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

FORM 10-K

☒ **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2022

OR

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

For the transition period from _____________to_____________________

COMMISSION FILE NUMBER 001-38229

FIDELITY D & D BANCORP, INC.

COMMONWEALTH OF PENNSYLVANIA I.R.S. EMPLOYER IDENTIFICATION NO: **23-3017653**

BLAKELY AND DRINKER STREETS
DUNMORE, PENNSYLVANIA 18512
TELEPHONE NUMBER (570) 342-8281

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE ACT:

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

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE ACT: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

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

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

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

Indicate by check mark whether the registrant has filed a report on the attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☐

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant’s executive officers during the relevant recovery period pursuant to § 240.10D-1(b). ☐

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant was $193.9 million as of June 30, 2022, based on the closing price of $40.70. The number of shares of common stock outstanding as of February 28, 2023 was 5,653,684.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s definitive Proxy Statement to be used in connection with the 2023 Annual Meeting of Shareholders are incorporated herein by reference in partial response to Part III.

Fidelity D & D Bancorp, Inc.
2022 Annual Report on Form 10-K
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PART I

Forward-Looking Statements

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

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

- local, regional and national economic conditions and changes thereto;
- the short-term and long-term effects of inflation, and rising costs to the Company, its customers and on the economy;
- securities markets and monetary fluctuations and volatility;
- impacts of the capital and liquidity requirements of the Basel III standards and other regulatory pronouncements, regulations and rules;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- effects of short- and long-term federal budget and tax negotiations and their effect on economic and business conditions;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- the impact of new or changes in existing laws and regulations, including laws and regulations concerning taxes, banking, securities and insurance and their application with which the Company and its subsidiaries must comply;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- the risks of changes and volatility of interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- the effects of economic conditions particularly with regard to the negative impact of lingering disruptions caused by the spread of Coronavirus Disease 2019 (COVID-19) and any other pandemic, epidemic or other health-related crisis and responses thereto on current customers and the operations of the Company, specifically the effect of the economy on loan customers’ ability to repay loans;
- technological changes;
- the interruption or breach in security of our information systems, continually evolving cybersecurity and other technological risks and attacks resulting in failures or disruptions in customer account management, general ledger processing and loan or deposit updates and potential impacts resulting therefrom including additional costs, reputational damage, regulatory penalties, and financial losses;
- acquisitions and integration of acquired businesses;
- the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities;
- acts of war or terrorism;
- disruption of credit and equity markets; and
- the risk that our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful.

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

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

ITEM 1: BUSINESS

Fidelity D & D Bancorp, Inc. (the Company) was incorporated in the Commonwealth of Pennsylvania, on August 10, 1999, and is a bank holding company, whose wholly-owned state chartered commercial bank subsidiary is The Fidelity Deposit and Discount Bank (the Bank) (collectively, the Company). The Company is headquartered at Blakely and Drinker Streets in Dunmore, Pennsylvania.

Federal and state banking laws contain numerous provisions that affect various aspects of the business and operations of the Company and the Bank. The Company is subject to, among others, the regulations of the Securities and Exchange Commission (the SEC) and the Federal Reserve Board (the FRB) and the Bank is subject to, among others, the regulations of the Pennsylvania Department of Banking and Securities, the Federal Deposit Insurance Corporation (the FDIC) and the rules promulgated by the Consumer Financial Protection Bureau (the CFPB) but continues to be examined and supervised by federal banking regulators for consumer compliance purposes. Refer to Part II, Item 7 "Supervision and Regulation" for descriptions of and references to applicable statutes and regulations which are not intended to be complete descriptions of these provisions or their effects on the Company or the Bank. They are summaries only and are qualified in their entirety by reference to such statutes and regulations. Applicable regulations relate to, among other things:

- operations
- securities
- risk management
- consumer compliance
- consolidation
- reserves
- dividends
- branches
- disclosure
- community reinvestment
- mergers
- capital adequacy

The Bank is examined periodically by the Pennsylvania Department of Banking and Securities and the FDIC.

The Bank has offered a full range of traditional banking services since it commenced operations in 1903. The Bank has a personal and corporate trust department and also provides alternative financial and insurance products with asset management services. A full list of services provided by the Bank is detailed in the section entitled "Products and Services" contained within the 2022 Annual Report to Shareholders, incorporated by reference. The service area is comprised of the Borough of Dunmore and the surrounding communities within Lackawanna and Luzerne counties in Northeastern Pennsylvania and Northampton County in Eastern Pennsylvania. In 2022, the Company had 14.48% of Lackawanna County's total deposit market share ranking 2nd in total deposits, 6.70% of Luzerne County's total deposit market share ranking 6th in total deposits and 6.34% of Northampton County's total deposit market share ranking 7th in total deposits.

On July 1, 2021, the Company completed its acquisition of Landmark Bancorp, Inc. ("Landmark") of Pittston, Pennsylvania. Landmark was the holding company of Landmark Community Bank ("Landmark Bank") which operated 5 retail community banking offices in Northeastern Pennsylvania.

On May 1, 2020, the Company completed its acquisition of MNB Corporation ("MNB") of Bangor, Pennsylvania. MNB was the holding company Merchants Bank of Bangor ("Merchants Bank") which operated nine bank centers located in Northampton County, Pennsylvania.

The banking business is highly competitive, and the success and profitability of the Company depends principally on its ability to compete in its market area. Competition includes, among other sources: local community banks; savings banks; regional banks; national banks; credit unions; savings & loans; insurance companies; money market funds; mutual funds; small loan companies and other financial services companies. The Company has been able to compete effectively with other financial institutions by emphasizing customer service enhanced by local decision making. These efforts enable the Company to establish long-term customer relationships and build customer loyalty by providing products and services designed to address their specific needs.

The banking industry is affected by general economic conditions including the effects of inflation, recession, unemployment, real estate values, trends in national and global economies and other factors beyond the Company's control. The Company's success is dependent, to a significant degree, on economic conditions in Northeastern Pennsylvania, especially within Lackawanna and Luzerne counties and Eastern Pennsylvania, especially Northampton County which the Company defines as its primary market areas. An economic recession or a delayed economic recovery over a prolonged period of time in the Company's market could cause an increase in the level of the Company's non-performing assets and loan losses, and thereby cause operating losses, impairment of liquidity and erosion of capital. There are no concentrations of loans or customers that, if lost, would have a material adverse effect on the continued business of the Company. There is no material concentration within a single industry or a group of related industries that is vulnerable to the risk of a near-term severe impact.

The Company's profitability is significantly affected by general economic and competitive conditions, changes in market interest rates, government policies and actions of regulatory authorities. The Company's loan portfolio is comprised principally of residential real estate, consumer, commercial and commercial real estate loans. The properties underlying the Company's mortgages are concentrated in Northeastern and Eastern Pennsylvania. Credit risk, which represents the possibility of the Company not recovering amounts due from its borrowers, is significantly related to local economic conditions in the areas where the properties are located as well as the Company's underwriting standards. Economic conditions affect the market value of the underlying collateral as well as the levels of adequate cash flow and revenue generation from income-producing commercial properties.

During 2022, the national unemployment rate fell to 3.5% compared to 3.9% at the end of 2021. The unemployment rates in the Company's local statistical markets, Scranton-Wilkes-Barre-Hazleton and Allentown-Bethlehem-Easton, dropped to 4.3% and 3.3%, respectively, from 4.8% and 4.0%, respectively, at the end of 2021. The local economy has been volatile in recent years and generally lags the national market trends. The Company's credit function strives to mitigate the negative impact of economic conditions by maintaining disciplined underwriting principles for commercial and consumer lending and ensuring that home mortgage underwriting adheres to the standards of secondary market makers. As it has in the past, the Company continued to pursue property foreclosure, wherever possible, to lessen the negative impact of foreclosed property ownership. Refer to Item 1A, "Risk Factors" for material risks and uncertainties that management believes affect the Company.

The Company's website address is http://www.bankatfidelity.com. The Company makes available free of charge on or through this website the annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports as soon as reasonably practical after filing with the SEC. This reference to the Company's website shall not, under any circumstances, be deemed to incorporate the information available at such Internet address into this Form 10-K or other SEC filings. The information available at the Company's website is not part of this Form 10-K or any other report filed by the Company with the SEC. The SEC also maintains an internet site that contains reports, proxy and information statements and other information about the Company at http://www.sec.gov.

The Company's accounting policies and procedures are designed to comply with accounting principles generally accepted in the United States of America (GAAP). Refer to "Critical Accounting Policies," which are incorporated by reference in Part II, Item 7.

Human Capital

Mission and Core Values

Mission: We are Fidelity Bank. We are passionate about success and committed to building strong relationships through exceptional experiences. We will be the best bank for our bankers to work, our clients to bank, our shareholders to invest and for our community to prosper. Our bankers are our first stakeholder by design as their actions, knowledge and focus on the client experience drive our success. We continuously invest in our bankers by offering competitive total compensation, a strong benefit package for themselves and their families, opportunity to invest in the Company through stock ownership, continuous learning, career development and programs to engage and enhance the work experience.

Fidelity Bankers have a voice in the Company and are called upon to provide opinions and ideas through dialogue programs with the CEO, Service Quality Surveys and the annual Climate Survey. Collectively, they have assisted in the development of the Core Values:

- Relationships
- Integrity
- Commitment
- Passion
- Innovation
- Success

Culturally, the Fidelity Model Experience provides a strategic vision to build a performance-based corporation. It guides all bankers on solidifying internal and external relationships and becoming the Trusted Financial Advisor for clients.

Demographics

As of December 31, 2022, the Company employed 320 bankers within its network located in Northeast and Lehigh Valley, Pennsylvania. The Company employed 29 part-time bankers and 291 full-time bankers. Employment levels are aligned with the needs of the business.

Health and Wellness

The Company provides a strong health benefit package to bankers, to include medical, dental and vision insurances, life insurance, long- and short-term disability coverage and flexible spending accounts. Packages include options to cover family members according to established guidelines, creating a focus on caring for both the personal and professional needs of the banker. Telemedicine options, enhanced and delivered through the COVID-19 pandemic create an optional, ease of use method for health provider access. The telemedicine program continues to provide quality care for ongoing COVID-19 cases as well as for routine ailments and illnesses.

Each year, the benefit suite is reviewed, repriced and evaluated for strength and value. Care is taken to provide a cost contained package while requiring bankers to share in the cost of healthcare. Additional programs are vetted and added where meaningful. Bankers may enroll and view benefit information through a Company Benefits Portal, providing access to insurance policies, forms, pricing, and general benefit information. Additionally, access is available directly through the medical plan insurer, giving all participants an avenue to gain pertinent information including medical care records, health and wellness articles on prevention, specific illnesses and diseases, physicians and facilities and cost of care comparisons.

The Company provides assistance to bankers in the form of an Employee Assistance Program through a confidential provider. During the difficulties experienced throughout the pandemic, bankers made use of the program for personal and professional struggles and continue to have ongoing access to round-the-clock support at no charge, including confidential counseling, work-life solutions, legal support and financial guidance.

In addition to benefit packages, the Company offers paid time off for vacation, sick and personal time, as it is an important part of balancing a fulfilling work and personal life.

Diversity and Inclusion

The Company is committed to promoting a diverse and inclusive workforce and values the strength it brings to the organization. Hiring practices include outreach to organizations representing groups of color and ethnicity, veteran status, disabled persons and women. Recruitment sources are varied to reach a broad audience. These practices have resulted in a continuously increased diverse representation and an enhanced ability to provide for the diverse needs of the communities we serve. The Affirmative Action Plan monitors the Company's success in creating equal employment opportunities for bankers and applicants and guides staff in hiring practices.

Training and Development

The investment into the continuous improvement of all bankers is evident in the bank's commitment of training dollars and resources. Key Performance Indicators (KPIs), tracked quarterly, outline training goals bank-wide and training dollars spent. The Company has a devoted training team and all bankers are offered and encouraged to participate in continuous training initiatives. Innovative programs, including Fidelity Bank University, leadership training, the education assistance program, enrichment programs through conferences, seminars and workshops and options for certifications are offered to educate bankers at all levels.

The bank monitors other Human Capital KPIs tracking banker activities; KPIs include and are not limited to community service and participation goals, turnover, new hire retention and climate survey scores. Results are monitored against goals.

The Company believes banker engagement is a tenet of its success. The practice of giving each banker a voice, providing fair compensation and opportunity for stock ownership, recognizing exceptional service through a formalized recognition program, providing a quality benefit and retirement package, promoting career development opportunities and delivering strong programs and processes creates a strong and engaged workforce. The programs assist in aligning the interests of the bankers with those of the shareholders and they provide further incentive to bankers to enhance the financial results of the Company.

ITEM 1A: RISK FACTORS

An investment in the Company's common stock is subject to risks inherent to the Company's business. The material risks and uncertainties that management believes affect the Company are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Company's common stock could decline significantly, and you could lose all or part of your investment.

Risks Related to the Company's Business

The short-term and long-term effects of inflation and rising costs may adversely affect the Company's financial performance.

Inflation, both in the short-term and/or in the long-term, may adversely affect the Company's business in that it may increase our overall costs even if it does not adversely affect every aspect of our business evenly. The Company employs various strategies to manage its costs but there is no assurance that these strategies will be successful in containing costs as higher rates of inflation may result in increased costs for goods and services, including employee salaries and benefits, which may adversely affect the Company's results of operation and financial performance. Inflation may also increase the cost of doing business for the Company's borrowers thereby affecting the creditworthiness of current or prospective customers.

The Company's business is subject to interest rate risk and variations in interest rates may negatively affect its financial performance.

Changes in the interest rate environment may reduce profits. The Company's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. As prevailing interest rates change, net interest spreads are affected by the difference between the maturities and re-pricing characteristics of interest-earning assets and interest-bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. An increase in the general level of interest rates may also adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially adversely affect the Company's net interest spread, asset quality, loan origination volume and overall profitability.

The Company is subject to lending risk.

There are inherent risks associated with the Company's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Company operates as well as those across the Commonwealth of Pennsylvania and the United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Company is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Company.

Commercial, commercial real estate and real estate construction loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because these loans generally have larger balances than residential real estate loans and consumer loans, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company's allowance for possible loan losses may be insufficient.

The Company maintains an allowance for possible loan losses, which is a reserve established through a provision for possible loan losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for possible loan losses. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. Further, if charge-offs in future periods exceed the allowance for possible loan losses, the Company will need additional provisions to increase the allowance for possible loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and capital and may have a material adverse effect on the Company's financial condition and results of operations.

The Financial Accounting Standards Board ("FASB") has recently issued an accounting standard update that will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations.

In June 2016, FASB issued an accounting standard update ("ASU") entitled "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, banks will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current generally accepted accounting principles ("GAAP"), which delays recognition until it is probable a loss has been incurred.

The new CECL standard was originally expected to become effective for the Company on January 1, 2020, and for interim periods within that year. In November 2019, FASB agreed to delay implementation of the new CECL standard for certain companies, including those companies that qualify as a smaller reporting company under SEC rules, until January 1, 2023. The Company adopted the new CECL standard as of January 1, 2023. The CECL model may create more volatility in the level of the allowance for loan losses. If the Company is required to materially increase the level of its allowance for credit losses and reserve for unfunded commitments for any reason, such increase could adversely affect its business, financial condition and results of operations. The Company is currently assessing the impact of CECL. This is discussed further in Footnote 18, "Recent Accounting Pronouncements," of Part II, Item 8 "Financial Statements and Supplementary Data", which is incorporated herein by reference.

If we conclude that the decline in value of any of our investment securities is other-than-temporary, we will be required to write down the credit-related portion of the impairment of that security through a charge to earnings.

We review our investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the decline is other-than-temporary. If we conclude that the decline is other-than-temporary, we will be required to write down the credit-related portion of the impairment of that security through a charge to earnings.

The Basel III capital requirements may require us to maintain higher levels of capital, which could reduce our profitability.

Basel III targets higher levels of base capital, certain capital buffers and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are phased in over the next decade and may change substantially before final implementation, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. The direction of the Basel III implementation activities or other regulatory viewpoints could require additional capital to support our business risk profile prior to final implementation of the Basel III standards. If the Company and the Bank are required to maintain higher levels of capital, the Company and the Bank may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to the Company and the Bank and adversely impact our financial condition and results of operations.

The Company may need or be compelled to raise additional capital in the future, but that capital may not be available when it is needed and on terms favorable to current shareholders.

Federal banking regulators require the Company and Bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation and banking regulatory agencies. In addition, capital levels are also determined by the Company's management and board of directors based on capital levels that they believe are necessary to support the Company's business operations. The Company is evaluating its present and future capital requirements and needs, is developing a comprehensive capital plan and is analyzing capital raising alternatives, methods and options. Even if the Company succeeds in meeting the current regulatory capital requirements, the Company may need to raise additional capital in the near future to support possible loan losses during future periods or to meet future regulatory capital requirements.

Further, the Company's regulators may require it to increase its capital levels. If the Company raises capital through the issuance of additional shares of its common stock or other securities, it may dilute the ownership interests of current investors and may dilute the per-share book value and earnings per share of its common stock. Furthermore, it may have an adverse impact on the Company's stock price. New investors may also have rights, preferences and privileges senior to the Company's current shareholders, which may adversely impact its current shareholders. The Company's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. Accordingly, the Company cannot assure you of its ability to raise additional capital on terms and time frames acceptable to it or to raise additional capital at all. If the Company cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect the Company's operations, financial condition and results of operations.

The Company is subject to environmental liability risk associated with lending activities.

A significant portion of the Company's loan portfolio is secured by real property. During the ordinary course of business, the Company may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expense and may materially reduce the affected property's value or limit the Company's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Company's exposure to environmental liability. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on the Company's financial condition and results of operations.

The Company's profitability depends significantly on economic conditions in the Commonwealth of Pennsylvania and the local regions in which it conducts business.

The Company's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in Lackawanna and Luzerne Counties in Northeastern Pennsylvania and Northampton County in Eastern Pennsylvania. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A significant decline in general economic conditions caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic occurrences or instability, unemployment, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Company's financial condition and results of operations.

There is no assurance that the Company will be able to successfully compete with others for business.

The Company competes for loans, deposits and investment dollars with numerous regional and national banks and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers and private lenders. Many competitors have substantially greater resources than the Company does, and operate under less stringent regulatory environments. The differences in resources and regulations may make it more difficult for the Company to compete profitably, reduce the rates that it can earn on loans and on its investments, increase the rates it must offer on deposits and other funds, and adversely affect its overall financial condition and earnings.

The Company is subject to extensive government regulation and supervision.

The Company, primarily through the Bank, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Federal or commonwealth regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

The Company's controls and procedures may fail or be circumvented.

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

New lines of business or new products and services may subject the Company to additional risks.

From time-to-time, the Company may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services the Company may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Company's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Company's business, results of operations and financial condition.

The Company's future acquisitions could dilute your ownership and may cause it to become more susceptible to adverse economic events.

The Company may use its common stock to acquire other companies or make investments in banks and other complementary businesses in the future. The Company may issue additional shares of common stock to pay for future acquisitions, which would dilute your ownership interest in the Company. Future business acquisitions could be material to the Company, and the degree of success achieved in acquiring and integrating these businesses into the Company could have a material effect on the value of the Company's common stock. In addition, any acquisition could require it to use substantial cash or other liquid assets or to incur debt. In those events, it could become more susceptible to economic downturns and competitive pressures.

The Company may not be able to attract and retain skilled people.

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan and other systems. The Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, however there can be no assurance that any such failures, interruptions or security breaches will not occur. The occurrence of any failures, interruptions or security breaches of the Company's information systems could damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

The Company continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

The operations of our business, including our interaction with customers, are increasingly done via electronic means, and this has increased our risks related to cyber security.

We are exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. We have observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, policies and procedures are in place to prevent or limit the effect of the possible security breach of our information systems and we have insurance against some cyber-risks and attacks. While we have not incurred any material losses related to cyber-attacks, nor are we aware of any specific or threatened cyber-incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

The Company is subject to claims and litigation pertaining to fiduciary responsibility.

From time-to-time, customers make claims and take legal action pertaining to the Company's performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Company, they may result in significant financial liability and/or adversely affect the market perception of the Company and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

Pennsylvania Business Corporation Law and various anti-takeover provisions under our articles and bylaws could impede the takeover of the Company.

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire the Company, even if the acquisition would be advantageous to shareholders. In addition, we have various anti-takeover measures in place under our articles of incorporation and bylaws, including a supermajority vote requirement for mergers, a staggered board of directors, and the absence of cumulative voting. Any one or more of these measures may impede the takeover of the Company without the approval of our board of directors and may prevent our shareholders from taking part in a transaction in which they could realize a premium over the current market price of our common stock.

The Company is a holding company and relies on dividends from its banking subsidiary for substantially all of its revenue and its ability to make dividends, distributions, and other payments.

As a bank holding company, the Company's ability to pay dividends depends primarily on its receipt of dividends from its subsidiary bank. Dividend payments from the bank are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by bank regulatory agencies. The ability of the bank to pay dividends is also subject to profitability, financial condition, regulatory capital requirements, capital expenditures and other cash flow requirements. There is no assurance that the bank will be able to pay dividends in the future or that the Company will generate cash flow to pay dividends in the future. The Company's failure to pay dividends on its common stock may have a material adverse effect on the market price of its common stock.

The Company's banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect its earnings.

The Company generally is unable to control the amount of premiums or special assessments that its subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on our results of operations, financial condition, and our ability to continue to pay dividends on our common stock at the current rate or at all.

Severe weather, natural disasters, acts of war or terrorism, global instability, pandemics and other external events could significantly impact the Company's business.

Severe weather, natural disasters, acts of war or terrorism, global instability, pandemics and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism, global instability, pandemics or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

The increasing use of social media platforms presents new risks and challenges and our inability or failure to recognize, respond to and effectively manage the accelerated impact of social media could materially adversely impact our business.

There has been a marked increase in the use of social media platforms, including weblogs (blogs), social media websites, and other forms of Internet-based communications which allow individuals access to a broad audience of consumers and other interested persons. Social media practices in the banking industry are evolving, which creates uncertainty and risk of noncompliance with regulations applicable to our business. Consumers value readily available information concerning businesses and their goods and services and often act on such information without further investigation and without regard to its accuracy. Many social media platforms immediately publish the content their subscribers and participants post, often without filters or checks on accuracy of the content posted. Information posted on such platforms at any time may be adverse to our interests and/or may be inaccurate. The dissemination of information online could harm our business, prospects, financial condition, and results of operations, regardless of the information's accuracy. The harm may be immediate without affording us an opportunity for redress or correction.

Other risks associated with the use of social media include improper disclosure of proprietary information, negative comments about our business, exposure of personally identifiable information, fraud, out-of-date information, and improper use by employees and customers. The inappropriate use of social media by our customers or employees could result in negative consequences including remediation costs including training for employees, additional regulatory scrutiny and possible regulatory penalties, litigation or negative publicity that could damage our reputation adversely affecting customer or investor confidence.

Risks Associated with the Company's Common Stock

The Company's stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. The Company's stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations.
- Recommendations by securities analysts.
- Operating and stock price performance of other companies that investors deem comparable to the Company.
- News reports relating to trends, concerns and other issues in the financial services industry.
- Perceptions in the marketplace regarding the Company and/or its competitors.
- New technology used, or services offered, by competitors.
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors.
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions.
- Changes in government regulations.
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause the Company's stock price to decrease regardless of operating results.

The trading volume in the Company's common stock is less than that of other larger financial services companies.

The Company's common stock is listed for trading on Nasdaq and the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation of these sales, could cause the Company's stock price to fall.

Furthermore, from time to time, the Company's common stock may be included in certain and various stock market indices. Inclusion in these indices may positively impact the price, trading volume, and liquidity of the Company's common stock, in part, because index funds or other institutional investors often purchase securities that are in these indices. Conversely, if the Company's market capitalization falls below the minimum necessary to be included in any of the indices at any annual reconstitution date, the opposite could occur. Further, the Company's inclusion in indices may be weighted based on the size of its market capitalization, so even if the Company's market capitalization remains above the amount required to be included on these indices, if its market capitalization is below the amount it was on the most recent reconstitution date, the Company's common stock could be weighted at a lower level, holders attempting to track the composition of these indices will be required to sell the Company's common stock to match the reweighting of the indices.

Risks Associated with the Company's Industry

Future governmental regulation and legislation could limit the Company's future growth.

The Company is a registered bank holding company, and its subsidiary bank is a depository institution whose deposits are insured by the FDIC. As a result, the Company is subject to various regulations and examinations by various regulatory authorities. In general, statutes establish the corporate governance and eligible business activities for the Company, certain acquisition and merger restrictions, limitations on inter-company transactions such as loans and dividends, capital adequacy requirements, requirements for anti-money laundering programs and other compliance matters, among other regulations. The Company is extensively regulated under federal and state banking laws and regulations that are intended primarily for the protection of depositors, federal deposit insurance funds and the banking system as a whole. Compliance with these statutes and regulations is important to the Company's ability to engage in new activities and consummate additional acquisitions.

In addition, the Company is subject to changes in federal and state tax laws as well as changes in banking and credit regulations, accounting principles and governmental economic and monetary policies. The Company cannot predict whether any of these changes may adversely and materially affect it. Federal and state banking regulators also possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums and limitations on the Company's activities that could have a material adverse effect on its business and profitability. While these statutes are generally designed to minimize potential loss to depositors and the FDIC insurance funds, they do not eliminate risk, and compliance with such statutes increases the Company's expense, requires management's attention and can be a disadvantage from a competitive standpoint with respect to non-regulated competitors.

The earnings of financial services companies are significantly affected by general business and economic conditions.

The Company's operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which the Company operates, all of which are beyond the Company's control. Deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for the Company's products and services, among other things, any of which could have a material adverse impact on the Company's financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, the Company may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. The Company may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on the Company's financial condition and results of operations.

A protracted government shutdown or issues relating to debt and the deficit may adversely affect the Company.

Extended shutdowns of parts of the federal government could negatively impact the financial performance of certain customers and could impact customers' future access to certain loan and guarantee programs. As a result, this could impact the Company's business, financial condition and results of operations.

As a result of past difficulties of the federal government to reach agreement over federal debt and issues connected with the debt ceiling, certain rating agencies placed the United States government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which the Company invests and receives lines of credit on negative watch and a downgrade of the United States government's credit rating would trigger a similar downgrade in the credit rating of these government-sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may also be downgraded should the United States government's credit rating be downgraded. The impact that a credit rating downgrade may have on the national and local economy could have an adverse effect on the Company's financial condition and results of operations.

The regulatory environment for the financial services is being significantly impacted by financial regulatory reform initiatives in the United States and elsewhere, including Dodd-Frank and regulations promulgated to implement it.

The Dodd-Frank Act comprehensively reforms the regulation of financial institutions and their products and services. Dodd-Frank requires various federal regulatory agencies to implement numerous rules and regulations. Because federal agencies are granted broad discretion in drafting these rules and regulations, many of the details and the full impact of Dodd-Frank may not be known for many months or years.

Dodd-Frank, like other financial industry reforms, has had and will continue to have a significant effect on our entire industry. Although it is difficult to predict with certainty the magnitude and extend of these effects at this time, we believe compliance with Dodd-Frank, its interpretive regulations, rules, and initiatives will negatively impact revenue and increase the cost of doing business. Additional expenses associated with compliance with the Act, currently and on an ongoing basis, are likely to continue and the effects of full implementation of the Act may limit our ability to pursue certain business opportunities.

