SHAREHOLDER INFORMATION

ANNUAL MEETING

We invite shareholders to join us on Monday, May 1, 2023, at the Houlton Higher Education Center on Military Street in Houlton, Maine.

SHAREHOLDER RELATIONS

Katahdin Bankshares Corp. and Katahdin Trust Company welcome shareholder and public interest in our services and activities. Questions or comments pertaining to this report and requests for other information should be directed to:

Matthew M. Nightingale
Executive Vice President, Treasurer & CFO
PO Box 36 | Houlton, ME 04730
(207) 521-3200
m.nightingale@katahdintrust.com

STOCK

Katahdin Bankshares Corp. stock is quoted on the OTC Markets quote board OTCQX under the symbol KTHN. Current stock information can be found at otcmarkets.com/stock/KTHN/quote.

TRANSFER AGENT

For shareholder inquiries regarding change of address or title, please contact:

Computershare Trust Company, N.A .
PO Box 30170 | College Station, TX 77842-3170
1-800-368-5948 (U.S. or Canada)
1-781-575-4223 (outside the U.S. or Canada)
computershare.com/investor

DIRECT STOCK PURCHASE AND DIVIDEND REINVESTMENT PLAN

Katahdin's transfer agent, Computershare Trust Company, N.A. ("Computershare"), sponsors and administers the Computershare Investment Plan (CIP) for Katahdin Bankshares Corp. Common Stock. This plan offers direct stock purchase and dividend reinvestment options and is available to current Katahdin Bankshares Corp. shareholders as well as new investors. For more information, you may contact Computershare.

BRANCH LOCATIONS

NORTHERN MAINE

Ashland
17 Main Street
435-6461

Caribou
105 Bennett Drive
498-4200

Eagle Lake
3440 Aroostook Road
444-5543

Fort Fairfield
290 Main Street
472-3161

Fort Kent
79 West Main Street
834-2348

Houlton
65 North Street
532-4277

Island Falls
1007 Crystal Road
463-2228

Mars Hill
28 Main Street
429-8400

Oakfield
200 Oakfield Smyrna Rd
757-8288

Patten
11 Main Street
528-2211

Presque Isle
6 North Street
764-8000

Van Buren
29 Main Street, Ste.105
868-2728

GREATER BANGOR

Bangor
609 Broadway
942-3146

Bangor
52 Springer Drive
947-9674

Hampden
57 Western Avenue
862-2211

GREATER PORTLAND

Scarborough
136 US Route One
510-7017

Maine Financial Group
144 US Route One
Scarborough
1-800-974-9995