ITEM 1B: UNRESOLVED STAFF COMMENTS
None

ITEM 2: PROPERTIES

As of December 31, 2022, the Company and the Bank operated 21 full-service banking offices, of which eleven were owned and ten were leased. The Pittston branch property is subject to a lease with a company of which director, William J. Joyce, Sr., is a partner. With the exception of the Pittston branch, none of the lessors of the properties leased by the Company are affiliated with the Company and all of the properties are located in the Commonwealth of Pennsylvania. The Company is headquartered at its owner-occupied main branch located on the corner of Blakely and Drinker Streets in Dunmore, PA. Executive and administrative, commercial lending, trust and asset management services are located at the Main Branch. The Company also operates a financial center in downtown Scranton, PA. Executive, mortgage and consumer lending, finance, operations and a full-service call center are located in this building. During 2022, the Company purchased the Scranton Electric Building for a future corporate headquarters in Scranton, PA, which is in the process to be placed on the National Register of Historic Places. Demolition of non-historical interior improvements is currently underway to allow for the next phase of planned remodeling with the expected completion ready for 2025. We believe each of our facilities is suitable and adequate to meet our current operational needs and intended purposes.

The Company also operates a wealth management office in Minersville, PA under a short-term lease agreement.

Additionally, the Company has a limited production office in Scranton, PA that is currently leased for certain commercial lenders and credit department employees.

The Company currently owns a property in Wilkes-Barre, PA that will become a full-service branch during 2023.

The Company acquired a leased building in Scranton from the merger with Landmark. The branch in the building was closed in September 2021 and the building was converted into a training center during 2022.

Foreclosed assets held-for-sale includes other real estate owned (ORE). The Company had two ORE properties as of December 31, 2022, which stemmed from two unrelated borrowers. Upon possession, foreclosed properties are recorded on the Company’s balance sheet at the lower of cost or fair value. For a further discussion of ORE properties, see “Foreclosed assets held-for-sale”, located in the comparison of financial condition section of managements’ discussion and analysis.

ITEM 3: LEGAL PROCEEDINGS

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

ITEM 4: MINE SAFETY DISCLOSURES

Not Applicable

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of the Company is listed on Nasdaq and traded on The NASDAQ Global Market under the symbol "FDBC." Shareholders requesting information about the Company's common stock may contact:

Salvatore R. DeFrancesco, Jr., Treasurer
Fidelity D & D Bancorp, Inc.
Blakely and Drinker Streets
Dunmore, PA 18512
(570) 342-8281

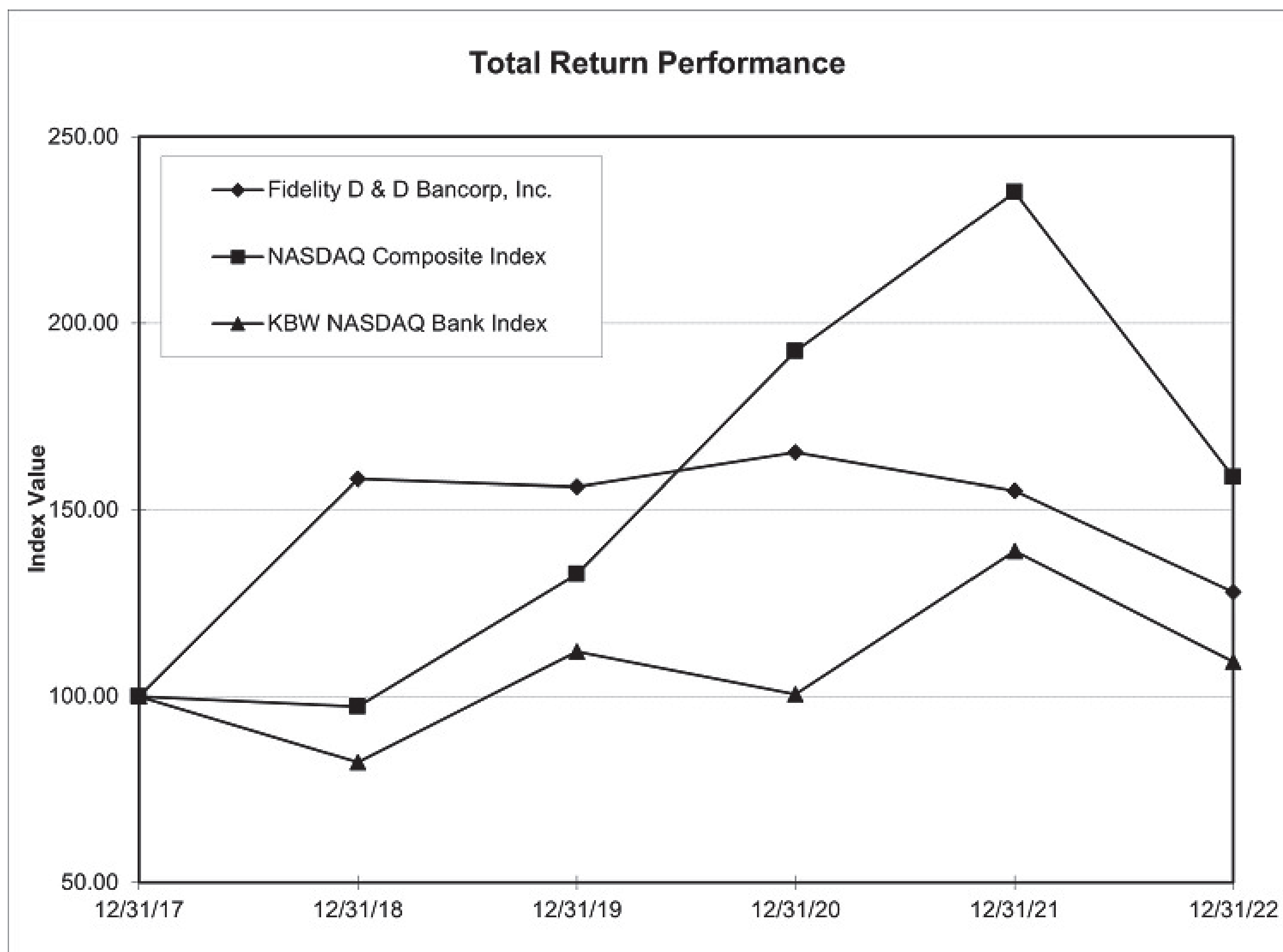
Dividends are determined and declared by the Board of Directors of the Company. The Company expects to continue to pay cash dividends in the future; however, future dividends are dependent upon earnings, financial condition, capital strength and other factors of the Company. For a further discussion of regulatory capital requirements see Note 15, "Regulatory Matters," contained within the notes to the consolidated financial statements, incorporated by reference in Part II, Item 8.

The Company offers a dividend reinvestment plan (DRP) for its shareholders. The DRP provides shareholders with a convenient and economical method of investing cash dividends payable on their common stock and the opportunity to make voluntary optional cash payments to purchase additional shares of the Company's common stock. Participants pay no brokerage commissions or service charges when they acquire additional shares of common stock through the DRP. The administrator may purchase shares directly from the Company, in the open market, in negotiated transactions with third parties or using a combination of these methods.

The Company had approximately 1,663 shareholders at December 31, 2022 and 1,681 shareholders as of February 28, 2023. The number of shareholders is the actual number of distinct shareholders of record. Each security depository is considered a single shareholder for purposes of determining the approximate number of shareholders.

Performance graph

The following graph and table compare the cumulative total shareholder return on the Company's common stock against the cumulative total return of the NASDAQ Composite and KBW NASDAQ Bank index (the KBW NASDAQ index) for the period of five fiscal years commencing January 1, 2018, and ending December 31, 2022. The graph illustrates the cumulative investment return to shareholders, based on the assumption that a $100 investment was made on December 31, 2017, in each of: the Company's common stock, the NASDAQ Composite and the KBW NASDAQ index. As of December 31, 2022, the KBW NASDAQ index consisted of 24 banks. A listing of the banks that comprise the KBW NASDAQ index can be found on the Company's website at www.bankatfidelity.com and then on the bottom of the page clicking on*, Investor Relations, Stock Info, The KBW NASDAQ Bank index* in the drop-down menu. All cumulative total returns are computed assuming the reinvestment of dividends into the applicable securities. The shareholder return shown on the graph and table below is not necessarily indicative of future performance:



	Period Ending					
Index	**12/31/17**	**12/31/18**	**12/31/19**	**12/31/20**	**12/31/21**	**12/31/22**
Fidelity D & D Bancorp, Inc.	100.00	158.27	156.08	165.34	155.10	127.90
NASDAQ Composite Index	100.00	97.16	132.81	192.47	235.15	158.65
KBW NASDAQ Bank Index	100.00	82.29	112.01	100.46	138.97	109.23

Purchases of equity securities by the issuer and affiliated purchasers

The following information describes the Company's stock repurchases during the fourth quarter of the fiscal year ended December 31, 2022.

Period	(a) Total number of shares (or units) purchased		(b) Average price paid per share (or unit)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs		(d) Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
October 1, 2022 to October 31, 2022	715	$	39.45	715	$	3,739,242
November 1, 2022 to November 30, 2022	-		-	-		3,739,242
December 1, 2022 to December 31, 2022	-		-	-		3,739,242
Total	715	$	39.45	715	$	3,739,242

On May 18, 2022, the Company announced that the Board of Directors approved a plan to purchase, in open market and privately negotiated transactions, up to 3% of its outstanding common stock in accordance with all applicable securities laws and regulations, including SEC Rule 10b-18 of the Exchange Act. The plan shall terminate on the earlier of the date an aggregate of $5,000,000 of stock have been purchased or August 9, 2023.

ITEM 6: [Reserved]

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Critical accounting policies

The presentation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at December 31, 2022 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions and could, therefore, calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Fair values of investment securities are determined by pricing provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes may be obtained from more than one source. As described in Notes 1 and 4 of the consolidated financial statements, incorporated by reference in Part II, Item 8, the Company's investment securities are classified as available-for-sale (AFS) or held-to-maturity (HTM). AFS securities are carried at fair value on the consolidated balance sheets, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity as a component of accumulated other comprehensive income (loss) (AOCI).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells residential mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan portfolio to loans HFS. Under these circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. For a further discussion on the accounting treatment of HFS loans, see the section entitled "Loans held-for-sale," contained within this management's discussion and analysis.

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

Goodwill is tested at least annually at November 30 for impairment, or more often if events or circumstances indicate there may be impairment. Impairment write-downs are charged to the consolidated statement of income in the period in which the impairment is determined. In testing goodwill for impairment, the Company performed a qualitative assessment, resulting in the determination that the fair value of its reporting unit exceeded its carrying amount. Accordingly, there is no goodwill impairment at December 31, 2022. Other acquired intangible assets that have finite lives, such as core deposit intangibles, are amortized over their estimated useful lives and subject to periodic impairment testing.

All significant accounting policies are contained in Note 1, "Nature of Operations and Summary of Significant Accounting Policies", within the notes to consolidated financial statements and incorporated by reference in Part II, Item 8.

The following discussion and analysis presents the significant changes in the financial condition and in the results of operations of the Company as of December 31, 2022 and 2021 and for each of the years then ended. This discussion should be read in conjunction with the consolidated financial statements and notes thereto included in Part II, Item 8 of this report.

Non-GAAP Financial Measures

The following are non-GAAP financial measures which provide useful insight to the reader of the consolidated financial statements but should be supplemental to GAAP used to prepare the Company's financial statements and should not be read in isolation or relied upon as a substitute for GAAP measures. In addition, the Company's non-GAAP measures may not be comparable to non-GAAP measures of other companies. The Company's tax rate used to calculate the fully-taxable equivalent (FTE) adjustment was 21% at December 31, 2022, 2021, 2020, 2019 and 2018.

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

(dollars in thousands)	**2022**	2021	2020	2019	2018
Interest income (GAAP)	**$ 78,672**	$ 65,468	$ 49,496	$ 39,269	$ 35,330
Adjustment to FTE	**2,738**	2,135	1,095	750	718
Interest income adjusted to FTE (non-GAAP)	**81,410**	67,603	50,591	40,019	36,048
Interest expense (GAAP)	**6,398**	3,639	5,311	7,554	4,873
Net interest income adjusted to FTE (non-GAAP)	**$ 75,012**	$ 63,964	$ 45,280	$ 32,465	$ 31,175

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

(dollars in thousands)	**2022**	2021	2020	2019	2018
Efficiency Ratio (non-GAAP)					
Non-interest expenses (GAAP)	**$ 51,348**	$ 50,107	$ 38,319	$ 26,921	$ 25,072
Net interest income (GAAP)	**72,274**	61,829	44,185	31,715	30,457
Plus: taxable equivalent adjustment	**2,738**	2,135	1,095	750	718
Non-interest income (GAAP)	**16,642**	18,287	14,668	10,193	9,200
Net interest income (FTE) plus non-interest income (non-GAAP)	**$ 91,654**	$ 82,251	$ 59,948	$ 42,658	$ 40,375
Efficiency ratio (non-GAAP)	**56.02%**	60.92%	63.92%	63.11%	62.10%

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

(dollars in thousands)	**2022**	2021	2020	2019	2018
Tangible Book Value per Share (non-GAAP)					
Total assets (GAAP)	**$ 2,378,372**	$ 2,419,104	$ 1,699,510	$ 1,009,927	$ 981,102
Less: Intangible assets, primarily goodwill	**(21,168)**	(21,569)	(8,787)	(209)	(209)
Tangible assets	**2,357,204**	2,397,535	1,690,723	1,009,718	980,893
Total shareholders' equity (GAAP)	**162,950**	211,729	166,670	106,835	93,557
Less: Intangible assets, primarily goodwill	**(21,168)**	(21,569)	(8,787)	(209)	(209)
Tangible common equity	**$ 141,782**	$ 190,160	$ 157,883	$ 106,626	$ 93,348
Common shares outstanding, end of period	**5,630,794**	5,645,687	4,977,750	3,781,500	3,759,426
Tangible Common Book Value per Share	**$ 25.18**	$ 33.68	$ 31.72	$ 28.20	$ 24.83

The following tables provides a reconciliation of the Company's earnings results under GAAP to comparative non-GAAP results excluding merger-related expenses and an FHLB prepayment penalty:

	2022			
(dollars in thousands except per share data)	Income before income taxes	Provision for income taxes	Net income	Diluted earnings per share
Results of operations (GAAP)	**$ 35,468**	**$ 5,447**	**$ 30,021**	**$ 5.29**
Add: Merger-related expenses	**-**	**-**	**-**	**-**
Add: FHLB prepayment penalty	**-**	**-**	**-**	**-**
Adjusted earnings (non-GAAP)	**$ 35,468**	**$ 5,447**	**$ 30,021**	**$ 5.29**

	2021			
(dollars in thousands except per share data)	Income before income taxes	Provision for income taxes	Net income	Diluted earnings per share
Results of operations (GAAP)	$ 28,009	$ 4,001	$ 24,008	$ 4.48
Add: Merger-related expenses	3,033	491	2,542	0.47
Add: FHLB prepayment penalty	369	78	291	0.05
Adjusted earnings (non-GAAP)	$ 31,411	$ 4,570	$ 26,841	$ 5.00

	2020			
(dollars in thousands except per share data)	Income before income taxes	Provision for income taxes	Net income	Diluted earnings per share
Results of operations (GAAP)	$ 15,284	$ 2,249	$ 13,035	$ 2.82
Add: Merger-related expenses	2,452	426	2,026	0.44
Add: FHLB prepayment penalty	481	101	380	0.08
Adjusted earnings (non-GAAP)	$ 18,217	$ 2,776	$ 15,441	$ 3.34

Comparison of Financial Condition as of December 31, 2022
and 2021 and Results of Operations for each of the Years then Ended

Executive Summary

The Company generated $30.0 million in net income in 2022, or $5.29 diluted earnings per share, up $6.0 million, or 25%, from $24.0 million, or $4.48 diluted earnings per share, in 2021. During 2022, rising interest rates and a well-diversified balance sheet contributed to the success of our earnings performance. Federal Open Market Committee (FOMC) officials raised the federal funds rate 425 basis points during 2022 and another 25 basis points in February 2023. The Company expects the fed funds rate to continue to rise during 2023 as the level of inflation and the labor market remains strong. The 2023 focus is to manage net interest income through a rising forecasted rate cycle by exercising disciplined and proactive loan pricing and managing deposit costs to maintain a reasonable spread. From a financial condition and performance perspective, our mission for 2023 will be to continue to strengthen our capital position through retained earnings by implementing creative marketing and revenue enhancing strategies, continuing to manage the cost of deposits, growing and cultivating more of our wealth management and business services and managing credit risk at tolerable levels thereby maintaining overall asset quality.

Nationally, the unemployment rate fell from 3.9% at December 31, 2021 to 3.5% at December 31, 2022. The unemployment rates in the Scranton - Wilkes-Barre - Hazleton (market area north) and the Allentown – Bethlehem - Easton (market area south) Metropolitan Statistical Areas (local) also decreased but the market area north remained at a higher level than the national unemployment rate. According to the U.S. Bureau of Labor Statistics, the local unemployment rates at December 31, 2022 were 4.3% in the market area north and 3.3% in the market area south, respectively, a decrease of 0.5 and 0.7 percentage points from the 4.8% and 4.0%, respectively, at December 31, 2021. The national and local unemployment rates have decreased as a result of the improving economic environment. The median home values in the Scranton-Wilkes-Barre-Hazleton metro and Allentown-Bethlehem-Easton metro each increased 6.0% and 10.7% from a year ago, according to Zillow, an online database advertising firm providing access to its real estate search engines to various media outlets, and values are expected to grow 3.0% and 0.8% in the next year. In light of these expectations, we are uncertain if real estate values could continue to increase at these levels with the continued rising rate environment, however we will continue to monitor the economic climate in our region and scrutinize growth prospects with credit quality as a principal consideration.

On May 1, 2020, the Company completed its acquisition of MNB Corporation ("MNB"). The merger expanded the Company's full-service footprint into Northampton County, PA and the Lehigh Valley. Non-recurring costs to facilitate the merger and integrate systems of $2.5 million were incurred during 2020.

On July 1, 2021, the Company completed its acquisition of Landmark Bancorp, Inc. ("Landmark"). Non-recurring costs to facilitate the merger and integrate systems of $3.0 million were incurred during 2021.

Non-recurring merger-related costs and a FHLB prepayment penalty incurred during 2021 and 2020 are not a part of the Company's normal operations. There were no non-recurring costs during 2022.

For the years ended December 31, 2022 and 2021, tangible common book value per share (non-GAAP) was $25.18 and $33.68, respectively, a decrease of 25.2%. The decrease in tangible book value was due to the decline in tangible common equity resulting within AOCI from the after-tax net unrealized losses on available-for-sale securities. These non-GAAP measures should be reviewed in connection with the reconciliation of these non-GAAP ratios. See "Non-GAAP Financial Measures" located above within this management's discussion and analysis.

During 2022, the Company's assets declined by 2% primarily from unrealized losses in the investment portfolio. In 2023, we expect total loans to increase and a decline in the investment portfolio. The increase in the loan portfolio is expected to be funded primarily by deposit growth supplemented by short-term borrowings, when necessary. No long-term FHLB advances are expected in 2023.

Non-performing assets represented 0.17% of total assets as of December 31, 2022, down from 0.27% at the prior year end. Non-performing assets to total assets was lower during 2022 mostly due to the amount (or dollar value) of non-performing assets decreasing while there was growth in total assets.

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

During 2023, the Company expects to operate in a higher interest rate environment. The Company's balance sheet is positioned to improve its net interest income performance, but increases in yields may not keep pace with higher cost of funds which may compress net interest spread. Expectations are for short-term rates to continue to increase throughout 2023, which could continue to increase deposit rate pricing. The Company currently expects net interest margin to remain unchanged for 2023.

Financial Condition

Consolidated assets decreased $40.7 million, or 2%, to $2.4 billion as of December 31, 2022 from $2.4 billion at December 31, 2021. The decrease in assets occurred primarily from a decrease in the investment portfolio and a reduction in excess cash balances. Loan portfolio growth was funded by utilizing cash balances and short-term borrowings.

The following table is a comparison of condensed balance sheet data as of December 31:

(dollars in thousands)

Assets:	**2022**	%	2021	%	2020	%
Cash and cash equivalents	**$ 29,091**	**1.2%**	$ 96,877	4.0%	$ 69,346	4.1%
Investment securities	**643,606**	**27.1**	738,980	30.6	392,420	23.1
Restricted investments in bank stock	**5,268**	**0.2**	3,206	0.1	2,813	0.2
Loans and leases, net	**1,548,662**	**65.1**	1,449,231	59.9	1,135,236	66.8
Bank premises and equipment	**31,307**	**1.3**	29,310	1.2	27,626	1.6
Life insurance cash surrender value	**54,035**	**2.3**	52,745	2.2	44,285	2.6
Other assets	**66,403**	**2.8**	48,755	2.0	27,784	1.6
Total assets	**$ 2,378,372**	**100.0%**	$ 2,419,104	100.0%	$ 1,699,510	100.0%
Liabilities:						
Total deposits	**$ 2,166,913**	**91.1%**	$ 2,169,865	89.7%	$ 1,509,505	88.8%
Secured borrowings	**7,619**	**0.3**	10,620	0.4	-	-
Short-term borrowings	**12,940**	**0.5**	-	-	-	-
FHLB advances	**-**	**-**	-	-	5,000	0.3
Other liabilities	**27,950**	**1.2**	26,890	1.1	18,335	1.1
Total liabilities	**2,215,422**	**93.1**	2,207,375	91.2	1,532,840	90.2
Shareholders' equity	**162,950**	**6.9**	211,729	8.8	166,670	9.8
Total liabilities and shareholders' equity	**$ 2,378,372**	**100.0%**	$ 2,419,104	100.0%	$ 1,699,510	100.0%

A comparison of net changes in selected balance sheet categories as of December 31, are as follows:

(dollars in thousands)	Assets	%	Earning assets*	%	Deposits	%	Other borrowings	%	FHLB advances	%
2022	**$ (40,732)**	**(2)**	**$ (35,954)**	**(2)**	**$ (2,952)**	**(0)**	**$ 9,939**	**94**	**$ -**	**-**
2021	719,594	42	682,812	43	660,360	44	10,620	100	(5,000)	(100)
2020	689,583	68	648,880	69	673,768	81	(37,839)	(100)	(10,000)	(67)
2019	28,825	3	21,878	2	65,554	9	(38,527)	(50)	(16,704)	(53)
2018	117,465	14	112,078	14	40,037	5	57,864	313	10,500	50

* Earning assets include interest-bearing deposits with financial institutions, gross loans and leases, loans held-for-sale, available-for-sale securities and restricted investments in bank stock excluding loans placed on non-accrual status.

For more information about the Company's capital, see Footnote 15, "Regulatory Matters," of Part II, Item 8 "Financial Statements and Supplementary Data", which is incorporated herein by reference and the "Capital Resources" section of management's discussion and analysis contained herein.

Funds Provided:

Deposits

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

The following table represents the components of total deposits as of December 31:

	2022		2021	
(dollars in thousands)	Amount	%	Amount	%
Interest-bearing checking	**$ 664,439**	**30.7%**	$ 730,595	33.7%
Savings and clubs	**238,174**	**11.0**	234,747	10.8
Money market	**544,468**	**25.1**	475,447	21.9
Certificates of deposit	**117,224**	**5.4**	138,793	6.4
Total interest-bearing	**1,564,305**	**72.2**	1,579,582	72.8
Non-interest bearing	**602,608**	**27.8**	590,283	27.2
Total deposits	**$ 2,166,913**	**100.0%**	$ 2,169,865	100.0%

Total deposits decreased $3.0 million, or less than 1%, to $2.2 billion at December 31, 2022 from $2.2 billion at December 31, 2021. During 2022, the Company accepted various Fidelity Bank wealth managed trust accounts into a money market account pledged by its securities portfolio which increased total deposits by $69.2 million at December 31, 2022. Money market accounts grew $69.0 million due to the $69.2 million from trust accounts along with a $24.0 million transfer from an interest-bearing checking account partially offset by outflows from personal and public accounts. Non-interest bearing checking accounts increased $12.3 million primarily due to increases in business checking accounts. Savings and clubs also increased $3.4 million due to personal savings growth. Interest-bearing checking accounts decreased $66.2 million during 2022 primarily from one large public customer that withdrew $30.8 million and the aforementioned $24.0 million transfer to a money market account plus declines in personal and business account balances. The Company focuses on obtaining a full-banking relationship with existing checking account customers as well as forming new customer relationships. The Company will continue to execute on its relationship development strategy, explore the demographics within its marketplace and develop creative programs for its customers to maintain and grow core deposits. For 2022, the Company experienced deposit balance declines as clients transferred their deposits to investments to earn higher interest and pay down debts. We currently expect this trend to continue throughout 2023. Seasonal public deposit fluctuations are expected to remain volatile and at times may partially offset future deposit growth. The Company had approximately $97 million in American Rescue Plan Act funds in public deposit accounts at December 31, 2022 that may be disbursed during 2023 resulting in declines in public deposits.

Partially offsetting these non-maturing deposit increases, CDs decreased $21.6 million, or 16%, during 2022. CD balances continue to decline as rates lagged capital market rate increases and CDs with promotional rates reached maturity. Some maturing CDs were closed as customers could earn higher yields by investing the money into other products. The Company will continue to pursue strategies to grow and retain retail and business customers with an emphasis on deepening and broadening existing and creating new relationships.

The Company uses the Certificate of Deposit Account Registry Service (CDARS) reciprocal program and Insured Cash Sweep (ICS) reciprocal program to obtain FDIC insurance protection for customers who have large deposits that at times may exceed the FDIC maximum insured amount of $250,000. The Company did not have any CDARs as of December 31, 2022 and 2021. As of December 31, 2022 and 2021, ICS reciprocal deposits represented $26.3 million and $27.6 million, or 1% each, of total deposits which are included in interest-bearing checking accounts in the table above. The $1.3 million decrease in ICS deposits is primarily due to business deposit transfers from ICS accounts to other interest-bearing checking accounts.

As of December 31, 2022, total uninsured deposits were estimated to be $985.2 million. The estimate of uninsured deposits is based on the same methodologies and assumptions used for regulatory reporting requirements. The Company aggregates deposit products by taxpayer identification number and classifies into ownership categories to estimate amounts over the FDIC insurance limit.

The maturity distribution of certificates of deposit that meet or exceed the FDIC limit, by account, at December 31, 2022 is as follows:

(dollars in thousands)		
Three months or less	$	2,168
More than three months to six months		3,377
More than six months to twelve months		6,340
More than twelve months		9,239
Total	$	21,124

Approximately 65% of the CDs, with a weighted-average interest rate of 0.51%, are scheduled to mature in 2023 and an additional 21%, with a weighted-average interest rate of 1.49%, are scheduled to mature in 2024. Renewing CDs are currently expected to re-price to higher market rates depending on the rate on the maturing CD, the pace and direction of interest rate movements, the shape of the yield curve, competition, the rate profile of the maturing accounts and depositor preference for alternative, non-term products. The Company plans to continue to address repricing CDs in the ordinary course of business on a relationship pricing basis and is prepared to match rates when prudent to maintain relationships. Growth in CD accounts is challenged by the current and expected rate environment and clients' preference for short-term rates. The Company will continue to develop CD promotional programs when the Company deems that it is economically feasible to do so or when demand exists. The Company will consider the needs of the customers and simultaneously be mindful of the liquidity levels, borrowing rates and the interest rate sensitivity exposure of the Company.

Short-term borrowings

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

Short-term borrowings may include overnight balances with FHLB line of credit and/or correspondent bank's federal funds lines which the Company may require to fund daily liquidity needs such as deposit outflow, loan demand and operations. The Company used $12.9 million in short-term borrowings to fund loan growth as of December 31, 2022. As of December 31, 2022, the Company had the ability to borrow $112.0 million from the Federal Reserve borrower-in-custody program, $145.9 million in overnight borrowings with the FHLB and $31.0 million from lines of credit with correspondent banks.

Information with respect to the Company's short-term borrowing's maximum and average outstanding balances and interest rates are contained in Note 8, "Short-term Borrowings," of the notes to consolidated financial statements incorporated by reference in Part II, Item 8.

Secured borrowings

As of December 31, 2022 and 2021, the Company had 9 and 11 secured borrowing agreements with third parties with a fair value of $7.6 million and $10.6 million, respectively, related to certain sold loan participations that did not qualify for sales treatment acquired from Landmark. Secured borrowings are expected to decrease for 2023 from scheduled amortization and, when possible, early pay-offs.

FHLB advances

The Company had no FHLB advances as of December 31, 2022 and 2021. As of December 31, 2022, the Company had the ability to borrow an additional $602.2 million from the FHLB, including any overnight borrowings. The Company does not expect to have any FHLB advances in 2023.

Funds Deployed:

Investment Securities

The Company’s investment policy is designed to complement its lending activities, provide monthly cash flow, manage interest rate sensitivity and generate a favorable return without incurring excessive interest rate and credit risk while managing liquidity at acceptable levels. In establishing investment strategies, the Company considers its business, growth strategies or restructuring plans, the economic environment, the interest rate sensitivity position, the types of securities in its portfolio, permissible purchases, credit quality, maturity and re-pricing terms, call or average-life intervals and investment concentrations. The Company’s policy prescribes permissible investment categories that meet the policy standards and management is responsible for structuring and executing the specific investment purchases within these policy parameters. Management buys and sells investment securities from time-to-time depending on market conditions, business trends, liquidity needs, capital levels and structuring strategies. Investment security purchases provide a way to quickly invest excess liquidity in order to generate additional earnings. The Company generally earns a positive interest spread by assuming interest rate risk using deposits or borrowings to purchase securities with longer maturities.

At the time of purchase, management classifies investment securities into one of three categories: trading, available-for-sale (AFS) or held-to-maturity (HTM). To date, management has not purchased any securities for trading purposes. Some of the securities the Company purchases are classified as AFS even though there is no immediate intent to sell them. The AFS designation affords management the flexibility to sell securities and position the balance sheet in response to capital levels, liquidity needs or changes in market conditions. Debt securities AFS are carried at fair value on the consolidated balance sheets with unrealized gains and losses, net of deferred income taxes, reported separately within shareholders’ equity as a component of accumulated other comprehensive income (AOCI). Securities designated as HTM are carried at amortized cost and represent debt securities that the Company has the ability and intent to hold until maturity. For the year ended December 31, 2022, AOCI was reduced by $71.3 million due to the change in fair value of the Company's investment securities.

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

As of December 31, 2022, the carrying value of investment securities amounted to $643.6 million, or 27% of total assets, compared to $739.0 million, or 31% of total assets, at December 31, 2021. On December 31, 2022, 34% of the carrying value of the investment portfolio was comprised of U.S. Government Sponsored Enterprise residential mortgage-backed securities (MBS – GSE residential or mortgage-backed securities) that amortize and provide monthly cash flow that the Company can use for reinvestment, loan demand, unexpected deposit outflow, facility expansion or operations. The mortgage-backed securities portfolio includes only pass-through bonds issued by Fannie Mae, Freddie Mac and the Government National Mortgage Association (GNMA).

The Company’s municipal (obligations of states and political subdivisions) portfolio is comprised of tax-free municipal bonds with a book value of $254.0 million and taxable municipal bonds with a book value of $86.3 million. The overall credit ratings of these municipal bonds was as follows: 37% AAA, 62% AA, and 1% A.

During 2022, the carrying value of total investments decreased $95.4 million, or 13%. Purchases for 2022 totaled $42.1 million, while principal reductions totaled $40.7 million, the decline in unrealized gain/loss was $68.1 million in the AFS portfolio and $23.9 million in unrealized losses were transferred to the HTM portfolio. The purchases were funded principally by cash flow generated from the portfolio and excess overnight liquidity. The Company attempts to maintain a well-diversified and proportionate investment portfolio that is structured to complement the strategic direction of the Company. Its growth typically supplements the lending activities but also considers the current and forecasted economic conditions, the Company’s liquidity needs and interest rate risk profile. During January 2023 with the 10-year U.S. Treasury yield declining, $31.2 million of securities were able to be sold yielding 3.62% (FTE yield of 4.33%) at a breakeven level. These proceeds were used to pay down FHLB overnight borrowings costing 4.80%.

A comparison of total investment securities as of December 31 follows:

	2022				2021			
(dollars in thousands)	Amount	%	Book yield	Reprice term	Amount	%	Book yield	Reprice term
HTM securities:								
Obligations of states & political subdivisions - tax exempt	**$ 83,426**	**13.0%**	**3.8%**	**21.8**	$ -	-%	-%	-
Obligations of states & political subdivisions - taxable	**59,012**	**9.1**	**3.1**	**12.3**	-	-	-	-
Agency - GSE	**80,306**	**12.5**	**2.6**	**7.4**	-	-	-	-
Total HTM securities	**$ 222,744**	**34.6%**	**3.2%**	**14.1**	$ -	-%	-%	-
AFS debt securities:								
MBS - GSE residential	**$ 217,435**	**33.8%**	**1.8%**	**6.4**	$ 257,267	34.8%	1.6%	5.1
Obligations of states & political subdivisions - tax exempt	**149,131**	**23.2**	**2.6**	**11.4**	272,909	37.0	2.4	7.3
Obligations of states & political subdivisions - taxable	**22,763**	**3.5**	**1.6**	**6.6**	91,801	12.4	1.9	8.1
Agency - GSE	**31,533**	**4.9**	**1.4**	**4.6**	117,003	15.8	1.4	5.2
Total AFS debt securities	**$ 420,862**	**65.4%**	**2.0%**	**8.0**	$ 738,980	100.0%	1.9%	6.3
Total securities	**$ 643,606**	**100.0%**	**2.4%**	**9.9**	$ 738,980	100.0%	1.9%	6.3

The investment securities portfolio contained no private label mortgage-backed securities, collateralized mortgage obligations, collateralized debt obligations, or trust preferred securities, and no off-balance sheet derivatives were in use. The portfolio had no adjustable-rate instruments as of December 31, 2022 and 2021.

Investment securities were comprised of AFS and HTM securities as of December 31, 2022 and AFS securities as of December 31, 2021. The AFS securities were recorded with a net unrealized loss of $67.9 million and a net unrealized gain of $0.2 million as of December 31, 2022 and 2021, respectively. Of the $68.1 million net decline; $30.1 million was attributable to municipal securities; $35.9 million was attributable to mortgage-backed securities and $2.1 million was attributable to agency securities. During the second quarter of 2022, securities with net unrealized losses totaling $23.9 million were transferred to HTM of which subsequently $1.7 million was accreted against other comprehensive income. The direction and magnitude of the change in value of the Company's investment portfolio is attributable to the direction and magnitude of the change in interest rates along the treasury yield curve. Generally, the values of debt securities move in the opposite direction of the changes in interest rates. As interest rates along the treasury yield curve rise, especially at the intermediate and long end, the values of debt securities tend to decline. Whether or not the value of the Company's investment portfolio will change above or below its amortized cost will be largely dependent on the direction and magnitude of interest rate movements and the duration of the debt securities within the Company's investment portfolio. Management does not consider the reduction in value attributable to changes in credit quality. Correspondingly, when interest rates decline, the market values of the Company's debt securities portfolio could be subject to market value increases.

As of December 31, 2022, the Company had $350.7 million in public deposits, or 16% of total deposits. Pennsylvania state law requires the Company to maintain pledged securities on these public deposits or otherwise obtain a FHLB letter of credit or FDIC insurance for these customers. As of December 31, 2022, the balance of pledged securities required for public and trust deposits was $407.2 million, or 63% of total securities.

Quarterly, management performs a review of the investment portfolio to determine the causes of declines in the fair value of each security. The Company uses inputs provided by independent third parties to determine the fair value of its investment securities portfolio. Inputs provided by the third parties are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether impairment exists and whether the impairment is temporary or other-than-temporary. Considerations such as the Company's intent and ability to hold the securities until or sell prior to maturity, recoverability of the invested amounts over the intended holding period, the length of time and the severity in pricing decline below cost, the interest rate environment, the receipt of amounts contractually due and whether or not there is an active market for the securities, for example, are applied, along with an analysis of the financial condition of the issuer for management to make a realistic judgment of the probability that the Company will be unable to collect all amounts (principal and interest) due in determining whether a security is other-than-temporarily impaired. If a decline in value is deemed to be other-than-temporary, the amortized cost of the security is reduced by the credit impairment amount and a corresponding charge to current earnings is recognized. During the year ended December 31, 2022, the Company did not incur other-than-temporary impairment charges from its investment securities portfolio.

Restricted investments in bank stock

Investment in Federal Home Loan Bank (FHLB) stock is required for membership in the organization and is carried at cost since there is no market value available. The amount the Company is required to invest is dependent upon the relative size of outstanding borrowings the Company has with the FHLB of Pittsburgh. Excess stock is repurchased from the Company at par if the amount of borrowings decline to a predetermined level. In addition, the Company earns a return or dividend based on the amount invested. Atlantic Community Bankers Bank (ACBB) stock totaled $82 thousand as of December 31, 2022 and 2021. The balance in FHLB stock was $5.2 million and $3.1 million as of December 31, 2022 and 2021, respectively. The dividends received from the FHLB totaled $164 thousand and $130 thousand for the years ended December 31, 2022 and 2021, respectively.

Loans and leases

As of December 31, 2022, the Company had gross loans and leases, including originated and acquired loans and leases, totaling $1.6 billion compared to $1.4 billion at December 31, 2021, an increase of $131.4 million, or 9%.

During the year ended December 31, 2022, the growth in the portfolio was primarily attributed to the $79.6 million increase in the residential portfolio, including $13 million in mortgage loans originated during 2021 as available-for-sale but reclassified to the held-for-investment portfolio during the first quarter 2022. The Company elected to reclassify the mortgage loans, which meet FNMA underwriting guidelines and are considered high quality, to realize the better yields than those alternately available during the first quarter of 2022. This growth was supplemented by a $29.7 million increase in the consumer portfolio and a $22.1 million increase in the commercial portfolio during 2022.

A comparison of loan originations, net of participations is as follows for the periods indicated:

	2022	2021
(dollars in thousands)	Amount	Amount
Loans:		
Commercial and industrial	**$ 69,709**	$ 128,768
Commercial real estate	**77,517**	89,653
Consumer	**101,394**	68,482
Residential real estate	**122,892**	241,395
Total loans	**371,512**	528,298
Lines of credit:		
Commercial	**185,702**	77,194
Residential construction	**42,630**	54,110
Home equity and other consumer	**34,567**	40,214
Total lines of credit	**262,899**	171,518
Total originations closed	**$ 634,411**	$ 699,816

Commercial and industrial originations decreased by $59 million, or 46%, to $70 million in 2022. This occurred because the Company recorded PPP loans in the commercial and industrial category. PPP loan originations were $77 million in 2021 and there were no PPP loan originations in 2022.

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

As of December 31, 2022, the commercial loan portfolio increased by $22.1 million to $841.1 million compared to the December 31, 2021 balance of $819.0 million due to the $23.9 million increase in the commercial real estate portfolio partially offset by the $1.8 million decrease in the commercial and industrial portfolio, which was attributed to a $38.5 million reduction in PPP loans (net of deferred fees). Excluding the reduction in PPP loans (net of deferred fees) during the year ended December 31, 2022, the commercial portfolio grew $60.6 million with the growth stemming from both the C&I and CRE portfolios.

Excluding PPP loans, C&I loans grew $36.7 million primarily due to a focus on tax-free and municipal lending in 2022 with the addition of a public finance department. Other C&I loan originations in various industries were offset by scheduled and unscheduled paydowns in the portfolio.

CRE loans increased $23.9 million primarily due to growth of $22.1 million in owner occupied CRE primarily due to one fixed commercial loan and one floating commercial loan to unrelated borrowers during 2022.

Paycheck Protection Program Loans

The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act provided over $2.0 trillion in emergency economic relief to individuals and businesses impacted by the COVID-19 pandemic. The CARES Act authorized the Small Business Administration (SBA) to temporarily guarantee loans under a new 7(a) loan program called the Paycheck Protection Program (PPP).

As a qualified SBA lender, the Company was automatically authorized to originate PPP loans, and during the second and third quarters of 2020, the Company originated 1,551 loans totaling $159 million under the Paycheck Protection Program.

Under the PPP, the entire principal amount of the borrower's loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount, so long as the employer maintains or quickly rehires employees and maintains salary levels and 60% of the loan proceeds are used for payroll expenses, with the remaining 40% of the loan proceeds used for other qualifying expenses.

As part of the Economic Relief Act, an additional $284 billion of federal resources was allocated to a reauthorized and revised PPP. On January 19, 2021, the Company began processing and originating PPP loans for this second round, which subsequently ended on May 31, 2021, and during this round, the Company originated 1,022 loans totaling $77 million.

Beginning in the fourth quarter of 2020 and continuing during 2022, the Company submitted PPP forgiveness applications to the SBA, and through December 31, 2022, the Company received forgiveness or paydowns of $235.2 million, or 99%, of the original PPP loan balances of $236.3 million with $32.1 million occurring during the year ended December 31, 2022.

As a PPP lender, the Company received fee income of approximately $9.9 million with $9.9 million recognized to date, including $1.2 million recognized during 2022. Unearned fees attributed to PPP loans, net of fees paid to referral sources as prescribed by the SBA under the PPP, were $33 thousand as of December 31, 2022.

The PPP loans originated by size were as follows as of December 31, 2022:

(dollars in thousands)	Balance originated	Current balance	Total SBA fee	SBA fee recognized
$150,000 or less	$ 76,594	$ 107	$ 4,866	$ 4,858
Greater than $150,000 but less than $2,000,000	128,082	1,033	4,765	4,740
$2,000,000 or higher	31,656	-	316	316
Total PPP loans originated	$ 236,332	$ 1,140	$ 9,947	$ 9,914

The table above does not include the $20.3 million in PPP loans acquired because of the merger with Landmark during the third quarter of 2021. As of December 31, 2022, the balance of outstanding acquired PPP loans was $0.2 million.

Consumer

The consumer loan portfolio consisted of home equity installment, home equity line of credit, automobile, direct finance leases and other consumer loans.

As of December 31, 2022, the consumer loan portfolio increased by $29.7 million, or 12%, to $284.4 million compared to the December 31, 2021 balance of $254.7 million, primarily due to growth in the home equity installment, auto and direct finance lease portfolios. Auto loans grew $13.9 million from continued demand for higher priced automobiles and new dealer relationships. Direct finance leases increased $7.0 million primarily due to higher residual values and more automobile leases added than expired. Home equity installment loans also grew $11.5 million from the spring and fall home equity campaigns.

Residential

As of December 31, 2022, the residential loan portfolio increased by $79.6 million, or 22%, to $440.4 million compared to the December 31, 2021 balance of $360.8 million. The increase was due in part to a strategic reclassification of $13 million in available-for-sale mortgages booked during 2021 to held-for-investment loans during the first quarter of 2022. The remainder of the increase was due to a shift from mortgage loans sold to loans held-for-investment due to increased jumbo loans and the pricing of loans in the secondary market and more adjustable rate mortgages which are not being sold in the secondary market.

The residential loan portfolio consisted primarily of held-for-investment residential loans for primary residences. Management expects the sudden historic rise in interest rates to impact demand for residential mortgages for 2023.

A comparison of loans and related percentage of gross loans, at December 31, for the five previous periods is as follows:

	December 31, 2022		December 31, 2021	
(dollars in thousands)	Amount	%	Amount	%
Commercial and industrial	**$ 234,478**	**15.0%**	$ 236,304	16.5%
Commercial real estate:				
Non-owner occupied	**316,867**	**20.2**	312,848	21.8
Owner occupied	**270,810**	**17.3**	248,755	17.3
Construction	**18,941**	**1.2**	21,147	1.5
Consumer:				
Home equity installment	**59,118**	**3.8**	47,571	3.3
Home equity line of credit	**52,568**	**3.4**	54,878	3.8
Auto	**131,936**	**8.4**	118,029	8.2
Direct finance leases	**33,223**	**2.1**	26,232	1.8
Other	**7,611**	**0.5**	8,013	0.6
Residential:				
Real estate	**398,136**	**25.4**	325,861	22.8
Construction	**42,232**	**2.7**	34,919	2.4
Gross loans	**1,565,920**	**100.0%**	1,434,557	100.0%
Less:				
Allowance for loan losses	**(17,149)**		(15,624)	
Unearned lease revenue	**(1,746)**		(1,429)	
Net loans	**$ 1,547,025**		$ 1,417,504	
Loans held-for-sale	**$ 1,637**		$ 31,727	

(dollars in thousands)	2020 Amount	2020 %	2019 Amount	2019 %	2018 Amount	2018 %
Commercial and industrial	$ 280,757	25.0%	$ 122,594	16.2%	$ 126,884	17.4%
Commercial real estate:						
Non-owner occupied	192,143	17.1	99,801	13.2	95,515	13.1
Owner occupied	179,923	16.1	130,558	17.3	124,092	17.0
Construction	10,231	0.9	4,654	0.6	6,761	0.9
Consumer:						
Home equity installment	40,147	3.6	36,631	4.9	32,729	4.5
Home equity line of credit	49,725	4.4	47,282	6.3	52,517	7.2
Auto	98,386	8.8	105,870	14.0	105,576	14.5
Direct finance leases	20,095	1.8	16,355	2.2	17,004	2.3
Other	7,602	0.7	5,634	0.7	6,314	0.9
Residential:						
Real estate	218,445	19.5	167,164	22.2	145,951	20.0
Construction	23,357	2.1	17,770	2.4	15,749	2.2
Gross loans	1,120,811	100.0%	754,313	100.0%	729,092	100.0%
Less:						
Allowance for loan losses	(14,202)		(9,747)		(9,747)	
Unearned lease revenue	(1,159)		(903)		(1,028)	
Net loans	$ 1,105,450		$ 743,663		$ 718,317	
Loans held-for-sale	$ 29,786		$ 1,643		$ 5,707	

The following table sets forth the maturity distribution of select commercial and construction components of the loan portfolio at December 31, 2022. The determination of maturities is based on contractual terms. Non-contractual rollovers or extensions are included in one year or less category of the maturity classification. Excluded from the table are residential real estate and consumer loans:

(dollars in thousands)	One year or less	More than one year to five years	More than five years to fifteen years	More than fifteen years	Total
Commercial and industrial	$ 4,617	$ 77,014	$ 63,385	$ 89,462	$ 234,478
Commercial real estate	20,894	40,946	341,556	184,281	587,677
Commercial real estate construction *	18,941	-	-	-	18,941
Residential real estate construction *	42,232	-	-	-	42,232
Total	$ 86,684	$ 117,960	$ 404,941	$ 273,743	$ 883,328

*In the table above, both residential and CRE construction loans are included in the one year or less category since, by their nature, these loans are converted into residential and CRE loans within one year from the date the real estate construction loan was consummated. Upon conversion, the residential and CRE loans would normally mature after five years.

The following table sets forth the total amount of C&I and CRE loans due after one year which have predetermined interest rates (fixed) and floating or adjustable interest rates (variable) as of December 31, 2022:

(dollars in thousands)	One to five years	Five to fifteen years	Over fifteen years	Total
Fixed interest rate	$ 78,714	$ 69,607	$ 38,586	$ 186,907
Variable interest rate	39,246	335,334	235,157	609,737
Total	$ 117,960	$ 404,941	$ 273,743	$ 796,644

Non-refundable fees and costs associated with all loan originations are deferred. Using either the interest method or straight-line amortization, the deferral is released as credits or charges to loan interest income over the life of the loan.

There are no concentrations of loans or customers to several borrowers engaged in similar industries exceeding 10% of total loans that are not otherwise disclosed as a category in the tables above. There are no concentrations of loans that, if resulted in a loss, would have a material adverse effect on the business of the Company. The Company's loan portfolio does not have a material concentration within a single industry or group of related industries or customers that is vulnerable to the risk of a near-term severe negative business impact. As of December 31, 2022, approximately 75% of the gross loan portfolio was secured by real estate compared to 75% at December 31, 2021 and 66% at December 31, 2020.

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

Loans held-for-sale

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

As of December 31, 2022 and 2021, loans HFS consisted of residential mortgages with carrying amounts of $1.6 million and $31.7 million, respectively, which approximated their fair values. During the year ended December 31, 2022, residential mortgage loans with principal balances of $78.8 million were sold into the secondary market and the Company recognized net gains of $1.6 million, compared to $159.8 million and $4.1 million, respectively, during the year ended December 31, 2021. During the year ended December 31, 2021, the Company also sold one SBA guaranteed loan with a principal balance of $0.2 million and recognized a net gain of $24 thousand.

Management completed $13 million in transfers of mortgages HFS at December 31, 2021 to the held-for-investment portfolio during 2022.

The Company retains mortgage servicing rights (MSRs) on loans sold into the secondary market. MSRs are retained so that the Company can foster relationships. At December 31, 2022 and 2021, the servicing portfolio balance of sold residential mortgage loans was $465.7 million and $430.9 million, respectively, with mortgage servicing rights of $1.6 million and $1.7 million for the same periods, respectively.

Allowance for loan losses

Management evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for loan losses (allowance) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The provision for loan losses represents the amount necessary to maintain an appropriate allowance. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

- identification of specific impaired loans by loan category;
- calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
- determination of loans with similar credit characteristics within each class of the loan portfolio segment and eliminating the impaired loans;

- application of historical loss percentages (trailing twelve-quarter average) to pools to determine the allowance allocation; and
- application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio, regulations, and/or current economic conditions.

A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual commercial loans. Commercial loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management determines an upgrade or downgrade may be warranted. The credit risk grades for the commercial loan portfolio are considered in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience as well as what management believes to be best practices and within common industry standards. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the commercial loan portfolio from period-to-period are based upon the credit risk grading system and from periodic reviews of the loan portfolio.

Acquired loans are initially recorded at their acquisition date fair values with no carryover of the existing related allowance for loan losses. Fair values are based on a discounted cash flow methodology that involves assumptions and judgements as to credit risk, expected lifetime losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Upon acquisition, in accordance with GAAP, the Company has individually determined whether each acquired loan is within the scope of ASC 310-30. These loans are deemed purchased credit impaired loans and the excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable discount.

Acquired ASC 310-20 loans, which are loans that did not meet the criteria of ASC 310-30, were pooled into groups of similar loans based on various factors including borrower type, loan purpose, and collateral type. These loans are initially recorded at fair value and include credit and interest rate marks associated with purchase accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these loans after acquisition.

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

The following table sets forth the activity in the allowance for loan losses and certain key ratios for the periods indicated:

(dollars in thousands)	**2022**	2021	2020	2019	2018
Balance at beginning of period	**$ 15,624**	$ 14,202	$ 9,747	$ 9,747	$ 9,193
Charge-offs:					
Commercial and industrial	**(371)**	(130)	(372)	(184)	(196)
Commercial real estate	**(67)**	(491)	(465)	(597)	(268)
Consumer	**(377)**	(206)	(296)	(398)	(391)
Residential	**-**	(162)	(35)	(330)	(371)
Total	**(815)**	(989)	(1,168)	(1,509)	(1,226)
Recoveries:					
Commercial and industrial	**11**	23	26	32	77
Commercial real estate	**153**	250	30	317	42
Consumer	**74**	138	120	67	211
Residential	**2**	-	197	8	-
Total	**240**	411	373	424	330
Net charge-offs	**(575)**	(578)	(795)	(1,085)	(896)
Provision for loan losses	**2,100**	2,000	5,250	1,085	1,450
Balance at end of period	**$ 17,149**	$ 15,624	$ 14,202	$ 9,747	$ 9,747
Allowance for loan losses to total loans	**1.10%**	1.09%	1.27%	1.29%	1.34%
Net charge-offs to average total loans outstanding	**0.04%**	0.04%	0.08%	0.15%	0.13%
Average total loans	**$ 1,500,796**	$ 1,299,960	$ 1,019,373	$ 732,152	$ 687,853
Loans 30 - 89 days past due and accruing	**$ 1,838**	$ 1,982	$ 1,598	$ 1,366	$ 5,938
Loans 90 days or more past due and accruing	**$ 33**	$ 64	$ 61	$ -	$ 1
Non-accrual loans	**$ 2,535**	$ 2,949	$ 3,769	$ 3,674	$ 4,298
Allowance for loan losses to non-accrual loans	**6.76x**	5.30x	3.77x	2.65x	2.27x
Allowance for loan losses to non-performing loans	**6.68x**	5.19x	3.71x	2.65x	2.27x

For the twelve months ended December 31, 2022, the allowance increased $1.5 million, or 10%, to $17.1 million from $15.6 million at December 31, 2021 due to provisioning of $2.1 million partially offset by $0.6 million in net charge-offs. The allowance for loan and lease losses increased as a percentage of total loans at 1.10% as of December 31, 2022 compared to 1.09% at December 31, 2021 because the growth in the allowance (10%) outpaced the growth in the total loans (9%) through 2022.

Loans acquired from the Merchants and Landmark mergers (performing and non-performing) were initially recorded at their acquisition-date fair values. Since there is no initial credit valuation allowance recorded under this method, the Company established a post-acquisition allowance for loan losses to record losses which may subsequently arise on the acquired loans.

PPP loans made to eligible borrowers have a 100% SBA guarantee. Given this guarantee, no allowance for loan and lease losses was recorded for these loans.

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

During the first quarter of 2022, management increased the qualitative factors associated with its commercial, consumer, and residential portfolios related to the rise in rates that occurred during the quarter, and the adverse impact that these increased rates are anticipated to have on estimated credit losses.

During the second quarter of 2022, management increased the qualitative factors associated with its commercial, consumer, and residential portfolios related to the rise in rates that occurred during the quarter, and the adverse impact that these increased rates are anticipated to have on estimated credit losses. These increases were partially offset by a reduction in the qualitative factors for the owner occupied CRE and residential real estate portfolios related to the historically low delinquency observed in these portfolios.

During the third quarter of 2022, management decreased the qualitative factors associated with its commercial, consumer, and residential portfolios related to changes in the Company's loan policy that were expected to reduce credit losses.

During the fourth quarter of 2022, management decreased the qualitative factors for the term and nature of its loans. Reduction of the 10 Year Constant Treasury Rate and 30 Year Fixed Mortgage Rate lowered the risk of loss in its commercial, consumer, and residential portfolios.

The Company has determined its CECL methodologies, validated the CECL model and ran it concurrently for the fourth quarter of 2022. Upon adoption of CECL on January 1, 2023, the Company estimated an adjustment for the allowance for credit losses (ACL) which resulted in an increase in the allowance for loan losses of $0.7 million and reserve for unfunded commitments of $1.1 million. The Company will finalize the adoption during the first quarter of 2023.

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

(dollars in thousands)		**2022**	**% of Total Net Charge-offs**		2021	% of Total Net Charge-offs
Net charge-offs						
Commercial and industrial	**$**	**(360)**	**63%**	$	(107)	18%
Commercial real estate		**86**	**(15)**		(241)	42
Consumer		**(303)**	**53**		(68)	12
Residential		**2**	**(1)**		(162)	28
Total net charge-offs	**$**	**(575)**	**100%**	$	(578)	100%

For the year ended December 31, 2022, net charge-offs against the allowance totaled $575 thousand compared with net charge-offs of $578 thousand for the year ended December 31, 2021, representing a $3 thousand decline as decreases in residential and commercial real estate net charge offs were offset by increases in commercial & industrial and consumer net charge offs. Net charge offs were unchanged as a percentage of the total loan portfolio at 0.04% for both the years ended December 31, 2022 and 2021.

For a discussion on the provision for loan losses, see the "Provision for loan losses," located in the results of operations section of management's discussion and analysis contained herein.

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

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

(dollars in thousands)	**2022** Allowance	**2022** Category % of Loans	2021 Allowance	2021 Category % of Loans	2020 Allowance	2020 Category % of Loans	2019 Allowance	2019 Category % of Loans	2018 Allowance	2018 Category % of Loans
Category										
Commercial real estate	**$ 7,162**	**39%**	$ 7,422	41%	$ 6,383	34%	$ 3,933	31%	$ 3,901	31%
Commercial and industrial	**2,924**	**15**	2,204	16	2,407	25	1,484	16	1,432	18
Consumer	**2,827**	**18**	2,404	18	2,552	19	2,013	28	2,548	29
Residential real estate	**4,169**	**28**	3,508	25	2,781	22	2,278	25	1,844	22
Unallocated	**67**	**-**	86	-	79	-	39	-	22	-
Total	**$ 17,149**	**100%**	$ 15,624	100%	$ 14,202	100%	$ 9,747	100%	$ 9,747	100%

As of December 31, 2022, the commercial loan portfolio, consisting of CRE and C&I loans, comprised 59% of the total allowance for loan losses compared with 62% on December 31, 2021. The commercial loan allowance allocation declined due to the payoff of a commercial real estate loan to a single borrower with a large specific impairment during the first quarter of 2022 and the relative decrease in this loan category, which decreased to 54% as of December 31, 2022 from 57% at December 31, 2021.

As of December 31, 2022, the consumer loan portfolio comprised 16% of the total allowance for loan losses compared with 15% on December 31, 2021 due to the relative growth in the consumer portfolio.

As of December 31, 2022, the residential loan portfolio comprised 24% of the total allowance for loan losses compared with 22% on December 31, 2021. The two percentage point increase was the result of the relative increase in this loan category, which increased to 28% as of December 31, 2022 from 25% as of December 31, 2021.

As of December 31, 2022, the unallocated reserve, representing the portion of the allowance not specifically identified with a loan or groups of loans, was less than 1% of the total allowance for loan losses, unchanged from December 31, 2021.

Non-performing assets

The Company defines non-performing assets as accruing loans past due 90 days or more, non-accrual loans, troubled debt restructurings (TDRs), other real estate owned (ORE) and repossessed assets.

The following table sets forth non-performing assets at December 31:

(dollars in thousands)	**2022**	2021	2020	2019	2018
Loans past due 90 days or more and accruing	**$ 33**	$ 64	$ 61	$ -	$ 1
Non-accrual loans *	**2,535**	2,949	3,769	3,674	4,298
Total non-performing loans	**2,568**	3,013	3,830	3,674	4,299
Troubled debt restructurings	**1,333**	2,987	2,571	991	1,830
Other real estate owned and repossessed assets	**168**	434	256	369	190
Total non-performing assets	**$ 4,069**	$ 6,434	$ 6,657	$ 5,034	$ 6,319
Total loans, including loans held-for-sale	**$ 1,565,811**	$ 1,464,855	$ 1,149,438	$ 755,053	$ 755,053
Total assets	**$ 2,378,372**	$ 2,419,104	$ 1,699,510	$ 1,009,927	$ 981,102
Non-accrual loans to total loans	**0.16%**	0.20%	0.33%	0.49%	0.57%
Non-performing loans to total loans	**0.16%**	0.21%	0.33%	0.49%	0.57%
Non-performing assets to total assets	**0.17%**	0.27%	0.39%	0.50%	0.64%

* In the table above, the amount includes non-accrual TDRs of $0.2 million, $0.6 million, $0.7 million, $0.6 million and $1.7 million as of 2022, 2021, 2020, 2019 and 2018, respectively.

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

Non-performing assets represented 0.17% of total assets at December 31, 2022 compared with 0.27% at December 31, 2021. The improvement resulted from a $2.4 million, or 37%, decrease in non-performing assets. Non-performing assets decreased due to a $1.7 million reduction in accruing troubled debt restructurings, a $0.4 reduction in non-performing loans, and a $0.3 million reduction in other real estate owned and repossessed assets.

From December 31, 2021 to December 31, 2022, non-accrual loans decreased $0.4 million, or 14%, from $2.9 million to $2.5 million. The $0.4 million decrease in non-accrual loans was primarily the result of $1.5 million in payments, $0.7 million in moves to ORE, $0.5 million in charge offs, and $0.1 million in moves to accrual partially offset by $2.3 million in additions and $0.1 million in advances.

At December 31, 2022, there were a total of 39 loans to 29 unrelated borrowers with balances that ranged from less than $1 thousand to $0.6 million. At December 31, 2021, there were a total of 31 loans to 28 unrelated borrowers with balances that ranged from less than $1 thousand to $0.7 million.

There was one direct finance lease and one non-recourse auto loan totaling $33 thousand that were over 90 days past due as of December 31, 2022 compared to two direct finance leases totaling $64 thousand that were over 90 days past due as of December 31, 2021. All loans were well secured and in the process of collection.

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

The composition of non-performing loans as of December 31, 2022 is as follows:

(dollars in thousands)	Gross loan balances	Past due 90 days or more and still accruing	Non-accrual loans	Total non-performing loans	% of gross loans
Commercial and industrial	**$ 234,478**	**$ -**	**$ 719**	$ **719**	**0.31%**
Commercial real estate:					
Non-owner occupied	**316,867**	**-**	**383**	**383**	**0.12%**
Owner occupied	**270,810**	**-**	**1,066**	**1,066**	**0.39%**
Construction	**18,941**	**-**	**-**	**-**	**-**
Consumer:					
Home equity installment	**59,118**	**-**	**-**	**-**	**-**
Home equity line of credit	**52,568**	**-**	**211**	**211**	**0.40%**
Auto loans	**131,936**	**16**	**153**	**169**	**0.13%**
Direct finance leases *	**31,477**	**17**	**-**	**17**	**0.05%**
Other	**7,611**	**-**	**-**	**-**	**-**
Residential:					
Real estate	**398,136**	**-**	**3**	**3**	**0.00%**
Construction	**42,232**	**-**	**-**	**-**	**-**
Loans held-for-sale	**1,637**	**-**	**-**	**-**	**-**
Total	**$ 1,565,811**	**$ 33**	**$ 2,535**	$ **2,568**	**0.16%**

*Net of unearned lease revenue of $1.4 million.

Payments received from non-accrual loans are recognized on a cost recovery method. Payments are first applied to the outstanding principal balance, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of interest income. If the non-accrual loans that were outstanding as of December 31, 2022 had been performing in accordance with their original terms, the Company would have recognized interest income with respect to such loans of $160 thousand.

The following tables set forth the activity in accruing and non-accruing TDRs as of the period indicated:

As of and for the years ended December 31, 2022

(dollars in thousands)	Accruing	Non-accruing		
	Commercial real estate	Commercial real estate	Commercial & industrial	Total
Troubled Debt Restructures:				
Beginning balance	**$ 2,987**	**$ 419**	**$ 135**	**$ 3,541**
Additions	**-**	**-**	**-**	**-**
Transfers	-	**(158)**	-	**(158)**
Pay downs / payoffs	**(1,654)**	**(71)**	**(135)**	**(1,860)**
Charge offs	**-**	**-**	**-**	**-**
Ending balance	**$ 1,333**	**$ 190**	**$ -**	**$ 1,523**
Number of loans	**6**	**1**	**-**	**7**

As of and for the year ended December 31, 2021

(dollars in thousands)	Accruing	Non-accruing		
	Commercial real estate	Commercial real estate	Commercial & industrial	Total
Troubled Debt Restructures:				
Beginning balance	$ 2,571	$ 456	$ 206	$ 3,233
Additions	519	-	-	519
Pay downs / payoffs	(103)	(37)	(6)	(146)
Charge offs	-	-	(65)	(65)
Ending balance	$ 2,987	$ 419	$ 135	$ 3,541
Number of loans	8	1	2	11

The Company reviews changes to loans to determine if they meet the definition of a TDR, as modifications occur. TDRs arise when a borrower experiences financial difficulty and the Company grants a concession that it would not otherwise grant based on current underwriting standards to maximize the Company's recovery.

From December 31, 2021 to December 31, 2022, TDRs declined $2.0 million, or 57%, primarily due to the payoff of two commercial real estate TDRs to a single borrower totaling $1.6 million and the payoff of two C&I TDRs to a single borrower totaling $0.1 million.

At December 31, 2022, there were a total of 7 TDRs by 6 unrelated borrowers with balances that ranged from $87 thousand to $0.5 million. At December 31, 2021, there were a total of 11 TDRs by 8 unrelated borrowers with balances that ranged from $50 thousand to $1.3 million.

Loans modified in a TDR may or may not be placed on non-accrual status. At December 31, 2022, there was one TDR totaling $0.2 million that was on non-accrual status compared to three TDRs totaling $0.6 million at December 31, 2021.

Foreclosed assets held-for-sale

From December 31, 2021 to December 31, 2022, foreclosed assets held-for-sale (ORE) declined from $434 thousand to $168 thousand, a $266 thousand decrease, which was primarily attributed to two ORE properties totaling $283 thousand that were sold during the first quarter. Two properties totaling $595 thousand were also added to ORE and sold during 2022.

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

	2022		2021	
(dollars in thousands)	Amount	#	Amount	#
Balance at beginning of period	**$ 434**	**5**	$ 256	6
Additions	**762**	**3**	969	7
Pay downs	**(6)**		-	
Write downs	**(17)**		(16)	
Sold	**(1,005)**	**(6)**	(775)	(8)
Balance at end of period	**$ 168**	**2**	$ 434	5

As of December 31, 2022, ORE consisted of two properties securing loans to two unrelated borrowers totaling $168 thousand. One property ($167 thousand) was added in 2022 and one property ($1 thousand) was added in 2017. Both properties are listed for sale.

As of December 31, 2022 and December 31, 2021, the Company had no other repossessed assets held-for-sale.

Cash surrender value of bank owned life insurance

The Company maintains bank owned life insurance (BOLI) for a chosen group of employees at the time of purchase, namely its officers, where the Company is the owner and sole beneficiary of the policies. BOLI is classified as a non-interest earning asset. Increases in the cash surrender value are recorded as components of non-interest income. The BOLI is profitable from the appreciation of the cash surrender values of the pool of insurance and its tax-free advantage to the Company. This profitability is used to offset a portion of current and future employee benefit costs. As a result of the Landmark acquisition, the Company acquired $7.2 million in BOLI during the third quarter of 2021. The BOLI cash surrender value build-up can be liquidated if necessary, with associated tax costs. However, the Company intends to hold this pool of insurance, because it provides income that enhances the Company's capital position. Therefore, the Company has not provided for deferred income taxes on the earnings from the increase in cash surrender value. The Company was notified of a pending death benefit claim on two owned policies and received $0.8 million in return of cash surrender value and $0.1 million in other income during the first quarter of 2023.

Premises and equipment

Net of depreciation, premises and equipment increased $2.0 million during 2022. The Company purchased $1.8 million in fixed assets and added $3.7 million in construction in process during 2022. The increase in construction in process was primarily due to the purchase of the Scranton Electric Building for a new headquarters in Scranton, PA. These increases were partially offset by $2.2 million in depreciation expense and $1.2 million in transfers to other assets held-for-sale. The Company is planning to open a new branch in Wilkes-Barre in 2023. The Company has recently begun remodeling the Main Branch located in Dunmore, PA and estimated costs for the project are currently $3.9 million. The Company began corporate headquarters planning which may continue to increase construction in process and is evaluating its branch network looking for consolidation that makes sense for more efficient operations.

On December 23, 2020, the Commonwealth of Pennsylvania authorized the release of $2.0 million in Redevelopment Assistance Capital Program (RACP) funding for the Company's headquarters project in Lackawanna County. On December 2, 2021, the Company announced it would be receiving an additional $2.0 million in RACP funding in support of the project. The $4.0 million in total RACP grant funds will be allocated to the renovation and rehabilitation of the historic building located in downtown Scranton which will be used for the new corporate headquarters. The Company currently estimates net remaining costs for the corporate headquarters could range from $15 million to $20 million. This range estimate is subject to supply chain issues, commodities pricing and results of final planning over approximately two years through the end of 2024. In addition, the Company currently intends to pursue a federal historic preservation tax credit which would provide a 20% tax credit on qualified improvements on the historic property.

Other assets

During 2022, the $17.9 million increase in other assets was due mostly to a $16.5 million increase in deferred tax assets primarily from net unrealized losses in the investment portfolio and $0.7 million increase in prepaid dealer reserve.

Results of Operation

Earnings Summary

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

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

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

Overview

For the year ended December 31, 2022, the Company generated net income of $30.0 million, or $5.29 per diluted share, compared to $24.0 million, or $4.48 per diluted share, for the year ended December 31, 2021. The $6.0 million, or 25%, increase in net income stemmed from $10.4 million more net interest income which more than offset $1.6 million lower non-interest income, $1.2 million rise in non-interest expenses and $1.4 million higher provision for income taxes.

For the year ended December 31, 2022, return on average assets (ROA) and return on average shareholders' equity (ROE) were 1.25% and 17.37%, respectively, compared to 1.13% and 12.69% for the same period in 2021. The increase in ROA was the result of the growth in net income relative to the increase in average assets during 2022. ROE increased due to net income growth as well as average equity decreases during 2022.

Net interest income and interest sensitive assets / liabilities

Net interest income (FTE) increased $11.0 million, or 17%, from $64.0 million for the year ended December 31, 2021 to $75.0 million for the year ended December 31, 2022, due to interest income increasing more than the increase in interest expense. Total average interest-earning assets increased $310.0 million while the FTE yields earned on these assets rose 14 basis points resulting in $13.8 million of growth in FTE interest income. The loan portfolio contributed the most to this growth due to average balance growth of $200.8 million which had the effect of producing $8.7 million more FTE interest income, despite $3.9 million less in fees earned under the Paycheck Protection Program (PPP). In the investment portfolio, an increase in the average balances of securities was the biggest driver of interest income growth. The average balance of total securities grew $167.2 million supplemented by a 13 basis point increase in yields producing $4.3 million in additional FTE interest income. Interest income on interest-bearing cash also increased $0.7 million due to an increase in yields.

On the liability side, total interest-bearing liabilities grew $217.3 million in average balances with a 14 basis point increase in rates paid on these interest-bearing liabilities which caused interest expense to increase $2.8 million. Growth in average interest-bearing deposits of $217.4 million and a 14 basis point increase in rates paid on these deposits resulted in increasing interest expense by $2.7 million. In addition, the Company utilized more in average overnight borrowings in 2022 at higher rates and had more interest expense on secured borrowings compared to 2021 resulting in $0.1 million more interest expense from borrowings.

The FTE net interest rate spread was unchanged at 3.16% for the years ended December 31, 2022 and 2021. The FTE net interest rate margin increased by 5 basis points, respectively, for the year ended December 31, 2022 compared to the year ended December 31, 2021. The yields earned on interest-earning assets grew at the same pace as the increase in the rates paid on interest-bearing liabilities causing the net interest rate spread to remain flat. The increase in net interest rate margin was due to the higher average balance of non-interest bearing deposits. The overall cost of funds, which includes the impact of non-interest bearing deposits, increased 10 basis points for the year ended December 31, 2022 compared to the same period in 2021. The primary reason for the increase was the higher rates paid on deposits.

During 2023, the Company expects to operate in a rising short-term interest rate environment. A rate environment with rising interest rates positions the Company to improve its interest income performance from new and repricing earning assets. For 2023, the Company anticipates net interest income to grow at a slower pace as growth in interest income would likely help mitigate an adverse impact of rate movements on the cost of funds. The risk to continuing net interest income improvement is rapid acceleration of deposit rates in the Company's marketplace. The FOMC began increasing the federal funds rate during 2022, the first moves since they cut rates during the first quarter of 2020, which began to have an effect on rates paid on interest-bearing liabilities. On the asset side, the prime interest rate, the benchmark rate that banks use as a base rate for adjustable rate loans was also increased 425 basis points during 2022. Consensus economic forecasts are predicting increases in short-term rates throughout 2023. The 2023 focus is to manage net interest income and control deposit costs through a forecasted rising short-term rate cycle for primarily overnight to 12-month rates. Continued growth in the loan portfolios is expected to boost interest income, and when coupled with a proactive relationship approach to deposit cost setting strategies should help stop spread compression and contain the interest rate margin, preventing further reductions below acceptable levels.

The Company's cost of interest-bearing liabilities was 0.40% for the year ended December 31, 2022, or 14 basis points higher than the cost for the year ended December 31, 2021. The increase in interest paid on deposits contributed to the higher cost of interest-bearing liabilities. Management currently believes the FOMC is expected to continue to raise the federal funds rate in the immediate future, so the Company may continue to experience pressure to further increase rates paid on deposits. To help mitigate the impact of the imminent change to the economic landscape, the Company has successfully developed and will continue to strengthen its association with existing customers, develop new business relationships, generate new loan volumes, and retain and generate higher levels of average non-interest bearing deposit balances. Strategically deploying no- and low-cost deposits into interest earning-assets is an effective margin-preserving strategy that the Company expects to continue to pursue and expand to help stabilize net interest margin.

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

The table that follows sets forth a comparison of average balances of assets and liabilities and their related net tax equivalent yields and rates for the years indicated. Within the table, interest income was FTE adjusted, using the corporate federal tax rate of 21% for 2022, 2021 and 2020, to recognize the income from tax-exempt interest-earning assets as if the interest was taxable. See “Non-GAAP Financial Measures” within this management’s discussion and analysis for the FTE adjustments. This treatment allows a uniform comparison among yields on interest-earning assets. Loans include loans held-for-sale (HFS) and non-accrual loans but exclude the allowance for loan losses. HELOC are included in the residential real estate category since they are secured by real estate. Net deferred loan fee accretion of $0.2 million in 2022, $3.8 million in 2021 and $2.1 million in 2020, respectively, are included in interest income from loans. MNB and Landmark loan fair value purchase accounting adjustments of $3.3 million, $3.0 million and $0.6 million are included in interest income from loans and $160 thousand, $154 thousand and $213 thousand reduced interest expense on deposits and borrowings for 2022, 2021 and 2020. Average balances are based on amortized cost and do not reflect net unrealized gains or losses. Residual values for direct finance leases are included in the average balances for consumer loans. Net interest margin is calculated by dividing net interest income-FTE by total average interest-earning assets. Cost of funds includes the effect of average non-interest bearing deposits as a funding source:

(dollars in thousands)	2022			2021			2020		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets									
Interest-bearing deposits	**$ 53,483**	**$ 886**	**1.66%**	$ 111,936	$ 148	0.13%	$ 76,404	$ 121	0.16%
Restricted investments in bank stock	**3,565**	**184**	**5.15**	3,181	127	4.00	3,044	162	5.33
Investments:									
Agency - GSE	**117,598**	**1,748**	**1.49**	89,754	1,231	1.37	18,074	301	1.66
MBS - GSE residential	**265,993**	**4,573**	**1.72**	197,556	2,837	1.44	145,343	2,896	1.99
State and municipal (nontaxable)	**259,194**	**7,708**	**2.97**	207,819	6,171	2.97	89,350	3,146	3.52
State and municipal (taxable)	**87,954**	**1,795**	**2.04**	68,343	1,281	1.87	19,555	398	2.03
Other	**-**	**-**	**-**	27	-	0.40	89	3	3.42
Total investments	**730,739**	**15,824**	**2.17**	563,499	11,520	2.04	272,411	6,744	2.48
Loans and leases:									
C&I and CRE (taxable)	**754,225**	**37,328**	**4.95**	712,838	34,507	4.84	526,805	24,485	4.65
C&I and CRE (nontaxable)	**70,697**	**2,406**	**3.40**	48,574	1,890	3.89	41,261	1,579	3.83
Consumer	**215,740**	**8,326**	**3.86**	180,991	7,100	3.92	166,389	6,690	4.02
Residential real estate	**460,133**	**16,456**	**3.58**	357,557	12,311	3.44	284,918	10,810	3.79
Total loans and leases	**1,500,795**	**64,516**	**4.30**	1,299,960	55,808	4.29	1,019,373	43,564	4.27
Total interest-earning assets	**2,288,582**	**81,410**	**3.56%**	1,978,576	67,603	3.42%	1,371,232	50,591	3.69%
Non-interest earning assets	**110,994**			137,011			124,433		
Total assets	**$ 2,399,576**			$ 2,115,587			$ 1,495,665		
Liabilities and shareholders' equity									
Interest-bearing liabilities									
Deposits:									
Interest-bearing checking	**$ 709,340**	**$ 2,453**	**0.35%**	$ 608,441	$ 1,742	0.29%	$ 369,645	$ 1,405	0.38%
Savings and clubs	**244,038**	**264**	**0.11**	209,890	113	0.05	148,505	115	0.08
MMDA	**514,033**	**2,949**	**0.57**	425,282	957	0.22	280,344	1,573	0.56
Certificates of deposit	**126,394**	**478**	**0.38**	132,751	644	0.49	135,487	1,663	1.23
Total interest-bearing deposits	**1,593,805**	**6,144**	**0.39**	1,376,364	3,456	0.25	933,981	4,756	0.51
Secured borrowings	**8,886**	**209**	**2.35**	9,122	156	1.71	-	-	-
Short-term borrowings	**1,031**	**45**	**4.37**	97	1	1.06	49,165	248	0.50
FHLB advances	**-**	**-**	**-**	848	26	3.07	10,608	307	2.90
Total interest-bearing liabilities	**1,603,722**	**6,398**	**0.40%**	1,386,431	3,639	0.26%	993,754	5,311	0.53%
Non-interest bearing deposits	**594,541**			517,599			340,211		
Non-interest bearing liabilities	**28,434**			22,322			17,765		
Total liabilities	**2,226,697**			1,926,352			1,351,730		
Shareholders' equity	**172,879**			189,235			143,935		
Total liabilities and shareholders' equity	**$ 2,399,576**			$ 2,115,587			$ 1,495,665		
Net interest income - FTE		**$75,012**			$63,964			$45,280	
Net interest spread			**3.16%**			3.16%			3.16%
Net interest margin			**3.28%**			3.23%			3.30%
Cost of funds			**0.29%**			0.19%			0.40%

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

	Years ended December 31,					
(dollars in thousands)	**2022 compared to 2021**			2021 compared to 2020		
	Increase (decrease) due to					
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Interest-bearing deposits	**$ (116)**	**$ 854**	**$ 738**	$ 50	$ (23)	$ 27
Restricted investments in bank stock	**17**	**40**	**57**	7	(42)	(35)
Investments:						
Agency - GSE	**407**	**110**	**517**	992	(62)	930
MBS - GSE residential	**1,106**	**630**	**1,736**	877	(936)	(59)
State and municipal	**1,483**	**84**	**1,567**	3,537	(615)	2,922
Other	**-**	**-**	**-**	(1)	(2)	(3)
Total investments	**2,996**	**824**	**3,820**	5,405	(1,615)	3,790
Loans and leases:						
Residential real estate	**3,652**	**492**	**4,144**	2,569	(1,067)	1,502
C&I and CRE	**3,020**	**199**	**3,219**	9,102	1,177	10,279
Consumer	**1,343**	**(117)**	**1,226**	576	(167)	409
Total loans and leases	**8,015**	**574**	**8,589**	12,247	(57)	12,190
Total interest income	**10,912**	**2,292**	**13,204**	17,709	(1,737)	15,972
Interest expense:						
Deposits:						
Interest-bearing checking	**316**	**395**	**711**	745	(408)	337
Savings and clubs	**21**	**130**	**151**	39	(41)	(2)
Money market	**236**	**1,756**	**1,992**	588	(1,204)	(616)
Certificates of deposit	**(30)**	**(136)**	**(166)**	(33)	(986)	(1,019)
Total deposits	**543**	**2,145**	**2,688**	1,339	(2,639)	(1,300)
Secured borrowings	**(4)**	**57**	**53**	156	-	156
Overnight borrowings	**33**	**11**	**44**	(377)	130	(247)
FHLB advances	**(26)**	**-**	**(26)**	(299)	18	(281)
Total interest expense	**546**	**2,213**	**2,759**	819	(2,491)	(1,672)
Net interest income	**$ 10,366**	**$ 79**	**$ 10,445**	$ 16,890	$ 754	$ 17,644

Provision for loan losses

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

Management continuously reviews the risks inherent in the loan portfolio. Specific factors used to evaluate the adequacy of the loan loss provision during the formal process include:

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

For the year ended December 31, 2022 and 2021, the provision for loan losses was $2.1 million, a $0.1 million increase compared to $2.0 million for the year ended December 31, 2021. This amount of provisioning reflected the loan growth achieved during 2022 and what management deemed necessary to maintain the allowance for loan and lease losses at an adequate level.

The provision for loan losses derives from the reserve required from the allowance for loan losses calculation. The Company continued provisioning for the year December 31, 2022 to maintain an allowance level that management deemed adequate.

For a discussion on the allowance for loan losses, see “Allowance for loan losses,” located in the comparison of financial condition section of management’s discussion and analysis contained herein.

Other income

For the year ended December 31, 2022, non-interest income amounted to $16.6 million, a $1.6 million, or 9%, decrease compared to $18.2 million recorded for the year ended December 31, 2021. The decrease was primarily due to $2.5 million lower gains on loan sales and $0.7 million less loan service charges due to scaled back demand for mortgages. Partially offsetting these decreases, service charges on deposits increased $0.9 million. Interchange fees grew $0.2 million due to a higher volume of debit card transactions. Fees from trust fiduciary activities increased $0.2 million year-over-year.

Other operating expenses

For the year ended December 31, 2022, total other operating expenses totaled $51.3 million, an increase of $1.2 million, or 2%, compared to $50.1 million for the year ended December 31, 2021. Non-interest expenses would have increased $3.4 million more if not for $3.0 million in merger-related expenses and a $0.4 million FHLB prepayment penalty incurred by the Company during 2021. Salaries and employee benefit expenses grew $2.9 million, or 12%. The increase was primarily due to less deferred loan origination costs reducing salaries and employee benefits expense from a lower volume of originations from mortgages and PPP loans. Additionally, salaries and employee benefits were higher from new positions added and merit increases and higher group insurance from a larger amount of claims. Premises and equipment expenses increased $0.6 million, or 9%, due to higher expenses for lease payments, equipment maintenance and rental and other expenses related to premises and equipment acquired from the merger with Landmark. PA shares tax expense was $0.3 million higher from growth in equity.

The ratios of non-interest expense less non-interest income to average assets, known as the expense ratio, at December 31, 2022 and 2021 were 1.45% and 1.50%, respectively. The expense ratio decreased because of increased levels of average assets. The efficiency ratio decreased from 60.92% at December 31, 2021 to 56.02% at December 31, 2022 due to revenue increasing faster than expenses in 2022. For more information on the calculation of the efficiency ratio, see “Non-GAAP Financial Measures” located within this management’s discussion and analysis.

Open positions and the cost of maintaining talent may increase salaries and employee benefit expenses in 2023. Additionally, the Company's technology platforms continue to evolve and require periodic upgrades. Therefore, the Company continues to devote financial resources and personnel necessary to maintain and improve the information technology systems and platforms for optimal operational efficiency, customer convenience and compliance with applicable laws, regulations and regulatory guidance within a secure environment. Although these costs are expected, the costs of software and software subscriptions continue to rise and our ability to attract and retain qualified information technology personnel during a historically tight labor market may require further investment by the Company.

Provision for income taxes

The Company's effective income tax rate approximated 15.4% in 2022 and 14.3% in 2021. The difference between the effective rate and the enacted statutory corporate rate of 21% is due mostly to the effect of tax-exempt income in relation to the level of pre-tax income. The provision for income taxes increased $1.4 million, or 36%, from $4.0 million at December 31, 2021 to $5.4 million at December 31, 2022. The increase was primarily due to higher pre-tax income in 2022. If the federal corporate tax rate is increased, the Company's net deferred tax liabilities and deferred tax assets will be re-valued upon adoption of the new tax rate. A federal tax rate increase will decrease net deferred tax assets with a corresponding decrease to provision for income taxes.

Comparison of Financial Condition as of December 31, 2021 and 2020 and Results of Operations for each of the Years then Ended

Executive Summary

The Company generated $24.0 million in net income in 2021, or $4.48 diluted earnings per share, up $11.0 million, or 84%, from $13.0 million, or $2.82 diluted earnings per share, in 2020. In 2021, our larger and well diversified balance sheet from organic and inorganic growth contributed to the success of our earnings performance. Federal Open Market Committee (FOMC) officials dropped the federal funds rate down to 0%-0.25% during the first quarter of 2020 at the start of the pandemic where it remained through 2021.

Nationally, the unemployment rate fell from 6.7% at December 31, 2020 to 3.9% at December 31, 2021. The unemployment rates in the Scranton - Wilkes-Barre - Hazleton and the Allentown – Bethlehem - Easton Metropolitan Statistical Areas (local) decreased but remained at a higher level than the national unemployment rate. According to the U.S. Bureau of Labor Statistics, the local unemployment rates at December 31, 2021 were 4.8% and 4.0%, respectively, a decrease of 3.2 and 2.6 percentage points from the 8.0% and 6.6%, respectively, at December 31, 2020. The national and local unemployment rates have decreased as a result of the improving economic environment. The pandemic-related business restrictions had been lifted in our local area and employees started heading back to work. Stimulus payments and enhanced unemployment benefits supported the economy throughout 2020 and 2021. The median home values in the Scranton-Wilkes-Barre-Hazleton metro and Allentown-Bethlehem-Easton metro each increased 20.4% and 17.9% from a year ago, according to Zillow, an online database advertising firm providing access to its real estate search engines to various media outlets.

Non-recurring merger-related costs and a FHLB prepayment penalty incurred during 2021 and 2020 are not a part of the Company's normal operations. If these expenses had not occurred, adjusted net income (non-GAAP) for the years ended December 31, 2021 and 2020 would have been $26.8 million and $15.4 million, respectively. Adjusted diluted EPS (non-GAAP) would have been $5.00 and $3.34 for the years ended December 31, 2021 and 2020. For the same time periods, adjusted ROA (non-GAAP) would have been 1.27% and 1.03%, respectively, and adjusted ROE (non-GAAP) would have been 14.18% and 10.73%, respectively.

For the years ended December 31, 2021 and 2020, tangible common book value per share (non-GAAP) was $33.68 and $31.72, respectively, an increase of 6.2%.

During 2021, the Company's assets grew by 42% primarily from assets acquired from the merger with Landmark and additional growth in deposits, which were used to fund growth in the loan and security portfolios. Non-performing assets represented 0.27% of total assets as of December 31, 2021, down from 0.39% at the prior year end. Non-performing assets to total assets was lower during 2021 mostly due to the amount (or dollar value) of non-performing assets decreasing while there was growth in total assets.

Financial Condition

Consolidated assets increased $719.6 million, or 42%, to $2.4 billion as of December 31, 2021 from $1.7 billion at December 31, 2020. The increase in assets occurred primarily from assets acquired in the merger with Landmark and deposit inflow. The asset growth was funded by utilizing growth in deposits of $660.4 million.

Funds Provided:

Deposits

Total deposits increased $660.4 million, or 44%, from $1.5 billion at December 31, 2020 to $2.2 billion at December 31, 2021. Non-interest bearing and interest-bearing checking accounts contributed the most to the deposit growth with increases of $182.8 million and $276.7 million, respectively. The growth in non-interest bearing checking accounts was primarily due to accounts acquired from the Landmark merger supplemented by business and personal account growth. The increase in interest-bearing checking accounts was primarily due to accounts from the Landmark merger, seasonal tax cycles, business activity, federal pandemic relief funds and shifts from maturing CDs. Money market accounts also increased $134.8 million, mostly due to acquired Landmark accounts, higher balances of personal and business accounts and shifts from other types of deposit accounts. The Company focuses on obtaining a full-banking relationship with existing checking account customers as well as forming new customer relationships. Savings accounts increased $55.1 million due to accounts added from the Landmark merger and also an increase in personal account balances.

Additionally, CDs also increased $11.0 million due to CDs acquired from the merger with Landmark. Otherwise, CD balances continue to decline as rates dropped during 2020 and 2021 and previous years' promotional CDs reached maturity. Of the balance of outstanding CDs at December 31, 2021, $70.8 million, or 51%, had a balance at December 31, 2020. The majority of the remaining maturing CD balances were transferred to transactional accounts primarily interest-bearing checking and money market accounts. During the third quarter of 2021, $12.0 million in CDs from one public customer was transferred to an interest-bearing checking account.

The Company did not have any CDARs as of December 31, 2021 and 2020. As of December 31, 2021 and 2020, ICS reciprocal deposits represented $27.6 million and $46.2 million, or 1% and 3%, of total deposits which are included in interest-bearing checking accounts in the table above. The $18.6 million decrease in ICS deposits is primarily due to public funds deposit transfers from ICS accounts to other interest-bearing checking accounts partially offset by ICS accounts acquired from Landmark.

As of December 31, 2021, total uninsured deposits were estimated to be $919.3 million.

Short-term borrowings

There were no short-term borrowings as of December 31, 2021 and 2020 as growth in deposits funded asset growth. As of December 31, 2021, the Company had the ability to borrow $91.7 million from the Federal Reserve borrower-in-custody program and $31.0 million from lines of credit with correspondent banks.

Secured borrowings

As of December 31, 2021, the Company had secured borrowings with a fair value of $10.6 million related to certain sold loan participations that did not qualify for sales treatment acquired from Landmark.

FHLB advances

The Company had no FHLB advances as of December 31, 2021. During the first quarter of 2021, the Company paid off $5 million in FHLB advances with a weighted average interest rate of 3.07%. During the third quarter of 2021, the Company acquired $4.5 million in FHLB advances from the Landmark merger that was subsequently paid off. As of December 31, 2021, the Company had the ability to borrow an additional $568.9 million from the FHLB.

Funds Deployed:

Investment Securities

As of December 31, 2021, the carrying value of investment securities amounted to $739.0 million, or 31% of total assets, compared to $392.4 million, or 23% of total assets at December 31, 2020.

The Company's municipal (obligations of states and political subdivisions) portfolio is comprised of tax-free municipal bonds with a book value of $267.5 million and taxable municipal bonds with a book value of $93.2 million. The overall credit ratings of these municipal bonds was as follows: 36% AAA, 62% AA, 1% A and 1% escrowed.

During 2021, the carrying value of total investments increased $346.6 million, or 88%. Purchases for the year totaled $411.4 million, while maturities and principal reductions totaled $54.2 million and proceeds from sales were $44.5 million. The purchases were funded principally by cash flow generated from the portfolio and excess overnight liquidity. The growth in the investment portfolio was due to the increase in low earning cash that was used to purchase higher yielding securities. As a result of the acquisition of Landmark, the Company acquired $49.4 million in securities of which $16.5 million was retained and the remaining securities were liquidated and reinvested.

The investment securities portfolio contained no private label mortgage-backed securities, collateralized mortgage obligations, collateralized debt obligations, or trust preferred securities, and no off-balance sheet derivatives were in use. The portfolio had no adjustable-rate instruments as of December 31, 2021 and 2020.

Investment securities were comprised of AFS securities as of December 31, 2021 and 2020. The AFS securities were recorded with a net unrealized gain of $0.2 million and a net unrealized gain of $11.3 million as of December 31, 2021 and 2020, respectively. Of the net decline in the unrealized gain position of $11.1 million: $3.3 million was attributable to municipal securities; $5.1 million was attributable to mortgage-backed securities and $2.7 million was attributable to agency securities.

As of December 31, 2021, the Company had $417.8 million in public deposits, or 19% of total deposits. Pennsylvania state law requires the Company to maintain pledged securities on these public deposits or otherwise obtain a FHLB letter of credit or FDIC insurance for these customers. As of December 31, 2021, the balance of pledged securities required for public and trust deposits was $394.3 million, or 53% of total securities.

During the year ended December 31, 2021, the Company did not incur other-than-temporary impairment charges from its investment securities portfolio.

Restricted investments in bank stock

Atlantic Community Bankers Bank (ACBB) stock totaled $82 thousand and $45 thousand as of December 31, 2021 and 2020. ACBB stock totaling $37 thousand was acquired from the merger with Landmark in 2021. The dividends received from the FHLB totaled $130 thousand and $203 thousand for the years ended December 31, 2021 and 2020, respectively. The balance in FHLB and ACBB stock was $3.2 million and $2.8 million as of December 31, 2021 and 2020, respectively.

Loans and leases

As of December 31, 2021, the Company had gross loans and leases, including originated and acquired loans and leases, totaling $1.4 billion compared to $1.1 billion at December 31, 2020, an increase of $314 million, or 28%.

Growth in the portfolio was attributed to a $118 million, or 13%, increase in the originated portfolio and a $196 million, or 93%, increase in the acquired portfolio. Growth in the originated portfolio was primarily attributed to the $83 million increase in the commercial real estate portfolio, resulting from the origination of several large commercial real estate loans during 2021, and the $95 million increase in the residential portfolio, stemming from the strength of the housing market in the Company's service area and the low interest rate environment along with management's decision to retain a greater percentage of potentially saleable mortgages. Growth in the acquired portfolio was attributed to the $299 million in loans added to the Company's balance sheet from the Landmark merger, which closed in the third quarter of 2021.

Commercial and industrial originations decreased by $70 million, or 35%, to $129 million in 2021. This occurred because the Company recorded PPP loans in the commercial and industrial category. PPP loan originations decreased from $159 million in 2020 to $77 million in 2021.

Commercial and industrial and commercial real estate

As of December 31, 2021, the commercial loan portfolio increased by $156 million, or 24%, to $819 million over the December 31, 2020 balance of $663 million due to $145 million in growth in the acquired portfolio and $11 million in growth in the originated portfolio. Excluding the $98 million reduction in originated PPP loans (net of deferred fees) during the twelve months ended December 31, 2021, the originated commercial portfolio grew $110 million due to the origination of several large CRE loans during the year along with increased overall lending activity due to the Company's larger size and market area.

The commercial loan portfolio consisted of $513 million in originated loans, including $32 million in originated PPP loans, and $306 million in loans acquired from MNB and Landmark, including $8 million in acquired PPP loans,
as of December 31, 2021.

Paycheck Protection Program Loans

Beginning in the fourth quarter of 2020 and continuing during 2021, the Company submitted PPP forgiveness applications to the SBA, and through December 31, 2021, the Company received forgiveness or paydowns of $203 million, or 86%, of the original PPP loan balances of $236 million with $176 million occurring during the twelve months ended December 31, 2021.

As a PPP lender, the Company received fee income of approximately $9.9 million with $8.7 million recognized to date, including $3.3 million of PPP fee income recognized during 2020 and $5.4 million recognized during 2021. Unearned fees attributed to PPP loans, net of $0.1 million in fees paid to referral sources as prescribed by the SBA under the PPP, were $1.2 million as of December 31, 2021.

The PPP loans originated by size were as follows as of December 31, 2021:

(dollars in thousands)	Balance originated	Current balance	Total SBA fee	SBA fee recognized
$150,000 or less	$ **76,594**	$ **12,877**	$ **4,866**	$ **4,085**
Greater than $150,000 but less than $2,000,000	**128,082**	**20,331**	**4,765**	**4,254**
$2,000,000 or higher	**31,656**	**-**	**316**	**316**
Total PPP loans originated	$ **236,332**	$ **33,208**	$ **9,947**	$ **8,655**

The table above does not include the $20.3 million in PPP loans acquired because of the merger with Landmark during the third quarter of 2021. As of December 31, 2021, the balance of outstanding acquired PPP loans was $7.9 million.

Consumer

As of December 31, 2021, the consumer loan portfolio increased by $39 million, or 18%, to $255 million compared to the December 31, 2020 balance of $216 million, due to $27 million in growth in the acquired portfolio, primarily automobile, related to the Landmark merger and $12 million in growth in the originated portfolio, specifically from the home equity line of credit and direct finance lease portfolios.

Residential

As of December 31, 2021, the residential loan portfolio increased by $119 million, or 49%, to $361 million compared to the December 31, 2020 balance of $242 million. For the twelve months ended December 31, 2021, $25 million in growth was attributed to loans acquired in the Landmark merger and $94 million in growth originated mainly in the Company’s service area spurred by a historically low interest rate environment, strong demand for residential loans and management’s decision to retain potentially saleable mortgages.

The residential loan portfolio consisted primarily of held-for-investment residential loans for primary residences. Originated loans totaled $298 million and acquired loans totaled $63 million as of December 31, 2021 compared to originated loans of $204 million and acquired loans of $38 million as of December 31, 2020.

Loans held-for-sale

As of December 31, 2021 and 2020, loans HFS consisted of residential mortgages with carrying amounts of $31.7 million and $29.8 million, respectively, which approximated their fair values. During the year ended December 31, 2021, residential mortgage loans with principal balances of $159.8 million were sold into the secondary market and the Company recognized net gains of $4.1 million, compared to $155.1 million and $3.5 million, respectively, during the year ended December 31, 2020. During the year ended December 31, 2021, the Company also sold one SBA guaranteed loan with a principal balance of $0.2 million and recognized a net gain of $24 thousand compared to one SBA guaranteed loan with a principal balance of $0.6 million and recognized a net gain on the sale of $93 thousand during the year ended December 31, 2020.

During 2021, management decided to hold mortgages HFS longer to earn interest income. Management completed a $13 million transfer of mortgages HFS to the held-for-investment portfolio during the first quarter of 2022.

The Company retains mortgage servicing rights (MSRs) on loans sold into the secondary market. MSRs are retained so that the Company can foster personal relationships. At December 31, 2021 and 2020, the servicing portfolio balance of sold residential mortgage loans was $430.9 million and $366.5 million, respectively, with mortgage servicing rights of $1.7 million and $1.3 million for the same periods, respectively.

Allowance for loan losses

For the twelve months ended December 31, 2021, the allowance increased $1.4 million, or 10%, to $15.6 million from $14.2 million at December 31, 2020 due to provisioning of $2.0 million partially offset by $0.6 million in net charge-offs. The allowance for loan and lease losses decreased as a percentage of total loans to 1.09% from 1.27% at December 31, 2020 as the growth in the loan portfolio (28%) outpaced the growth in the allowance for loan losses (10%) during the same period.

During the first quarter of 2021, management increased the qualitative factors associated with its commercial, consumer, and residential portfolios related to the rise in rates that occurred during the quarter, and the adverse impact that these increased rates are anticipated to have on estimated credit losses.

During the second quarter of 2021, management increased the qualitative factors associated with its commercial & industrial portfolio related to the rising delinquency observed during this period, which was on a worsening trend on both a quarter-over-quarter and year-over-year basis.

During the third quarter of 2021, management reduced the qualitative factors associated with its commercial, consumer, and residential portfolios related to the improvement in the economic environment compared to the prior period, which was attributed to the improving key risk indicators used in the analysis including national unemployment rate, personal consumer expenditures, industrial production and consumer sentiment.

During the fourth quarter of 2021, management reduced the qualitative factors associated with its commercial, consumer, and residential portfolios related to the sustained, low level of delinquency in these portfolios observed during the year and improvement compared to the year earlier period. Management also reduced the qualitative factors associated with its commercial portfolio related to the improvement in the key risk indicators used in the analysis including national unemployment rate, personal consumer expenditures, and industrial production.

For the twelve months ended December 31, 2021, net charge-offs against the allowance totaled $578 thousand compared with net charge-offs of $795 thousand for the twelve months ended December 31, 2020, representing a $217 thousand, or 27%, decrease. This decrease was attributed to general economic improvement and continued high levels of liquidity for the Company's customers.

As of December 31, 2021, the commercial loan portfolio, consisting of CRE and C&I loans, comprised 62% of the total allowance for loan losses compared with 62% on December 31, 2020. The commercial loan allowance allocation remained unchanged due to the greater inherent risk in this portfolio.

As of December 31, 2021, the consumer loan portfolio comprised 15% of the total allowance for loan losses compared with 18% on December 31, 2020. The 3-percentage point decrease in the consumer loan allowance allocation was the result of the relative reduction in this loan category, which declined from 19% as of December 31, 2020 to 18% as of December 31, 2021.

As of December 31, 2021, the residential loan portfolio comprised 22% of the total allowance for loan losses compared with 19% on December 31, 2020. The 3-percentage point increase was the result of the relative increase in this loan category, which increased from 22% as of December 31, 2020 to 25% as of December 31, 2021.

As of December 31, 2021, the unallocated reserve, representing the portion of the allowance not specifically identified with a loan or groups of loans, was less than 1% of the total allowance for loan losses compared with less than 1% of the total allowance for loan losses on December 31, 2020.

Non-performing assets

Non-performing assets represented 0.27% of total assets at December 31, 2021 compared with 0.39% at December 31, 2020 with the improvement resulting from the $0.2 million, or 3%, decrease in non-performing assets, specifically non-accrual loans, coupled with the $720 million, or 42%, increase in total assets to $2.4 billion at December 31, 2021.

From December 31, 2020 to December 31, 2021, non-accrual loans declined $0.8 million, or 21%, from $3.8 million to $3.0 million. The $0.8 million decline in non-accrual loans was the result of $1.3 million in payments, $0.7million in charge-offs, $0.2 million in moves to ORE, and $0.2 million in moves back to accrual offset by $1.6 million in additions. At December 31, 2021, there were a total of 31 loans to 28 unrelated borrowers with balances that ranged from less than $1 thousand to $0.7 million. At December 31, 2020, there were a total of 46 loans to 38 unrelated borrowers with balances that ranged from less than $1 thousand to $0.5 million.

There were two direct finance leases totaling $64 thousand that were over 90 days past due as of December 31, 2021 compared to two direct finance leases totaling $61 thousand that were over 90 days past due as of December 31, 2020. The delinquent direct finance leases are fully guaranteed under a formal recourse agreement with the originating auto dealer and were in process of orderly collection.

If the non-accrual loans that were outstanding as of December 31, 2021 had been performing in accordance with their original terms, the Company would have recognized interest income with respect to such loans of $169 thousand.

From December 31, 2020 to December 31, 2021, TDRs increased $0.3 million, or 10%, primarily due to the addition of a $0.5 million commercial real estate TDR in the fourth quarter offset by paydowns of $0.1 million and charge-offs for two non-accrual commercial real estate TDRs to a single borrower totaling $0.1 million. At December 31, 2020, there were a total of 12 TDRs by 9 unrelated borrowers with balances that ranged from $1 thousand to $1.3 million, and at December 31, 2021, there were a total of 11 TDRs by 8 unrelated borrowers with balances that ranged from $50 thousand to $1.3 million.

Loans modified in a TDR may or may not be placed on non-accrual status. At December 31, 2021, there were three TDRs totaling $0.6 million that were on non-accrual status compared to four TDRs totaling $0.7 million at December 31, 2020.

Beginning the week of March 16, 2020, the Company began receiving requests for temporary modifications to the repayment structure for borrower loans. Modification terms included interest only or full payment deferral for up to 6 months. As of December 31, 2021, the Company had no COVID-related modifications outstanding.

Foreclosed assets held-for-sale

From December 31, 2020 to December 31, 2021, foreclosed assets held-for-sale (ORE) increased from $256 thousand to $435 thousand, a $179 thousand increase, which was primarily attributed to one $236 thousand ORE property that was added during the first quarter of 2021.

As of December 31, 2021, ORE consisted of five properties securing loans to five unrelated borrowers totaling $435 thousand. Four properties ($434 thousand) to four unrelated borrowers were added in 2021 and one property ($1 thousand) was added in 2017. Of the five properties, three properties are under agreement of sale and two properties are listed for sale.

As of December 31, 2021 and December 31, 2020, the Company had no other repossessed assets held-for-sale.

Cash surrender value of bank owned life insurance

In March 2019, the Company invested $2.0 million in additional BOLI as a source of funding for additional life insurance benefits that provides for payments upon death for officers and employee benefit expenses related to the Company's non-qualified SERP implemented for certain executive officers. In December 2020, the Company invested $6 million in BOLI and $5 million in BOLI with taxable annuity rider investments. As a result of the Landmark acquisition, the Company acquired $7.2 million in BOLI during the third quarter of 2021.

Premises and equipment

Net of depreciation, premises and equipment increased $1.7 million during 2021. The Company added $3.4 million in fixed assets from the Landmark merger and purchased $2.2 million in fixed assets throughout 2021. These increases were partially offset by $2.2 million in depreciation expense and $1.5 million in transfers to other assets held-for-sale.

Other assets

During 2021, the $3.2 million, or 57%, increase in other assets was due mostly to a $3.1 million increase in deferred tax assets primarily from the reduction in unrealized gains in the investment portfolio.

Results of Operations

Overview

For the year ended December 31, 2021, the Company generated net income of $24.0 million, or $4.48 per diluted share, compared to $13.0 million, or $2.82 per diluted share, for the year ended December 31, 2020. The $11.0 million, or 84%, increase in net income stemmed from $17.6 million more net interest income, $3.6 million in additional non-interest income and $3.3 million lower provision for loan losses which more than offset an $11.8 million rise in non-interest expenses and $1.7 million higher provision for income taxes.

For the year ended December 31, 2021, return on average assets (ROA) and return on average shareholders' equity (ROE) were 1.13% and 12.69%, respectively, compared to 0.87% and 9.06% for the same period in 2020. The increase in ROA and ROE was the result of the growth in net income relative to the increase in average assets and equity during 2021.

Net interest income and interest sensitive assets / liabilities

Net interest income (FTE) increased $18.7 million, or 41%, from $45.3 million for the year ended December 31, 2020 to $64.0 million for the year ended December 31, 2021, due to the higher interest income and lower interest expense. Total average interest-earning assets increased $607.3 million while the FTE yields earned on these assets declined 27 basis points resulting in $17.0 million of growth in FTE interest income. The loan portfolio contributed the most to this growth due to average balance growth of $280.6 million which had the effect of producing $12.2 million more FTE interest income, including $2.0 million in additional fees earned under the Paycheck Protection Program (PPP). In the investment portfolio, an increase in the average balances of municipal securities was the biggest driver of interest income growth. The average balance of total securities grew $291.1 million producing $4.8 million in additional FTE interest income despite a decrease of 44 basis points in yields earned on investments. On the liability side, total interest-bearing liabilities grew $392.7 million in average balances with a 27 basis point decrease in rates paid on these interest-bearing liabilities. Growth in average interest-bearing deposits of $442.4 million was offset by the effect of a 26 basis point reduction in rates paid on these deposits lowering interest expense by $1.3 million. In addition, the Company utilized $49.7 million less in average borrowings in 2021 compared to 2020 resulting in $0.4 million less interest expense from borrowings.

The FTE net interest rate spread was unchanged at 3.16% for the years ended December 31, 2021 and 2020. The FTE net interest rate margin decreased by 7 basis points, respectively, for the year ended December 31, 2021 compared to the year ended December 31, 2020. The yields earned on interest-earning assets declined at the same pace as the decline in the rates paid on interest-bearing liabilities causing the net interest rate spread to remain flat. The decrease in net interest rate margin was due to the higher average balance of interest-bearing cash. The overall cost of funds, which includes the impact of non-interest bearing deposits, decreased 21 basis points for the year ended December 31, 2021 compared to the same period in 2020. The primary reason for the decline was the reduction in rates paid on deposits coupled with the increased average balances of non-interest bearing deposits.

The Company's cost of interest-bearing liabilities was 0.26% for the year ended December 31, 2021, or 27 basis points lower than the cost for the year ended December 31, 2020. The decrease in interest paid on both deposits and borrowings contributed to the lower cost of interest-bearing liabilities.

Provision for loan losses

For the twelve months ended December 31, 2021 and 2020, the Company recorded a provision for loan losses of $2.0 million and $5.3 million, respectively, a $3.3 million, or 62%, decrease. The decrease in the provision for loan losses from the year earlier period was primarily attributed to the COVID-related provisioning that occurred during the twelve months ended December 31, 2020, which was not similarly warranted during the twelve months ended December 31, 2021 due to the higher level of economic certainty in the Company's operating area when compared to the year earlier period.

Other income

For the year ended December 31, 2021, non-interest income amounted to $18.3 million, a $3.6 million, or 25%, increase compared to $14.7 million recorded for the year ended December 31, 2020. Interchange fees grew $1.1 million due to a higher volume of debit card transactions. Wealth management fees (fees from trust fiduciary activities and financial services) increased $0.7 million year-over-year as assets under management and administration grew from $364 million to $427 million. Gains on loan sales were $0.6 million higher for the year ended December 31, 2021 than the year earlier period due to the higher dollar amount of loans sold. Service charges on deposits increased $0.5 million. Earnings on bank-owned life insurance increased $0.4 million from the larger amount of BOLI due to the Landmark acquisition. Service charges on loans were $0.3 million higher in 2021 compared to 2020 primarily driven by more fees for commercial loans.

Other operating expenses

For the year ended December 31, 2021, total other operating expenses totaled $50.1 million, an increase of $11.8 million, or 31%, compared to $38.3 million for the year ended December 31, 2020. Merger related expenses were $0.5 million of this increase. Salaries and employee benefits contributed the most to the increase rising $5.4 million, or 27%, in 2021 compared to 2020. The basis of the increase includes $3.0 million higher salaries with more full-time equivalent employees, $1.7 million increase in employee bonuses, $0.8 million more in group insurance and $0.5 million higher commissions. These increases in salaries and employee benefits were partially offset by $0.9 million more in loan origination costs deferred. Premises and equipment expenses were $1.4 million higher due to an increase in depreciation, equipment maintenance and rental expenses. Advertising and marketing increased $1.0 million due to more advertising and donations in 2021. Professional services were $0.5 million higher due to pandemic-related expenses and higher consulting and audit expenses. The FDIC assessment was $0.4 million higher due to the larger average assets. Automated transaction processing expenses increased $0.3 million. Data processing and communications expense increased $0.3 million during 2021 compared to 2020 because of additional costs for data center services from more accounts and additional branches.

The ratios of non-interest expense less non-interest income to average assets, known as the expense ratio, at December 31, 2021 and 2020 were 1.50% and 1.58%, respectively. The expense ratio decreased because of increased levels of average assets. The efficiency ratio decreased from 63.92% at December 31, 2020 to 60.92% at December 31, 2021 due to revenue increasing faster than expenses in 2021.

Provision for income taxes

The Company's effective income tax rate approximated 14.3% in 2021 and 14.7% in 2020. The difference between the effective rate and the enacted statutory corporate rate of 21% is due mostly to the effect of tax-exempt income in relation to the level of pre-tax income. The provision for income taxes increased $1.8 million, or 78%, from $2.2 million at December 31, 2020 to $4.0 million at December 31, 2021. The increase was primarily due to higher pre-tax income in 2021 which partially offset the effect of higher tax-exempt interest income.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Lending commitments include commitments to originate loans and commitments to fund unused lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

In addition to lending commitments, the Company has contractual obligations related to operating lease and capital lease commitments. Operating lease commitments are obligations under various non-cancelable operating leases on buildings and land used for office space and banking purposes. Capital lease commitments are obligations on buildings and equipment.

The following table presents, as of December 31, 2022, the Company's significant determinable contractual obligations and significant commitments by payment date. The payment amounts represent those amounts contractually due to the recipient, excluding interest:

(dollars in thousands)	One year or less	Over one year through three years	Over three years through five years	Over five years	Total
Contractual obligations:					
Certificates of deposit	$ 76,685	$ 34,321	$ 5,467	$ 721	$ 117,194
Secured borrowings	853	20	-	6,693	7,566
Short-term borrowings	12,940	-	-	-	12,940
Operating leases	695	1,285	1,289	10,147	13,416
Finance leases	227	332	300	313	1,172
Commitments:					
Letters of credit	9,062	6,565	-	1,007	16,634
Loan commitments (1)	65,151	-	-	-	65,151
Total	$ 165,613	$ 42,523	$ 7,056	$ 18,881	$ 234,073

(1) Available credit to borrowers in the amount of $325.5 million is excluded from the above table since, by its nature, the borrowers may not have the need for additional funding, and, therefore, the credit may or may not be disbursed by the Company.

Related Party Transactions

Information with respect to related parties is contained in Note 16, "Related Party Transactions", within the notes to the consolidated financial statements, and incorporated by reference in Part II, Item 8.

Impact of Accounting Standards and Interpretations

Information with respect to the impact of accounting standards is contained in Note 19, "Recent Accounting Pronouncements", within the notes to the consolidated financial statements, and incorporated by reference in Part II, Item 8.

Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with U.S. GAAP, which requires the measurement of the Company's financial condition and results of operations in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial businesses, most all of the Company's assets and liabilities are financial in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation as interest rates do not necessarily move in the same direction or, to the same extent, as the price of goods and services.

Capital Resources

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

Under these guidelines, assets and certain off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting ratios represent capital as a percentage of total risk-weighted assets and certain off-balance sheet items. The guidelines require all banks and bank holding companies to maintain minimum ratios for capital adequacy purposes. Refer to the information with respect to capital requirements contained in Note 15, "Regulatory Matters", within the notes to the consolidated financial statements, and incorporated by reference in Part II, Item 8.

During the year ended December 31, 2022, total shareholders' equity decreased $48.8 million, or 23%, due principally to a $71.3 million after tax reduction in the net unrealized gain position to a net unrealized loss position in the Company's investment portfolio, $7.7 million of cash dividends declared on the Company's common stock and $1.3 million in treasury stock purchases. Partially offsetting these decreases, capital was enhanced by $30.0 million in net income added into retained earnings, $0.3 million from investments in the Company's common stock via the Employee Stock Purchase Plan (ESPP) and $1.3 million from stock-based compensation expense from the ESPP and restricted stock and SSARs. The Company's dividend payout ratio, defined as the rate at which current earnings are paid to shareholders, was 25.7% for the year ended December 31, 2022. The balance of earnings is retained to further strengthen the Company's capital position. The Company's sources (uses) of capital during the previous five years are indicated below:

(dollars in thousands)	Net income	Cash dividends declared	Other retained earnings adjustments	Earnings retained	DRP and ESPP infusion	Issuance of common stock for acquisition	Changes in AOCI and other changes	Capital retained (utilized)
2022	**$ 30,021**	**$ (7,709)**	**$ -**	**$ 22,312**	**$ 252**	**$ -**	**$ (71,343)**	**$ (48,779)**
2021	24,008	(6,608)	-	17,400	270	35,056	(7,667)	45,059
2020	13,035	(5,378)	-	7,657	219	45,408	6,551	59,835
2019	11,576	(4,037)	(91)	7,448	175	-	5,655	13,278
2018	11,006	(3,708)	421	7,719	460	-	(2,005)	6,174

As of December 31, 2022, the Company reported a net unrealized loss position of $71.1 million, net of tax, from the securities AFS portfolio compared to a net unrealized gain of $0.2 million as of December 31, 2021. The $71.3 million decline during 2022 was from the $53.8 million reduction in net unrealized gains to net unrealized losses on AFS securities, net of tax, and $17.5 million in net unrealized losses on HTM securities transferred from AFS, net of tax. Lower unrealized gains and higher unrealized losses on all types of securities contributed to the net unrealized losses in investment portfolio. Management believes that changes in fair value of the Company's securities are due to changes in interest rates and not in the creditworthiness of the issuers.

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

To help maintain a healthy capital position, the Company can issue stock to participants in the DRP and ESPP plans. The DRP affords the Company the option to acquire shares in open market purchases and/or issue shares directly from the Company to plan participants. During 2022, the Company acquired shares in the open market to fulfill the needs of the DRP. Both the DRP and the ESPP plans have been a consistent source of capital from the Company's loyal employees and shareholders and their participation in these plans will continue to help strengthen the Company's balance sheet.

See the section entitled “Supervision and Regulation”, below for a discussion on regulatory capital changes and other recent enactments, including a summary of the federal banking agencies final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act.

Liquidity

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

The Company’s contingency funding plan (CFP) sets a framework for handling liquidity issues in the event circumstances arise which the Company deems to be less than normal. The Company established guidelines for identifying, measuring, monitoring and managing the resolution of potentially serious liquidity crises. The CFP outlines required monitoring tools, acceptable alternative funding sources and required actions during various liquidity scenarios. Thus, the Company has implemented a proactive means for the measurement and resolution for handling potentially significant adverse liquidity conditions. At least quarterly, the CFP monitoring tools, current liquidity position and monthly projected liquidity sources and uses are presented and reviewed by the Company’s Asset/Liability Committee. As of December 31, 2022, the Company had not experienced any adverse issues that would give rise to its inability to raise liquidity in an emergency situation.

During the year ended December 31, 2022, the Company utilized $67.8 million of cash. During the period, the Company’s operations provided approximately $49.4 million mostly from $73.3 million of net cash inflow from the components of net interest income plus $11.9 million in proceeds over originations of loans HFS partially offset by net non-interest expense/income related payments of $33.1 million and $3.1 million in quarterly estimated tax payments. Cash inflow from interest-earning assets, short-term borrowings and loan payments were used to purchase investment securities and replace maturing and cash runoff of securities, fund the loan portfolio, invest in bank premises and equipment and make net dividend payments. The Company received a large amount of public deposits over the past six years. The seasonal nature of deposits from municipalities and other public funding sources requires the Company to be prepared for the inherent volatility and the unpredictable timing of cash outflow from this customer base, including maintaining the requirements to pledge investment securities. Accordingly, the use of short-term overnight borrowings could be used to fulfill funding gap needs. The CFP is a tool to help the Company ensure that alternative funding sources are available to meet its liquidity needs.

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

During 2021 and 2022, the Company also experienced deposit inflow resulting from businesses and municipalities that received relief from the CARES Act, American Rescue Plan Act and other government stimulus. There is uncertainty about the length of time that these deposits will remain which could require the Company to maintain elevated cash balances. The Company had approximately $97 million in American Rescue Plan Act funds in public deposit accounts at December 31, 2022 that may be disbursed during 2023 resulting in declines in public deposits. The Company will continue to monitor deposit fluctuation for other significant changes.

As of December 31, 2022, the Company maintained $29.1 million in cash and cash equivalents and $422.5 million of investments AFS and loans HFS. Also as of December 31, 2022, the Company had approximately $602.2 million available to borrow from the FHLB, $31.0 million from correspondent banks, $112.0 million from the FRB and $365.4 million from the IntraFi Network One-Way Buy program. The combined total of $1,562.2 million represented 66% of total assets at December 31, 2022. Management believes this level of liquidity to be strong and adequate to support current operations.

On March 12, 2023, the Federal Reserve Board announced the creation of a new Bank Term Funding Program (BTFP). The Company would be able to borrow advances through the BTFP using certain types of securities as collateral. The qualifying assets used as collateral would be valued at par.

For a discussion on the Company’s significant determinable contractual obligations and significant commitments, see “Off-Balance Sheet Arrangements and Contractual Obligations,” above.

Management of interest rate risk and market risk analysis

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

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

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

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

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

To manage this interest rate sensitivity gap position, an asset/liability model commonly known as cumulative gap analysis is used to monitor the difference in the volume of the Company's interest sensitive assets and liabilities that mature or re-price within given time intervals. A positive gap (asset sensitive) indicates that more assets will re-price during a given period compared to liabilities, while a negative gap (liability sensitive) indicates the opposite effect. The Company employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO to gauge the effects of the interest rate changes on interest-sensitive assets and liabilities in order to determine what impact these rate changes will have upon the net interest spread. At December 31, 2022, the Company maintained a one-year cumulative gap of negative (liability sensitive) $105.5 million, or -4%, of total assets. The effect of this negative gap position provided a mismatch of assets and liabilities which may expose the Company to interest rate risk during periods of rising interest rates. Conversely, in a decreasing interest rate environment, net interest income could be positively impacted because more liabilities than assets will re-price downward during the one-year period.

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

The following table reflects the re-pricing of the balance sheet or "gap" position at December 31, 2022:

(dollars in thousands)	Three months or less	More than three months to twelve months	More than one year to three years	More than three years	Total
Cash and cash equivalents	$ 25,549	$ -	$ -	$ 3,542	$ 29,091
Investment securities (1)(2)	8,395	24,126	60,027	556,326	648,874
Loans and leases (2)	313,844	216,645	421,556	596,617	1,548,662
Fixed and other assets	-	54,035	-	97,710	151,745
Total assets	$ 347,788	$ 294,806	$ 481,583	$ 1,254,195	$ 2,378,372
Total cumulative assets	$ 347,788	$ 642,594	$ 1,124,177	$ 2,378,372	
Non-interest-bearing transaction deposits (3)	$ -	$ 60,321	$ 165,596	$ 376,691	$ 602,608
Interest-bearing transaction deposits (3)	591,794	-	342,114	513,173	1,447,081
Certificates of deposit	24,308	52,478	34,337	6,101	117,224
Secured borrowings	6,287	-	1,332	-	7,619
Short-term borrowings	12,940	-	-	-	12,940
Other liabilities	-	-	-	27,950	27,950
Total liabilities	$ 635,329	$ 112,799	$ 543,379	$ 923,915	$ 2,215,422
Total cumulative liabilities	$ 635,329	$ 748,128	$ 1,291,507	$ 2,215,422	
Interest sensitivity gap	$ (287,541)	$ 182,007	$ (61,796)	$ 330,280	
Cumulative gap	$ (287,541)	$ (105,534)	$ (167,330)	$ 162,950	
Cumulative gap to total assets	(12.1)%	(4.4)%	(7.0)%	6.9%	

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

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

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

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

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

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

The following table illustrates the simulated impact of an immediate 200 basis points upward or downward movement in interest rates on net interest income, net income and the change in the economic value (portfolio equity). This analysis assumed that the adjusted interest-earning asset and interest-bearing liability levels at December 31, 2022 remained constant. The impact of the rate movements was developed by simulating the effect of the rate change over a twelve-month period from the December 31, 2022 levels:

	% change	
	Rates +200	Rates -200
Earnings at risk:		
Net interest income	(4.4)%	(2.5)%
Net income	(7.5)	(5.9)
Economic value at risk:		
Economic value of equity	(12.0)	1.6
Economic value of equity as a percent of total assets	(1.8)	0.2

Economic value has the most meaning when viewed within the context of risk-based capital. Therefore, the economic value may normally change beyond the Company’s policy guideline for a short period of time as long as the risk-based capital ratio (after adjusting for the excess equity exposure) is greater than 10%. At December 31, 2022, the Company’s risk-based capital ratio was 14.35%.

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

(dollars in thousands)	Net interest income	$ variance	% variance
Simulated change in interest rates			
+200 basis points	$ 77,526	$ (3,546)	(4.4)%
+100 basis points	79,715	(1,357)	(1.7)%
Flat rate	81,072	-	-%
-100 basis points	80,460	(612)	(0.8)%
-200 basis points	79,009	(2,063)	(2.5)%

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

Supervision and Regulation

The following is a brief summary of the regulatory environment in which the Company and the Bank operate and is not designed to be a complete discussion of all statutes and regulations affecting such operations, including those statutes and regulations specifically mentioned herein. Changes in the laws and regulations applicable to the Company and the Bank can affect the operating environment in substantial and unpredictable ways. We cannot accurately predict whether legislation will ultimately be enacted, and if enacted, the ultimate effect that legislation or implementing regulations would have on our financial condition or results of operations. While banking regulations are material to the operations of the Company and the Bank, it should be noted that supervision, regulation and examination of the Company and the Bank are intended primarily for the protection of depositors, not shareholders.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act (SOX), also known as the "Public Company Accounting Reform and Investor Protection Act," was established in 2002 and introduced major changes to the regulation of financial practice. SOX represents a comprehensive revision of laws affecting corporate governance, accounting obligations, and corporate reporting. SOX is applicable to all companies with equity or debt securities that are either registered, or file reports under the Securities Exchange Act of 1934. In particular, SOX establishes: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) additional responsibilities regarding financial statements for the Principal Executive Officer and Principal Financial Officer of the reporting company; (iii) standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) increased civil and criminal penalties for violations of the securities laws.

Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)

The FDICIA established five different levels of capitalization of financial institutions, with "prompt corrective actions" and significant operational restrictions imposed on institutions that are capital deficient under the categories. The five categories are:

- well capitalized;
- adequately capitalized;
- undercapitalized;
- significantly undercapitalized, and
- critically undercapitalized.

To be considered well capitalized, an institution must have a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 8%, a leverage capital ratio of at least 5%, and must not be subject to any order or directive requiring the institution to improve its capital level. An institution falls within the adequately capitalized category if it has a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 6%, and a leverage capital ratio of at least 4%. Institutions with lower capital levels are deemed to be undercapitalized, significantly undercapitalized or critically undercapitalized, depending on their actual capital levels. In addition, the appropriate federal regulatory agency may downgrade an institution to the next lower capital category upon a determination that the institution is in an unsafe or unsound condition, or is engaged in an unsafe or unsound practice. Institutions are required under the FDICIA to closely monitor their capital levels and to notify their appropriate regulatory agency of any basis for a change in capital category.

Regulatory oversight of an institution becomes more stringent with each lower capital category, with certain "prompt corrective actions" imposed depending on the level of capital deficiency.

Recent Legislation and Rulemaking

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began on January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) began compliance on January 1, 2014. The final rules call for the following capital requirements:

- A minimum ratio of common tier 1 capital to risk-weighted assets of 4.5%.
- A minimum ratio of tier 1 capital to risk-weighted assets of 6%.
- A minimum ratio of total capital to risk-weighted assets of 8% (no change from current rule).
- A minimum leverage ratio of 4%.

In addition, the final rules established a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments.

The final rules will not have a material impact on the Company's capital, operations, liquidity and earnings.

JOBS Act

The Jumpstart Our Business Startups Act (the "JOBS Act") is aimed at facilitating capital raising by smaller companies and banks and bank holding companies by implementing the following changes:

- raising the threshold requiring registration under the Securities Exchange Act of 1934 (the "Exchange Act") for banks and bank holdings companies from 500 to 2,000 holders of record;
- raising the threshold for triggering deregistration under the Exchange Act for banks and bank holding companies from 300 to 1,200 holders of record;
- raising the limit for Regulation A offerings from $5 million to $50 million per year and exempting some Regulation A offerings from state blue sky laws;
- permitting advertising and general solicitation in Rule 506 and Rule 144A offerings;
- allowing private companies to use "crowdfunding" to raise up to $1 million in any 12-month period, subject to certain conditions; and
- creating a new category of issuer, called an "Emerging Growth Company," for companies with less than $1 billion in annual gross revenue, which will benefit from certain changes that reduce the cost and burden of carrying out an equity IPO and complying with public company reporting obligations for up to five years.

The JOBS Act did not have any immediate application to the Company. However, management continues to monitor the implementation rules for potential effects which might benefit the Company.

Dodd-Frank Wall Street Reform and Consumer Protection Act.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) became law. Dodd-Frank is intended to effect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank creates a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank additionally creates a new independent federal regulator to administer federal consumer protection laws. Dodd-Frank is expected to have a significant impact on our business operations as its provisions take effect. Overtime, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense. Among the provisions that are likely to affect us and the community banking industry are the following:

Holding Company Capital Requirements. Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, pooled trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank holding company with less than $15 billion in assets. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

Deposit Insurance. Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, and extended unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Dodd-Frank also eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance. Dodd-Frank requires publicly traded companies to give shareholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on "golden parachute" payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The SEC has finalized the rules implementing these requirements. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Prohibition Against Charter Conversions of Troubled Institutions. Dodd-Frank prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating thereto.

Interstate Branching. Dodd-Frank authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

Limits on Interstate Acquisitions and Mergers. Dodd-Frank precludes a bank holding company from engaging in an interstate acquisition – the acquisition of a bank outside its home state – unless the bank holding company is both well capitalized and well managed. Furthermore, a bank may not engage in an interstate merger with another bank headquartered in another state unless the surviving institution will be well capitalized and well managed. The previous standard in both cases was adequately capitalized and adequately managed.

Limits on Interchange Fees. Dodd-Frank amends the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. The interchange rules became effective on October 1, 2011.

Consumer Financial Protection Bureau. Dodd-Frank creates a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, Dodd-Frank will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

In summary, the Dodd-Frank Act provides for sweeping financial regulatory reform and may have the effect of increasing the cost of doing business, limiting or expanding permissible activities and affect the competitive balance between banks and other financial intermediaries. While many of the provisions of the Dodd-Frank Act do not impact the existing business of the Company, the extension of FDIC insurance to all non-interest bearing deposit accounts and the repeal of prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts, will likely increase deposit funding costs paid by the Company in order to retain and grow deposits. In addition, the limitations imposed on the assessment of interchange fees have reduced the Company's ability to set revenue pricing on debit and credit card transactions. Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry as a whole. The Company will continue to monitor legislative developments and assess their potential impact on our business.

Department of Defense Military Lending Rule. In 2015, the U.S. Department of Defense issued a final rule which restricts pricing and terms of certain credit extended to active duty military personnel and their families. This rule, which was implemented effective October 3, 2016, caps the interest rate on certain credit extensions to an annual percentage rate of 36% and restricts other fees. The rule requires financial institutions to verify whether customers are military personnel subject to the rule. The impact of this final rule, and any subsequent amendments thereto, on the Company's lending activities and the Company's statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential side effects on the Company's business.

Future Federal and State Legislation and Rulemaking

From time-to-time, various types of federal and state legislation have been proposed that could result in additional regulations and restrictions on the business of the Company and the Bank. We cannot predict whether legislation will be adopted, or if adopted, how the new laws would affect our business. As a consequence, we are susceptible to legislation that may increase the cost of doing business. Management believes that the effect of any current legislative proposals on the liquidity, capital resources and the results of operations of the Company and the Bank will be minimal.

It is possible that there will be regulatory proposals which, if implemented, could have a material effect upon our liquidity, capital resources and results of operations. In addition, the general cost of compliance with numerous federal and state laws does have, and in the future may have, a negative impact on our results of operations. As with other banks, the status of the financial services industry can affect the Bank. Consolidations of institutions are expected to continue as the financial services industry seeks greater efficiencies and market share. Bank management believes that such consolidations may enhance the Bank's competitive position as a community bank.

Future Outlook

The Company is highly impacted by local economic factors that could influence the performance and strength of our loan portfolios and results of operations. Economic uncertainty continues due to inflationary pressures, rising interest rates and global risks such as war, terrorism and geopolitical instability. A consensus of economists predicts rising short-term rates during 2023. Uncertainty surrounding the velocity and timing of rate increases and the effect on the interest rate margin is the Company's greatest interest rate risk. Earning-asset yields are expected to improve throughout the year stemming from the rising rate environment while rates on interest-bearing liabilities are expected to rise to a lesser extent. Jobs grew in December 2022 from a year earlier in the Scranton/Wilkes-Barre/Hazleton and Allentown/Bethlehem/Easton metropolitan statistical areas. We believe expanding our market area gives us opportunity for growth and we will continue to monitor the economic climate in our region, scrutinize growth prospects and proactively observe existing credits for early warning signs of risk deterioration.

In addition to the challenging economic environment, regulatory oversight has changed significantly in recent years. As described in more detail in the "supervision and regulation" section above, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The rules revise the quantity and quality of required minimum risk-based and leverage capital requirements and revise the calculation of risk-weighted assets.

Management believes that the Company is prepared to face the challenges ahead. We expect that there could be a decline in asset quality from the current historically low levels. Our conservative approach to loan underwriting we believe will help keep non-performing asset levels at bay. The Company expects to overcome the further inversion of the yield curve by cautiously growing the balance sheet to enhance financial performance. We intend to grow all lending portfolios in both the business and retail sectors using growth in market-place low costing deposits to stabilize net interest margin and to enhance revenue performance.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by 7A is set forth at Item 7, under "Liquidity" and "Management of interest rate risk and market risk analysis," contained within management's discussion and analysis of financial condition and results of operations and incorporated herein by reference.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Fidelity D & D Bancorp, Inc. and Subsidiary

Opinion on the Financial Statements
We have audited the accompanying consolidated balance sheets of Fidelity D & D Bancorp, Inc. and subsidiary (the Company) as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2022, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2022, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion
These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters
The critical audit matter communicated below is a are matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for loan losses – Qualitative Factors
The allowance for loan losses as of December 31, 2022, was $17.1 million. As described in Notes 1 and 5 to the consolidated financial statements, the allowance for loan losses is established through a provision for loan losses and represents an amount which, in management's judgement, will be adequate to absorb losses on existing loans. The allowance consists of specific and general components in the amounts of $0.2 million and $16.9 million, respectively. The general loan loss allocation is set based upon a representative average historical net charge-off rate adjusted for the following qualitative factors: delinquency and nonaccrual trends, volume and loan term trends, changes in the lending policy, changes in legal and regulatory requirements, national and local economic trends and conditions, changes in concentrations of credit, changes in risk selection and underwriting standards, the experience, ability and depth of lending management, and charge-off and recovery trends. The evaluation of the qualitative factors requires a significant amount of judgement by management and involves a high degree of subjectivity.

We identified the qualitative factor component of the allowance for loan losses as a critical audit matter as auditing the underlying qualitative factors required significant auditor judgment as amounts determined by management rely on analysis that is often subjective in nature and the estimate is highly sensitive to changes in significant assumptions.

Our audit procedures related to the qualitative factors of the allowance for loan losses included the following, among others:

- We obtained an understanding of the relevant controls related to management's assessment and review of the qualitative factors, and tested such controls for design and operating effectiveness, including controls over management's establishment, review and approval of the qualitative factors including the data used in determining the qualitative factors.
- We obtained an understanding of how management developed the estimates and related assumptions, including:
  - Testing completeness and accuracy of key data inputs used in forming assumptions or calculations and testing the reliability of the underlying data on which these factors are based by comparing information to source documents and external information sources.
  - Evaluating the reasonableness of the qualitative factors established by management as compared to the underlying internal or external information sources.

/s/ RSM US LLP

We have served as the Company's auditor since 2015.

Blue Bell, Pennsylvania
March 20, 2023

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Balance Sheets

	As of December 31,	
(dollars in thousands)	**2022**	2021
Assets:		
Cash and due from banks	**$ 3,542**	$ 27,317
Interest-bearing deposits with financial institutions	**25,549**	69,560
Total cash and cash equivalents	**29,091**	96,877
Available-for-sale securities	**420,862**	738,980
Held-to-maturity securities (fair value of $187,280 in 2022; $0 in 2021)	**222,744**	-
Restricted investments in bank stock	**5,268**	3,206
Loans and leases, net (allowance for loan losses of $17,149 in 2022; $15,624 in 2021)	**1,547,025**	1,417,504
Loans held-for-sale (fair value $1,660 in 2022; $32,013 in 2021)	**1,637**	31,727
Foreclosed assets held-for-sale	**168**	434
Bank premises and equipment, net	**31,307**	29,310
Leased property under finance leases, net	**1,089**	1,307
Right-of-use assets	**8,642**	9,006
Cash surrender value of bank owned life insurance	**54,035**	52,745
Accrued interest receivable	**8,487**	7,526
Goodwill	**19,628**	19,628
Core deposit intangible, net	**1,540**	1,942
Other assets	**26,849**	8,912
Total assets	**$ 2,378,372**	$ 2,419,104
Liabilities:		
Deposits:		
Interest-bearing	**$ 1,564,305**	$ 1,579,582
Non-interest-bearing	**602,608**	590,283
Total deposits	**2,166,913**	2,169,865
Accrued interest payable and other liabilities	**17,483**	15,943
Finance lease obligation	**1,110**	1,320
Operating lease liabilities	**9,357**	9,627
Short-term borrowings	**12,940**	-
Secured borrowings	**7,619**	10,620
Total liabilities	**2,215,422**	2,207,375
Shareholders' equity:		
Preferred stock authorized 5,000,000 shares with no par value; none issued	**-**	-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 5,630,794 at December 31, 2022; and 5,645,687 at December 31, 2021)	**115,611**	114,108
Retained earnings	**119,754**	97,442
Accumulated other comprehensive (loss) income	**(71,152)**	179
Treasury stock, at cost (32,663 shares at December 31, 2022 and no shares at December 31, 2021)	**(1,263)**	-
Total shareholders' equity	**162,950**	211,729
Total liabilities and shareholders' equity	**$ 2,378,372**	$ 2,419,104

See notes to consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Income

(dollars in thousands except per share data)	Years Ended December 31, 2022	2021	2020
Interest income:			
Loans and leases:			
Taxable	**$ 62,110**	$ 53,918	$ 41,985
Nontaxable	**1,910**	1,513	1,256
Interest-bearing deposits with financial institutions	**886**	148	121
Restricted investments in bank stock	**184**	127	162
Investment securities:			
U.S. government agency and corporations	**6,321**	4,068	3,197
States and political subdivisions (nontaxable)	**5,466**	4,413	2,374
States and political subdivisions (taxable)	**1,795**	1,281	398
Other securities	**-**	-	3
Total interest income	**78,672**	65,468	49,496
Interest expense:			
Deposits	**6,144**	3,456	4,756
Secured borrowings	**209**	156	-
Other short-term borrowings	**45**	1	248
FHLB advances	**-**	26	307
Total interest expense	**6,398**	3,639	5,311
Net interest income	**72,274**	61,829	44,185
Provision for loan losses	**2,100**	2,000	5,250
Net interest income after provision for loan losses	**70,174**	59,829	38,935
Other income:			
Service charges on deposit accounts	**3,475**	2,623	2,117
Interchange fees	**4,532**	4,286	3,153
Service charges on loans	**1,316**	1,980	1,681
Fees from trust fiduciary activities	**2,481**	2,253	1,785
Fees from financial services	**955**	984	749
Fees and other revenue	**1,161**	902	813
Earnings on bank-owned life insurance	**1,290**	1,227	794
Gain (loss) on write-down, sale or disposal of:			
Loans	**1,623**	4,172	3,603
Available-for-sale debt securities	**4**	46	115
Premises and equipment	**(195)**	(186)	(142)
Total other income	**16,642**	18,287	14,668
Other expenses:			
Salaries and employee benefits	**26,977**	24,106	17,863
Premises and equipment	**7,624**	6,998	5,623
Data processing and communication	**2,635**	2,566	2,246
Advertising and marketing	**3,381**	3,253	2,269
Professional services	**3,441**	3,415	2,869
Merger-related expenses	**-**	3,033	2,452
Automated transaction processing	**1,557**	1,479	1,158
Office supplies and postage	**682**	640	541
PA shares tax	**716**	395	381
Loan collection	**248**	126	131
Other real estate owned	**15**	29	28
FDIC assessment	**694**	679	280
FHLB prepayment fee	**-**	369	481
Other	**3,378**	3,019	1,997
Total other expenses	**51,348**	50,107	38,319
Income before income taxes	**35,468**	28,009	15,284
Provision for income taxes	**5,447**	4,001	2,249
Net income	**$ 30,021**	$ 24,008	$ 13,035
Per share data:			
Net income - basic	**$ 5.32**	$ 4.51	$ 2.84
Net income - diluted	**$ 5.29**	$ 4.48	$ 2.82
Dividends	**$ 1.35**	$ 1.23	$ 1.14

See notes to consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

	Years Ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Net income	**$ 30,021**	$ 24,008	$ 13,035
Other comprehensive (loss) gain, before tax:			
Unrealized holding loss on available-for-sale debt securities	**(68,102)**	(11,059)	6,887
Reclassification adjustment for net gains realized in income	**(4)**	(46)	(115)
Reclassification of unrealized loss on securities transferred from available-for-sale to held-to-maturity	**(23,882)**	-	-
Amortization of unrealized loss on held-to-maturity securities	**1,695**	-	-
Net unrealized loss	**(90,293)**	(11,105)	6,772
Tax effect	**18,962**	2,332	(1,422)
Unrealized loss, net of tax	**(71,331)**	(8,773)	5,350
Other comprehensive loss, net of tax	**(71,331)**	(8,773)	5,350
Total comprehensive (loss) income, net of tax	**$ (41,310)**	$ 15,235	$ 18,385

See notes to consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 31, 2022, 2021 and 2020

(dollars in thousands)	Capital stock Shares	Capital stock Amount	Retained earnings	Accumulated other comprehensive income (loss)	Treasury Stock	Total
Balance, December 31, 2019	3,781,500	$ 30,848	$ 72,385	$ 3,602	$ -	$ 106,835
Net income			13,035			13,035
Other comprehensive income				5,350		5,350
Issuance of common stock through Employee Stock Purchase Plan	3,885	219				219
Issuance of common stock from vested restricted share grants through stock compensation plans	15,395					-
Stock-based compensation expense		1,201				1,201
Issuance of common stock for acquisition	1,176,970	45,408				45,408
Cash dividends declared			(5,378)			(5,378)
Balance, December 31, 2020	4,977,750	$ 77,676	$ 80,042	$ 8,952	$ -	$ 166,670
Net income			24,008			24,008
Other comprehensive loss				(8,773)		(8,773)
Issuance of common stock through Employee Stock Purchase Plan	4,738	270				270
Issuance of common stock from vested restricted share grants through stock compensation plans	13,209					-
Issuance of common stock through exercise of SSARs	2,000					-
Stock-based compensation expense		1,106				1,106
Issuance of common stock for acquisition	647,990	35,056				35,056
Cash in lieu of fractional shares						-
Cash dividends declared			(6,608)			(6,608)
Balance, December 31, 2021	5,645,687	$ 114,108	$ 97,442	$ 179	$ -	$ 211,729
Net income			**30,021**			**30,021**
Other comprehensive loss				**(71,331)**		**(71,331)**
Issuance of common stock through Employee Stock Purchase Plan	**4,891**	**252**				**252**
Forfeited restricted dividend reinvestment shares	**(109)**					-
Issuance of common stock from vested restricted share grants through stock compensation plans	**11,699**					-
Issuance of common stock through exercise of SSARs	**1,180**					-
Stock-based compensation expense		**1,271**				**1,271**
Common stock repurchased	**(32,554)**				**(1,263)**	**(1,263)**
Repurchase of shares to cover withholdings		**(20)**				**(20)**
Cash dividends declared			**(7,709)**			**(7,709)**
Balance, December 31, 2022	**5,630,794**	**$ 115,611**	**$ 119,754**	**$ (71,152)**	**$ (1,263)**	**$ 162,950**

See notes to consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	Years Ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Cash flows from operating activities:			
Net income	**$ 30,021**	$ 24,008	$ 13,035
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization and accretion	**5,255**	5,423	4,539
Provision for loan losses	**2,100**	2,000	5,250
Deferred income tax expense (benefit)	**1,835**	1,194	(400)
Stock-based compensation expense	**1,271**	1,096	1,077
Excess tax benefit from exercise of SSARs	**12**	26	-
Proceeds from sale of loans held-for-sale	**79,401**	162,343	158,300
Originations of loans held-for-sale	**(67,476)**	(186,768)	(176,939)
Earnings from bank-owned life insurance	**(1,290)**	(1,227)	(794)
Net gain from sales of loans	**(1,623)**	(4,172)	(3,603)
Net gain from sales of investment securities	**(4)**	(46)	(115)
Net gain from sale and write-down of foreclosed assets held-for-sale	**(19)**	(44)	(23)
Net loss from write-down and disposal of bank premises and equipment	**195**	186	142
Operating lease payments	**93**	60	29
Change in:			
Accrued interest receivable	**(961)**	(900)	(985)
Other assets	**(924)**	1,099	(710)
Accrued interest payable and other liabilities	**1,541**	2,921	1,493
Net cash provided by operating activities	**49,427**	7,199	296
Cash flows from investing activities:			
Available-for-sale securities:			
Proceeds from sales	**1,691**	44,474	123,459
Proceeds from maturities, calls and principal pay-downs	**40,749**	54,213	68,906
Purchases	**(42,087)**	(411,406)	(271,504)
(Increase) decrease in restricted investments in bank stock	**(2,061)**	792	2,149
Net (increase) decrease in loans and leases	**(116,055)**	7,134	(132,541)
Principal portion of lease payments received under direct finance leases	**5,733**	5,262	3,551
Purchase of life insurance policies	-	-	(11,000)
Purchases of bank premises and equipment	**(5,514)**	(2,520)	(1,390)
Net cash (used in) provided by acquisition	**-**	(3,746)	53,004
Proceeds from sale of bank premises and equipment	**1,095**	1,719	187
Proceeds from sale of foreclosed assets held-for-sale	**1,061**	835	936
Net cash used in investing activities	**(115,388)**	(303,243)	(164,243)
Cash flows from financing activities:			
Net (decrease) increase in deposits	**(2,916)**	351,903	278,342
Net increase (decrease) in other borrowings	**10,063**	(12,223)	(37,839)
Proceeds from Paycheck Protection Program Liquidity Facility (PPPLF)	-	-	152,791
Repayment of PPPLF	-	-	(152,791)
Repayment of FHLB advances	**-**	(9,602)	(17,627)
Repayment of finance lease obligation	**(232)**	(159)	(83)
Purchase of treasury stock	**(1,263)**	-	-
Proceeds from employee stock purchase plan participants	**252**	270	219
Repurchase of shares to cover withholdings	**(20)**	-	-
Dividends paid	**(7,709)**	(6,608)	(5,378)
Cash paid in lieu of fractional shares	**-**	(6)	(4)
Net cash (used in) provided by financing activities	**(1,825)**	323,575	217,630
Net (decrease) increase in cash and cash equivalents	**(67,786)**	27,531	53,683
Cash and cash equivalents, beginning	**96,877**	69,346	15,663
Cash and cash equivalents, ending	**$ 29,091**	$ 96,877	$ 69,346

See notes to consolidated financial statements

Fidelity D & D Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows (continued)

	Years Ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Supplemental Disclosures of Cash Flow Information			
Cash payments for:			
Interest	**$ 6,105**	$ 3,851	$ 5,820
Income tax	**3,050**	2,650	3,250
Supplemental Disclosures of Non-cash Investing Activities:			
Net change in unrealized gains (losses) on available-for-sale securities	**(68,106)**	(11,105)	6,772
Transfers of securities from available-for-sale to held-to-maturity	**245,536**	-	-
Unrealized losses on securities transferred from available-for-sale to held-to-maturity	**(22,188)**	-	-
Transfers from loans to foreclosed assets held-for-sale	**776**	481	800
Transfers from/(to) loans to/(from) loans held-for-sale, net	**(17,907)**	(23,821)	6,642
Transfers from premises and equipment to other assets held-for-sale	**1,184**	1,495	-
Right-of-use asset	**141**	1,519	72
Lease liability	**141**	1,519	72
Transactions related to acquisition			
Increase in assets and liabilities:			
Securities		$ 49,430	$ 123,420
Loans		298,860	245,283
Restricted investments in bank stocks		1,186	692
Premises and equipment		3,405	6,907
Investment in bank-owned life insurance		7,233	9,230
Goodwill		12,575	6,843
Core deposit intangible asset		597	1,973
Leased property under finance leases		1,188	-
Right-of-use assets		756	1,354
Other assets		4,127	2,680
Non-interest-bearing deposits		(100,472)	(118,822)
Interest-bearing deposits		(208,057)	(276,816)
Short-term borrowings		(2,224)	-
FHLB advances		(4,602)	(7,627)
Secured borrowings		(20,619)	-
Finance lease obligation		(1,188)	-
Operating lease liabilities		(756)	(1,354)
Other liabilities		(2,631)	(1,356)
Fair value of common shares issued		(35,056)	(45,408)

See notes to consolidated financial statements

FIDELITY D & D BANCORP, INC.

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Fidelity D & D Bancorp, Inc. and its wholly-owned subsidiary, The Fidelity Deposit and Discount Bank (the Bank) (collectively, the Company). All significant inter-company balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS

The Company provides a full range of banking, trust and financial services to individuals, small businesses and corporate customers. Its primary market areas are Lackawanna, Luzerne and Northampton Counties, Pennsylvania. The Company's primary deposit products are demand deposits and interest-bearing time, money market and savings accounts. It offers a full array of loan products to meet the needs of retail and commercial customers. The Company is subject to regulation by the Federal Deposit Insurance Corporation (FDIC) and the Pennsylvania Department of Banking.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of investment securities, the determination and the amount of impairment in the securities portfolios, and the related realization of the deferred tax assets related to the allowance for loan losses, other-than-temporary impairment on and valuations of investment securities.

In connection with the determination of the allowance for loan losses, management generally obtains independent appraisals for significant properties, utilizes historical loss factors and applies judgement to determine qualitative factor adjustments. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near-term. However, the amount of the change that is reasonably possible cannot be estimated.

The Company’s investment securities are comprised of a variety of financial instruments. The fair values of the securities are subject to various risks including changes in the interest rate environment and general economic conditions including illiquid conditions in the capital markets. Due to the increased level of these risks and their potential impact on the fair values of the securities, it is possible that the amounts reported in the accompanying financial statements could materially change in the near-term. Any credit-related impairment is included as a component of non-interest income in the consolidated income statements while non-credit-related impairment is charged to other comprehensive income, net of tax.

SIGNIFICANT GROUP CONCENTRATION OF CREDIT RISK

The Company originates commercial, consumer, and mortgage loans to customers primarily located in Lackawanna, Luzerne, Northampton, and Lehigh Counties of Pennsylvania. Although the Company has a diversified loan portfolio, a substantial portion of its debtors’ ability to honor their contracts is dependent on the economic sector in which the Company operates. The loan portfolio does not have any significant concentrations from one industry or customer.

HELD-TO-MATURITY SECURITIES

Debt securities, for which the Company has the positive intent and ability to hold to maturity, are reported at cost. Premiums and discounts are amortized or accreted, as a component of interest income over the life of the related security as an adjustment to yield using the interest method. The Company had held-to-maturity securities with balances of $222.7 million and $0 at December 31, 2022 and 2021.

TRADING SECURITIES

Debt securities held principally for resale in the near-term, or trading securities, are recorded at their fair values. Unrealized gains and losses are included in other income. The Company did not have investment securities held for trading purposes during 2022 or 2021.

AVAILABLE-FOR-SALE SECURITIES

Available-for-sale (AFS) securities consist of debt and equity securities classified as neither held-to-maturity nor trading and are reported at fair value. Premiums and discounts are amortized or accreted as a component of interest income over the life of the related security as an adjustment to yield using the interest method. Unrealized holding gains and losses, including non-credit-related other-than-temporary impairment (OTTI), on AFS securities are reported as a separate component of shareholders' equity, net of deferred income taxes, until realized. The net unrealized holding gains and losses are a component of accumulated other comprehensive income. Gains and losses from sales of securities AFS are determined using the specific identification method.

FEDERAL HOME LOAN BANK STOCK

The Company is a member of the Federal Home Loan Bank system, and as such is required to maintain an investment in capital stock of the Federal Home Loan Bank of Pittsburgh (FHLB). The amount the Company is required to invest is dependent upon the relative size of outstanding borrowings the Company has with the FHLB. Based on redemption provisions of the FHLB, the stock has no quoted market value and is carried at cost.

LOANS

Originated loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at face value, net of unamortized loan fees and costs and the allowance for loan losses. Interest on residential real estate loans is recorded based on principal pay downs on an actual days basis. Commercial loan interest is accrued on the principal balance on an actual days basis. Interest on consumer loans is determined using the simple interest method.

Acquired loans are initially recorded at their acquisition date fair values with no carryover of the existing related allowance for loan losses. Fair values are based on a discounted cash flow methodology that involves assumptions and judgements as to credit risk, expected lifetime losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Upon acquisition, in accordance with GAAP, the Company has individually determined whether each acquired loan is within the scope of ASC 310-30. These loans are deemed purchased credit impaired loans and the excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non accretable discount.

Acquired ASC 310-20 loans, which are loans that did not meet the criteria of ASC 310-30, were pooled into groups of similar loans based on various factors including borrower type, loan purpose, and collateral type. These loans are initially recorded at fair value, and include credit and interest rate marks associated with purchase accounting adjustments. Purchase premiums or discounts are subsequently amortized as an adjustment to yield over the estimated contractual lives of the loans. There is no allowance for loan losses established at the acquisition date for acquired performing loans. An allowance for loan losses is recorded for any credit deterioration in these individual loans subsequent to acquisitions.

Generally, loans are placed on non-accrual status when principal or interest is past due 90 days or more. When a loan is placed on non-accrual status, all interest previously accrued but not collected is charged against current earnings. Any payments received on non-accrual loans are applied, first to the outstanding loan amounts, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of lost interest.

Acquired loans that meet the criteria for impaired or non-accrual status prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company expects to fully collect the fair value of the loans.

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the Company grants a concession that it would not otherwise grant based on current underwriting standards. Although concessions may be made when modifying a loan, forgiveness of principal is rarely granted.

MORTGAGE BANKING OPERATIONS AND MORTGAGE SERVICING RIGHTS

The Company sells one-to-four family residential mortgage loans on a servicing retained basis. On a loan sold where servicing was retained, the Company determines at the time of sale the value of the retained servicing rights, which represents the present value of the differential between the contractual servicing fee and adequate compensation, defined as the fee a sub-servicer would require to assume the role of servicer, after considering the estimated effects of prepayments. If material, a portion of the gain on the sale of the loan is recognized due to the value of the servicing rights, and a mortgage servicing asset is recorded.

Commitments to sell one-to-four family residential mortgage loans are made primarily during the period between the intent to proceed and the closing of the mortgage loan. The timing of making these sale commitments is dependent upon the timing of the borrower's election to lock-in the mortgage interest rate and fees prior to loan closing. Most of these sales commitments are made on a best-efforts basis whereby the Company is only obligated to sell the mortgage if the mortgage loan is approved and closed by the Company. Commitments to fund mortgage loans (rate lock commitments) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as free standing derivatives. Fair values of these derivatives are estimated based on changes in mortgage interest rates from the date the interest rate on the loan is locked. The Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its commitments to fund the loans. Changes in the fair values of these derivatives are included in gains or losses on sales of loans. The fair value of these derivative instruments was not significant at December 31, 2022 and 2021.

Servicing assets are reported in other assets and amortized in proportion to and over the period during which estimated servicing income will be received. Servicing loans for others consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors, and processing foreclosures. Loan servicing income is recorded when earned and represents servicing fees from investors and certain charges collected from borrowers, such as late payment fees. The Company has fiduciary responsibility for related escrow and custodial funds.

Servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets. For sales of mortgage loans originated by the Company, a portion of the cost of originating the loan is allocated to the servicing retained right based on fair value. Capitalized servicing rights are amortized into interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Remaining servicing rights are charged against income upon payoff of the loan. Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned.

LOANS HELD-FOR-SALE

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Unrealized gains are recognized but only to the extent of previous write-downs.

AUTOMOBILE LEASING

Financing of automobiles, provided to customers under lease arrangements of varying terms obtained via an indirect arrangement primarily through a single dealer on a full recourse basis, are accounted for as direct finance leases. Interest on automobile direct finance leasing is determined using the interest method. Generally, the interest method is used to arrive at a level effective yield over the life of the lease. The lease residual and the lease receivable, net of unearned lease income, are recorded within loans and leases on the balance sheet.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through a provision for loan losses. The allowance represents an amount which, in management's judgment, will be adequate to absorb losses on existing loans. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of the loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrower's ability to pay, collateral value, overall portfolio quality and review of specific loans for impairment. Management applies two primary components during the estimation process to determine proper allowance levels; a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated based on historical charge-off history and qualitative factor adjustments for trends or changes in the loan portfolio and economic factors. Delinquencies, changes in lending policies and local economic conditions are some of the items used for the qualitative factor adjustments. Loans considered uncollectible are charged against the allowance. Recoveries on loans previously charged off are added to the allowance.

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

Acquired loans are marked to fair value on the date of acquisition and are evaluated on a quarterly basis to ensure the necessary purchase accounting updates are made in parallel with the allowance for loan loss calculation. The carryover of allowance for loan losses related to acquired loans is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. The allowance for loan losses on acquired loans reflects only those losses incurred after acquisition and represents the present value of cash flows expected at acquisition that is no longer expected to be collected. In conjunction with the quarterly evaluation of the adequacy of the allowance for loan losses, the Company performs an analysis on acquired loans to determine whether or not there has been subsequent deterioration in relation to these loans. If deterioration has occurred, the Company will include these loans in the calculation of the allowance for loan losses after the initial valuation and provide accordingly.

For acquired ASC 310-30 loans, the Company continues to estimate cash flows expected to be collected. Subsequent decreases to the expected cash flows would require the Company to evaluate the need for an additional allowance for loan losses. Subsequent improvement in expected cash flows would result in the reversal of a corresponding amount of the non accretable discount which would be reclassified as an accretable discount that will be recognized in interest income over the remaining life of the loan.

The risk characteristics of each of the identified portfolio segments are as follows:

Commercial and industrial loans (C&I): C&I loans are primarily based on the identified historic and/or the projected cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of the borrower, however, do fluctuate based on changes in the Company's internal and external environment including management, human and capital resources, economic conditions, competition and regulation. Most C&I loans are secured by business assets being financed such as equipment, accounts receivable, and/or inventory and generally incorporate a secured or unsecured personal guarantee. Unsecured loans may be made on a short-term basis. Loans to municipal borrowers, which carry the full faith and credit of each respective local government unit consistent with the PA Local Government Unit Debt Act (LGUDA) as well as loans to municipal authorities are included in C&I loans. The ability of the borrower to collect amounts due from its customers and perform under the terms of its loan may be affected by its customers' economic and financial condition.

Commercial real estate loans (CRE): Commercial real estate loans are made to finance the purchase of real estate, refinance existing obligations and/or to provide capital. These commercial real estate loans are generally secured by first lien security interests in the real estate as well as assignment of leases and rents. The real estate may include apartments, hotels, retail stores or plazas and healthcare facilities whether they are owner or non-owner occupied. These loans are typically originated in amounts of no more than 80% of the appraised value of the property. The ability of the borrower to collect amounts due from its customers and perform under the terms of its loan may be affected by its customers' or lessees' customers' economic and financial condition.

Consumer loans: The Company offers home equity installment loans and lines of credit. Risks associated with loans secured by residential properties are generally lower than commercial real estate loans and include general economic risks, such as the strength of the job market, employment stability and the strength of the housing market. Since most loans are secured by a primary or secondary residence or an automobile, the borrower's continued employment is considered the greatest risk to repayment. The Company also offers a variety of loans to individuals for personal and household purposes. These loans are generally considered to have greater risk than mortgages on real estate because they may be unsecured, or if they are secured, the value of the collateral may be difficult to assess and more likely to decrease in value than real estate.

Residential mortgage loans: Residential mortgages are secured by a first lien position of the borrower's residential real estate. These loans have varying loan rates depending on the financial condition of the borrower and the loan to value ratio. Since most loans are secured by a primary or secondary residence, the borrower's continued employment is considered the greatest risk to repayment. Residential mortgages have terms up to thirty years with amortizations varying from 10 to 30 years. The majority of the loans are underwritten according to FNMA and/or FHLB standards.

TRANSFER OF FINANCIAL ASSETS

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

LOAN FEES AND COSTS

Nonrefundable loan origination fees and certain direct loan origination costs are recognized as a component of interest income over the life of the related loans as an adjustment to yield. The unamortized balance of the deferred fees and costs are included as components of the loan balances to which they relate.

BANK PREMISES AND EQUIPMENT

Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the term of the lease or the estimated useful lives of the improved property. The Company leases several branches which are classified as operating leases. The Company also leases two stand-alone ATMs which are classified as operating leases and a building and equipment classified as finance leases. In most circumstances, management expects that in the normal course of business, leases will be renewed or replaced by other leases. Rent expense is recognized on the straight-line method over the term of the lease.

BANK OWNED LIFE INSURANCE

The Company maintains bank owned life insurance (BOLI) for a selected group of employees, namely its officers where the Company is the owner and sole beneficiary of the policies. The earnings from the BOLI are recognized as a component of other income in the consolidated statements of income. The BOLI is an asset that can be liquidated, if necessary, with tax consequences. However, the Company intends to hold these policies and, accordingly, the Company has not provided for deferred income taxes on the earnings from the increase in the cash surrender value.

EMPLOYEE BENEFITS

The Company holds separate supplemental executive retirement (SERP) agreements for certain officers and an amount is credited to each participant's SERP account monthly while they are actively employed by the bank until retirement. A deferred tax asset is provided for the non-deductible SERP expense. The Company also entered into separate split dollar life insurance arrangements with four executives providing post-retirement benefits and accrues monthly expense for this benefit. Monthly expenses for the SERP and post-retirement split dollar life benefit are recorded as components of salaries and employee benefit expense on the consolidated statements of income.

FORECLOSED ASSETS HELD-FOR-SALE

Foreclosed assets held-for-sale are carried at the lower of cost or fair value less cost to sell. Foreclosed assets held-for-sale is primarily other real estate owned, but also includes other repossessed assets. Losses from the acquisition of property in full and partial satisfaction of debt are treated as credit losses. Routine holding costs, gains and losses from sales, write-downs for subsequent declines in value and any rental income received are recognized net, as a component of other real estate owned expense in the consolidated statements of income. Gains or losses are recorded when the properties are sold.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, including bank premises and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to non-interest expense.

GOODWILL AND INTANGIBLE ASSETS

Goodwill is recorded on the consolidated balance sheets as the excess of liabilities assumed over identifiable assets acquired on the acquisition date. Goodwill is recorded at its net carrying value which represents estimated fair value. The goodwill is not deductible for tax purposes.

Goodwill is reviewed for impairment annually as of November 30 and between annual tests when events and circumstances indicate that impairment may have occurred. Goodwill impairment exists when the carrying amount of a reporting unit exceeds its fair value. A qualitative test can be performed to determine whether it is more likely than not that the fair value of the Company is less than its carrying amount, including goodwill. In this qualitative assessment, the Company evaluates events and circumstances which include general banking industry conditions and trends, the overall financial performance of the Company, the performance of the Company's common stock and key financial performance metrics of the Company. If the qualitative review indicates that it is not more likely than not that the carrying value exceeds its fair value, no further evaluation needs to be performed. If the results of the qualitative review indicate it is more likely than not that the fair value is less than the carrying value, then the Company performs a quantitative impairment test. During 2022, the Company determined it is not more likely than not that the fair value exceeds its carrying value therefore no quantitative analysis was necessary.

Other acquired intangible assets that have finite lives, such as core deposit intangibles, are amortized over their estimated useful lives and subject to periodic impairment testing.

STOCK PLANS

The Company has one stock-based compensation plan. The Company accounts for this plan under the recognition and measurement accounting principles, which requires the cost of share-based payment transactions be recognized in the financial statements. The stock-based compensation accounting guidance requires that compensation cost for stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. Compensation cost is recognized on a straight-line basis over the requisite service period. When granting stock-settled stock appreciation rights (SSARs), the Company uses Black-Scholes-Merton valuation model to determine fair value on the date of grant.

TRUST AND FINANCIAL SERVICE FEES

Trust and financial service fees are recorded on the cash basis, which is not materially different from the accrual basis.

ADVERTISING COSTS

Advertising costs are charged to expense as incurred.

LEGAL AND PROFESSIONAL EXPENSES

Generally, the Company recognizes legal and professional fees as incurred and are included as a component of professional services expense in the consolidated statements of income. Legal costs incurred that are associated with the collection of outstanding amounts due from delinquent borrowers are included as a component of loan collection expense in the consolidated statements of income. In the event of litigation proceedings brought about by an employee or third party against the Company, expenses for damages will be accrued if the likelihood of the outcome against the Company is probable, the amount can be reasonably estimated and the amount would have a material impact on the financial results of the Company.

INCOME TAXES

Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The benefit of a tax position is recognized on the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than-not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. For tax positions not meeting the more likely than not threshold, no tax benefit is recorded. Under the more likely than not threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. The Company had no material unrecognized tax benefits or accrued interest and penalties for the years ended December 31, 2022, 2021 or 2020, respectively.

COMPREHENSIVE INCOME (LOSS)

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, are reported as a separate component of the shareholders’ equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income (loss).

CASH FLOWS

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and interest-bearing deposits with financial institutions.

2. CASH

The Company is required by the Federal Reserve Bank to maintain average reserve balances based on a percentage of deposits. There were no reserve requirements on December 31, 2022 and 2021.

Deposits with any one financial institution are insured up to $250,000. From time-to-time, the Company may maintain cash and cash equivalents with certain other financial institutions in excess of the insured amount.

3. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

As of and for the year ended December 31, 2022

(dollars in thousands)	Unrealized gains (losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total
Beginning balance	**$ 179**	**$ -**	**$ 179**
Other comprehensive loss before reclassifications, net of tax	**(53,800)**	**(17,528)**	**(71,328)**
Amounts reclassified from accumulated other comprehensive income, net of tax	**(3)**	**-**	**(3)**
Net current-period other comprehensive loss	**(53,803)**	**(17,528)**	**(71,331)**
Ending balance	**$ (53,624)**	**$ (17,528)**	**$ (71,152)**

As of and for the year ended December 31, 2021

(dollars in thousands)	Unrealized gains (losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total
Beginning balance	$ 8,952	$ -	$ 8,952
Other comprehensive loss before reclassifications, net of tax	(8,737)	-	(8,737)
Amounts reclassified from accumulated other comprehensive income, net of tax	(36)	-	(36)
Net current-period other comprehensive loss	(8,773)	-	(8,773)
Ending balance	$ 179	$ -	$ 179

As of and for the year ended December 31, 2020

(dollars in thousands)	Unrealized gains (losses) on available-for-sale debt securities	Securities transferred to held-to-maturity	Total
Beginning balance	$ 3,602	$ -	$ 3,602
Other comprehensive income before reclassifications, net of tax	5,441	-	5,441
Amounts reclassified from accumulated other comprehensive income, net of tax	(91)	-	(91)
Net current-period other comprehensive income	5,350	-	5,350
Ending balance	$ 8,952	$ -	$ 8,952

Details about accumulated other comprehensive income components (dollars in thousands)	Amount reclassified from accumulated other comprehensive income			Affected line item in the statement where net income is presented
	2022	2021	2020	
Unrealized gains (losses) on AFS debt securities	**$ 4**	$ 46	$ 115	Gain (loss) on sale of investment securities
Income tax effect	**(1)**	(10)	(24)	Provision for income taxes
Total reclassifications for the period	**$ 3**	$ 36	$ 91	Net income

4. INVESTMENT SECURITIES

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

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

Obligations of states and political subdivisions (municipal)

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

Amortized cost and fair value of investment securities as of the period indicated are as follows:

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

(dollars in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2021				
Available-for-sale debt securities:				
Agency - GSE	$ 119,399	$ 204	$ (2,600)	$ 117,003
Obligations of states and political subdivisions	360,680	6,708	(2,678)	364,710
MBS - GSE residential	258,674	1,654	(3,061)	257,267
Total available-for-sale debt securities	$ 738,753	$ 8,566	$ (8,339)	$ 738,980

Some of the Company's debt securities are pledged to secure trust funds, public deposits, short-term borrowings, FHLB advances, Federal Reserve Bank of Philadelphia Discount Window borrowings and certain other deposits as required by law.

The amortized cost and fair value of debt securities at December 31, 2022 by contractual maturity are shown below:

(dollars in thousands)	Amortized cost	Fair value
Held-to-maturity securities:		
Due in one year or less	$ -	$ -
Due after one year through five years	7,022	6,470
Due after five years through ten years	76,864	67,709
Due after ten years	138,858	113,101
Total held-to-maturity securities	$ 222,744	$ 187,280
Available-for-sale securities:		
Debt securities:		
Due in one year or less	$ 3,997	$ 3,951
Due after one year through five years	18,791	16,974
Due after five years through ten years	42,692	35,451
Due after ten years	168,531	147,051
MBS - GSE residential	254,730	217,435
Total available-for-sale debt securities	$ 488,741	$ 420,862

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

Gross realized gains and losses from sales, determined using specific identification, for the periods indicated were as follows:

	December 31,		
(dollars in thousands)	**2022**	2021	2020
Gross realized gain	$ **18**	$ 98	$ 147
Gross realized loss	**(14)**	(52)	(32)
Net gain	$ **4**	$ 46	$ 115

The following table presents the fair value and gross unrealized losses of investments aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of the period indicated:

	Less than 12 months		More than 12 months		Total	
(dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
December 31, 2022						
Agency - GSE	**$ 9,285**	**$ (377)**	**$ 93,312**	**$ (13,409)**	**$ 102,597**	**$ (13,786)**
Obligations of states and political subdivisions	**170,484**	**(26,928)**	**112,353**	**(25,835)**	**282,837**	**(52,763)**
MBS - GSE residential	**61,803**	**(6,018)**	**155,632**	**(31,277)**	**217,435**	**(37,295)**
Total	**$ 241,572**	**$ (33,323)**	**$ 361,297**	**$ (70,521)**	**$ 602,869**	**$ (103,844)**
Number of securities	**272**		**213**		**485**	
December 31, 2021						
Agency - GSE	$ 84,308	$ (1,460)	$ 26,516	$ (1,140)	$ 110,824	$ (2,600)
Obligations of states and political subdivisions	193,124	(2,662)	12,796	(399)	205,920	(3,061)
MBS - GSE residential	137,495	(2,351)	9,469	(327)	146,964	(2,678)
Total	$ 414,927	$ (6,473)	$ 48,781	$ (1,866)	$ 463,708	$ (8,339)
Number of securities	187		26		213	

The Company had 485 debt securities in an unrealized loss position at December 31, 2022, including 51 agency-GSE securities, 144 MBS – GSE residential securities and 290 municipal securities. The severity of these unrealized losses based on their underlying cost basis was as follows at December 31, 2022: 11.84% for agency - GSE, 14.64% for total MBS-GSE residential; and 15.72% for municipals. 213 of these securities had been in an unrealized loss position in excess of 12 months. Management has no intent to sell any securities in an unrealized loss position as of December 31, 2022.

During the second quarter of 2022, the Company transferred investment securities with a book value of $245.5 million from available-for-sale to held-to-maturity. The accounting for securities held-to-maturity on this transfer will mitigate the effect on the other comprehensive income (OCI) component of stockholders' equity from the price risk of rising interest rates which will result in further future unrealized losses in the available-for-sale portfolio.

Management believes the cause of the unrealized losses is related to changes in interest rates and is not directly related to credit quality. Quarterly, management conducts a formal review of investment securities for the presence of other than temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under those circumstances, OTTI is considered to have occurred if: (1) the entity has the intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost. The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not expected to be sold be recognized in OCI. Non-credit-related OTTI is based on other factors affecting market value, including illiquidity.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt securities. The guidance set forth in the pronouncements require the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value which may be to maturity and other factors when evaluating for the existence of OTTI. The guidance requires that credit-related OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt securities.

For all debt securities, as of December 31, 2022, the Company applied the criteria provided in the recognition and presentation guidance related to OTTI. That is, management has no intent to sell the securities and nor any conditions were identified by management that, more likely than not, would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI in the Company's security portfolio. In addition, management believes the change in fair value is attributable to changes in interest rates.

5. LOANS AND LEASES

The classifications of loans and leases at December 31, 2022 and 2021 are summarized as follows:

(dollars in thousands)	**December 31, 2022**	December 31, 2021
Commercial and industrial	**$ 234,478**	$ 236,304
Commercial real estate:		
Non-owner occupied	**316,867**	312,848
Owner occupied	**270,810**	248,755
Construction	**18,941**	21,147
Consumer:		
Home equity installment	**59,118**	47,571
Home equity line of credit	**52,568**	54,878
Auto loans	**131,936**	118,029
Direct finance leases	**33,223**	26,232
Other	**7,611**	8,013
Residential:		
Real estate	**398,136**	325,861
Construction	**42,232**	34,919
Total	**1,565,920**	1,434,557
Less:		
Allowance for loan losses	**(17,149)**	(15,624)
Unearned lease revenue	**(1,746)**	(1,429)
Loans and leases, net	**$ 1,547,025**	$ 1,417,504

As of December 31, 2022, total loans of $1.6 billion were reflected including deferred loan costs of $4.6 million. As of December 31, 2021, total loans of $1.4 billion were reflected including deferred loan costs of $3.0 million, comprised of $4.2 million in deferred loan costs partially offset by $1.2 million in deferred fee income from Paycheck Protection Program (PPP) loans.

Commercial and industrial (C&I) loan balances were $234.5 million at December 31, 2022 and $236.3 million at December 31, 2021. The $1.8 million decrease was attributed to the reduction in PPP loans (net of deferred fees) which declined by $38.5 million to $1.3 million at December 31, 2022 due to standard forgiveness under the SBA program. As of December 31, 2022, the Company increased the balance of C&I loans by $36.7 million (excluding PPP loans).

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

The Company services real estate loans for investors in the secondary mortgage market which are not included in the accompanying consolidated balance sheets. The approximate unpaid principal balance of mortgages serviced for others amounted to $465.7 million as of December 31, 2022 and $430.9 million as of December 31, 2021. Mortgage servicing rights amounted to $1.6 million and $1.7 million as of December 31, 2022 and 2021, respectively.

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

Paycheck Protection Program Loans

The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, was signed into law on March 27, 2020, and provided over $2.0 trillion in emergency economic relief to individuals and businesses impacted by the COVID-19 pandemic. The CARES Act authorized the Small Business Administration (SBA) to temporarily guarantee loans under a new 7(a) loan program called the Paycheck Protection Program (PPP).

As a qualified SBA lender, the Company was automatically authorized to originate PPP loans. The SBA guaranteed 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrowers' PPP loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount under the PPP.

On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (Economic Aid Act) was enacted, extending the authority to make PPP loans through May 31, 2021, revising certain PPP requirements, and permitting second draw PPP loans. On March 11, 2021, the American Rescue Plan Act of 2021 (American Rescue Plan Act) was enacted expanding eligibility for first and second draw PPP loans and revising the exclusions from payroll costs for purposes of loan forgiveness.

Acquired loans

Acquired loans are marked to fair value on the date of acquisition. For detailed information on calculating the fair value of acquired loans, see Footnote 20, "Acquisition."

The carryover of allowance for loan losses related to acquired loans is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. The allowance for loan losses on acquired loans reflects only those losses incurred after acquisition and represents the present value of cash flows expected at acquisition that is no longer expected to be collected.

The Company reported fair value adjustments regarding the acquired MNB and Landmark loan portfolios. Therefore, the Company did not record an allowance on the acquired non-purchased credit impaired loans. In conjunction with the quarterly evaluation of the adequacy of the allowance for loan losses, the Company performs an analysis on acquired loans to determine whether there has been subsequent deterioration in relation to those loans. If deterioration has occurred, the Company will include these loans in the calculation of the allowance for loan losses after the initial valuation and provide reserves accordingly.

Upon acquisition, in accordance with U.S. GAAP, the Company has individually determined whether each acquired loan is within the scope of ASC 310-30 deemed as purchased credit impaired (PCI). As part of this process, the Company's senior management and other relevant individuals reviewed the seller's loan portfolio on a loan-by-loan basis to determine if any loans met the two-part definition of an impaired loan as defined by ASC 310-30: 1) Credit deterioration on the loan from its inception until the acquisition date, and 2) It is probable that not all contractual cash flows will be collected on the loan.

With regards to ASC 310-30 loans, for external disclosure purposes, the aggregate contractual cash flows less the aggregate expected cash flows result in a credit related non-accretable yield amount. The aggregate expected cash flows less the acquisition date fair value result in an accretable yield amount. The accretable yield reflects the contractual cash flows management expects to collect above the loan's acquisition date fair value and will be recognized over the life of the loan on a level-yield basis as a component of interest income.

Over the life of the acquired ASC 310-30 loan, the Company continues to estimate cash flows expected to be collected. Decreases in expected cash flows, other than from prepayments or rate adjustments, are recognized as impairments through a charge to the provision for credit losses resulting in an increase in the allowance for credit losses. Subsequent improvements in cash flows result in first, reversal of existing valuation allowances recognized after acquisition, if any, and next, an increase in the amount of accretable yield to be subsequently recognized on a prospective basis over the loan's remaining life.

Acquired ASC 310-30 loans that met the criteria for non-accrual of interest prior to acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent if the Company can reasonably estimate the timing and amount of expected cash flows on such loans. Accordingly, the Company does not consider acquired contractually delinquent loans to be non-accruing and continues to recognize accretable yield on these loans which is recognized as interest income on a level yield method over the life of the loan.

Acquired ASC 310-20 loans, which are loans that did not meet the criteria above, were pooled into groups of similar loans based on various factors including borrower type, loan purpose, and collateral type. For these pools, the Company used certain loan information, including outstanding principal balance, estimated expected losses, weighted average maturity, weighted average margin, and weighted average interest rate along with estimated prepayment rates, expected lifetime losses, and environment factors to estimate the expected cash flow for each loan pool.

Within the ASC 310-20 loans, the Company identified certain loans that have higher risk. Although performing at the time of acquisition and likely will continue making payments in accordance with contractual terms, management elected a higher credit adjustment on these loans to reflect the greater inherent risk that the borrower will default on payments. Risk factors used to identify these loans included: loans that received COVID-19 related forbearance consistent with the regulatory guidance, loans that were in industries determined to be at greater risk to economic disruption due to COVID-19, loans that had a prior history of delinquency greater than 60 days at any point in the lifetime of the loan; loans with a Special Mention or Substandard risk rating; and/or loans borrowers in the Gasoline Station industry due to the environmental risk potential of these loans.

The following table provides changes in accretable yield for all acquired loans accounted for under ASC 310-30. Loans accounted for under ASC 310-20 are not included in this table.

(dollars in thousands)	For the years ended **December 31, 2022**	For the years ended December 31, 2021
Balance at beginning of period	**$ 1,088**	$ 563
Accretable yield on acquired loans	**-**	589
Reclassification from non-accretable difference	**543**	453
Reclassification to loan balance due to charge-off	**(3)**	-
Accretion of accretable yield	**(399)**	(517)
Balance at end of period	**$ 1,229**	$ 1,088

The above table excludes the $275 thousand in non-accretable yield accreted to interest income for the year ended December 31, 2021.

During the twelve months ended December 31, 2022, management performed an analysis of all loans acquired from mergers, consistent with and applicable to ASC 310-30 (Purchased Credit Impaired loans – PCI). During this period, the accretable yield increased $141 thousand from $1,088 thousand to $1,229 thousand due to a $543 thousand reclassification from non-accretable discount to accretable discount resulting from five loans that had actual payments exceed estimates and one loan that had a positive change in collateral value, which was partially offset by yield accretion of $399 thousand and a reclassification of a loan balance for $3 thousand.

During the twelve months ended December 31, 2021, the accretable yield balance increased from $563 thousand to $1,088 thousand. The $525 thousand increase resulted from $589 thousand in accretable yield on loans acquired from the Landmark merger during the third quarter of 2021; $453 thousand reclassified from non-accretable yield to accretable yield including $167 thousand from improved collateral values and $286 thousand from payments received on PCI in excess of estimates partially offset by $517 thousand in accretable yield accreted to interest income due to contractual payments received during the twelve months ended December 31, 2021.

Expected cash flows on acquired loans are estimated quarterly by incorporating several key assumptions. These key assumptions include probability of default and the number of actual prepayments after the acquisition date. Prepayments affect the estimated life of the loans and could change the amount of interest income, and possibly principal expected to be collected. In reforecasting future estimated cash flows, credit loss expectations are adjusted as necessary. Improved cash flow expectations for loans or pools are recorded first as a reversal of previously recorded impairment, if any, and then as an increase in prospective yield when all previously recorded impairment has been recaptured.

Non-accrual loans

Non-accrual loans, segregated by class, at December 31, were as follows:

(dollars in thousands)	**December 31, 2022**		December 31, 2021	
Commercial and industrial	**$**	**719**	$	154
Commercial real estate:				
Non-owner occupied		**383**		478
Owner occupied		**1,066**		1,570
Consumer:				
Home equity installment		**-**		-
Home equity line of credit		**211**		97
Auto loans		**153**		78
Residential:				
Real estate		**3**		572
Total	**$**	**2,535**	$	2,949

The table above excludes $4.7 million and $4.7 million in purchased credit impaired loans, net of unamortized fair value adjustments as of December 31, 2022 and 2021, respectively.

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

Troubled Debt Restructuring

A modification of a loan constitutes a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company considers all TDRs to be impaired loans. The Company typically considers the following concessions when modifying a loan, which may include lowering interest rates below the market rate, temporary interest-only payment periods, term extensions at interest rates lower than the current market rate for new debt with similar risk and/or converting revolving credit lines to term loans. The Company typically does not forgive principal when granting a TDR modification.

The following presents by class, information related to loans modified in a TDR:

	Loans modified as TDRs for the twelve months ended:								
(dollars in thousands)	**December 31, 2022**					December 31, 2021			
	Number of contracts		Recorded investment (as of period end)		Increase in allowance (as of period end)	Number of contracts		Recorded investment (as of period end)	Increase in allowance (as of period end)
Commercial real estate - owner occupied	**-**	**$**	**-**	**$**	**-**	1	$	512	$ -
Total	**-**	**$**	**-**	**$**	**-**	1	$	512	$ -

In the above table, the period end balance is inclusive of all partial pay downs and charge-offs since the modification date. For all loans modified in a TDR, the pre-modification recorded investment was the same as the post-modification recorded investment.

Of the TDRs outstanding as of December 31, 2022 and 2021, when modified, the concessions granted consisted of temporary interest-only payments, extensions of maturity date, or a reduction in the rate of interest to a below-market rate for a contractual period of time. Other than the TDRs that were placed on non-accrual status, the TDRs were performing in accordance with their modified terms.

Loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. There were no loans modified as a TDR within the previous twelve months that subsequently defaulted (i.e. 90 days or more past due following a modification) during the twelve months ended December 31, 2022 and 2021.

The allowance for loan losses (allowance) may be increased, adjustments may be made in the allocation of the allowance or partial charge-offs may be taken to further write-down the carrying value of the loan. An allowance for impaired loans that have been modified in a TDR is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's observable market price. If the loan is collateral dependent, the estimated fair value of the collateral is used to establish the allowance.

As of December 31, 2022 and 2021, the balance of outstanding TDRs was $1.5 million and $3.5 million, respectively. As of December 31, 2022 and 2021, the allowance for impaired loans that have been modified in a TDR was $48 thousand and $0.5 million, respectively.

Past due loans

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

December 31, 2022	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more [1]	Total past due	Current	Total loans [3]	Recorded investment past due ≥ 90 days and accruing
Commercial and industrial	$ -	$ -	$ 719	$ 719	$ 233,759	$ 234,478	$ -
Commercial real estate:							
Non-owner occupied	-	-	383	383	316,484	316,867	-
Owner occupied	42	-	1,066	1,108	269,702	270,810	-
Construction	-	-	-	-	18,941	18,941	-
Consumer:							
Home equity installment	239	-	-	239	58,879	59,118	-
Home equity line of credit	110	151	211	472	52,096	52,568	-
Auto loans	563	201	169	933	131,003	131,936	16
Direct finance leases	186	-	17	203	31,274	31,477 (2)	17
Other	12	7	-	19	7,592	7,611	-
Residential:							
Real estate	-	327	3	330	397,806	398,136	-
Construction	-	-	-	-	42,232	42,232	-
Total	$ 1,152	$ 686	$ 2,568	$ 4,406	$1,559,768	$1,564,174	$ 33

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

December 31, 2021	30 - 59 Days past due	60 - 89 Days past due	Past due 90 days or more (1)	Total past due	Current	Total loans (3)	Recorded investment past due ≥ 90 days and accruing
Commercial and industrial	$ -	$ 4	$ 154	$ 158	$ 236,146	$ 236,304	$ -
Commercial real estate:							
Non-owner occupied	-	675	478	1,153	311,695	312,848	-
Owner occupied	-	-	1,570	1,570	247,185	248,755	-
Construction	-	-	-	-	21,147	21,147	-
Consumer:							
Home equity installment	87	32	-	119	47,452	47,571	-
Home equity line of credit	-	-	97	97	54,781	54,878	-
Auto loans	410	45	78	533	117,496	118,029	-
Direct finance leases	173	38	64	275	24,528	24,803 (2)	64
Other	49	17	-	66	7,947	8,013	-
Residential:							
Real estate	-	452	572	1,024	324,837	325,861	-
Construction	-	-	-	-	34,919	34,919	-
Total	$ 719	$ 1,263	$ 3,013	$ 4,995	$ 1,428,133	$ 1,433,128	$ 64

(1) Includes non-accrual loans. (2) Net of unearned lease revenue of $1.4 million. (3) Includes net deferred loan costs of $3.0 million.

Impaired loans

Impaired loans, segregated by class, as of the period indicated are detailed below:

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance
December 31, 2022					
Commercial and industrial	**$ 942**	**$ 139**	**$ 580**	**$ 719**	**$ 48**
Commercial real estate:					
Non-owner occupied	**762**	**215**	**547**	**762**	**42**
Owner occupied	**2,347**	**1,304**	**716**	**2,020**	**70**
Consumer:					
Home equity installment	**33**	**-**	**-**	**-**	**-**
Home equity line of credit	**255**	**-**	**211**	**211**	**-**
Auto loans	**213**	**18**	**135**	**153**	**1**
Residential:					
Real estate	**50**	**-**	**3**	**3**	**-**
Total	**$ 4,602**	**$ 1,676**	**$ 2,192**	**$ 3,868**	**$ 161**

(dollars in thousands)	Unpaid principal balance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment	Related allowance
December 31, 2021					
Commercial and industrial	$ 218	$ 18	$ 136	$ 154	$ 18
Commercial real estate:					
Non-owner occupied	2,470	1,674	796	2,470	474
Owner occupied	3,185	1,802	762	2,564	763
Consumer:					
Home equity installment	33	-	-	-	-
Home equity line of credit	137	-	97	97	-
Auto loans	98	10	68	78	4
Residential:					
Real estate	699	-	572	572	-
Total	$ 6,840	$ 3,504	$ 2,431	$ 5,935	$ 1,259

At December 31, 2022, impaired loans totaled $3.9 million consisting of $1.4 million in accruing TDRs and $2.5 million in non-accrual loans. At December 31, 2021, impaired loans totaled $5.9 million consisting of $3.0 million in accruing TDRs and $2.9 million in non-accrual loans. As of December 31, 2022, the non-accrual loans included one TDR totaling $0.2 million compared with three TDRs to two unrelated borrowers totaling $0.6 million as of December 31, 2021.

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

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

	December 31, 2022			December 31, 2021		
(dollars in thousands)	Average recorded investment	Interest income recognized	Cash basis interest income recognized	Average recorded investment	Interest income recognized	Cash basis interest income recognized
Commercial and industrial	**$ 468**	**$ -**	**$ -**	$ 380	$ 2	$ -
Commercial real estate:						
Non-owner occupied	**1,263**	**104**	**-**	2,698	195	-
Owner occupied	**2,279**	**125**	**-**	1,883	55	-
Construction	**-**	**-**	**-**	-	-	-
Consumer:						
Home equity installment	**-**	**-**	**-**	28	6	-
Home equity line of credit	**153**	**7**	**-**	202	20	-
Auto loans	**162**	**5**	**-**	42	2	-
Direct finance leases	**-**	**-**	**-**	-	-	-
Other	**-**	**-**	**-**	-	-	-
Residential:						
Real estate	**158**	**41**	**-**	682	-	-
Construction	**-**	**-**	**-**	-	-	-
Total	**$ 4,483**	**$ 282**	**$ -**	$ 5,915	$ 280	$ -

Average recorded investment refers to the five quarter average of impaired loans preceding the reporting period.

The average recorded investment for the year ended December 31, 2020 was $5.5 million. There was also interest income recognized of $147 thousand and cash basis interest income recognized of $0.

Credit Quality Indicators

Commercial and industrial and commercial real estate

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

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

Pass

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

Special Mention

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

Substandard

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

Doubtful

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

Consumer and residential

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

The following table presents loans including $4.6 million and $3.0 million of deferred costs, segregated by class, categorized into the appropriate credit quality indicator category as of December 31, 2022 and 2021, respectively:

Commercial credit exposure
Credit risk profile by creditworthiness category

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

Consumer & Mortgage lending credit exposure
Credit risk profile based on payment activity

	December 31, 2022		
(dollars in thousands)	Performing	Non-performing	Total
Consumer			
Home equity installment	**$ 59,118**	**$ -**	**$ 59,118**
Home equity line of credit	**52,357**	**211**	**52,568**
Auto loans	**131,767**	**169**	**131,936**
Direct finance leases (1)	**31,460**	**17**	**31,477**
Other	**7,611**	**-**	**7,611**
Total consumer	**282,313**	**397**	**282,710**
Residential			
Real estate	**398,133**	**3**	**398,136**
Construction	**42,232**	**-**	**42,232**
Total residential	**440,365**	**3**	**440,368**
Total consumer & residential	**$ 722,678**	**$ 400**	**$ 723,078**

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

Commercial credit exposure
Credit risk profile by creditworthiness category

	December 31, 2021				
(dollars in thousands)	Pass	Special mention	Substandard	Doubtful	Total
Commercial and industrial	$ 233,565	$ 339	$ 2,400	$ -	$ 236,304
Commercial real estate - non-owner occupied	289,679	16,614	6,555	-	312,848
Commercial real estate - owner occupied	230,146	7,089	11,520	-	248,755
Commercial real estate - construction	21,147	-	-	-	21,147
Total commercial	$ 774,537	$ 24,042	$ 20,475	$ -	$ 819,054

Consumer & Mortgage lending credit exposure
Credit risk profile based on payment activity

	December 31, 2021		
(dollars in thousands)	Performing	Non-performing	Total
Consumer			
Home equity installment	$ 47,571	$ -	$ 47,571
Home equity line of credit	54,781	97	54,878
Auto loans	117,951	78	118,029
Direct finance leases (2)	24,739	64	24,803
Other	8,013	-	8,013
Total consumer	253,055	239	253,294
Residential			
Real estate	325,289	572	325,861
Construction	34,919	-	34,919
Total residential	360,208	572	360,780
Total consumer & residential	$ 613,263	$ 811	$ 614,074

(2) Net of unearned lease revenue of $1.4 million.

<u>Allowance for loan losses</u>

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

- identification of specific impaired loans by loan category;
- identification of specific loans that are not impaired, but have an identified potential for loss;
- calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
- determination of loans with similar credit characteristics within each class of the loan portfolio segment and eliminating the impaired loans;
- application of historical loss percentages (trailing twelve-quarter average) to pools to determine the allowance allocation;
- application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio.
- Qualitative factor adjustments include:
    - levels of and trends in delinquencies and non-accrual loans;
    - levels of and trends in charge-offs and recoveries;
    - trends in volume and terms of loans;
    - changes in risk selection and underwriting standards;
    - changes in lending policies and legal and regulatory requirements;
    - experience, ability and depth of lending management;
    - national and local economic trends and conditions; and
    - changes in credit concentrations.

Allocation of the allowance for different categories of loans is based on the methodology as explained above. A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual C&I and CRE loans. C&I and CRE loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The credit risk grades for the C&I and CRE loan portfolios are considered in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience as well as what we believe to be best practices and common industry standards. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the C&I and CRE loan portfolio from period to period are based upon the credit risk grading system and from periodic reviews of the loan portfolio. 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.

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

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

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

As of and for the year ended December 31, 2022

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

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

As of and for the year ended December 31, 2021

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 2,407	$ 6,383	$ 2,552	$ 2,781	$ 79	$ 14,202
Charge-offs	(130)	(491)	(206)	(162)	-	(989)
Recoveries	23	250	138	-	-	411
Provision	(96)	1,280	(80)	889	7	2,000
Ending balance	$ 2,204	$ 7,422	$ 2,404	$ 3,508	$ 86	$ 15,624
Ending balance: individually evaluated for impairment	$ 18	$ 1,237	$ 4	$ -	$ -	$ 1,259
Ending balance: collectively evaluated for impairment	$ 2,186	$ 6,185	$ 2,400	$ 3,508	$ 86	$ 14,365
Loans Receivables:						
Ending balance (2)	$ 236,304	$ 582,750	$ 253,294 (1)	$ 360,780	$ -	$ 1,433,128
Ending balance: individually evaluated for impairment	$ 154	$ 5,034	$ 175	$ 572	$ -	$ 5,935
Ending balance: collectively evaluated for impairment	$ 236,150	$ 577,716	$ 253,119	$ 360,208	$ -	$ 1,427,193

(1) Net of unearned lease revenue of $1.4 million. (2) Includes $3.0 million of net deferred loan costs.

As of and for the year ended December 31, 2020

(dollars in thousands)	Commercial & industrial	Commercial real estate	Consumer	Residential real estate	Unallocated	Total
Allowance for Loan Losses:						
Beginning balance	$ 1,484	$ 3,933	$ 2,013	$ 2,278	$ 39	$ 9,747
Charge-offs	(372)	(465)	(296)	(35)	-	(1,168)
Recoveries	26	30	120	197	-	373
Provision	1,269	2,885	715	341	40	5,250
Ending balance	$ 2,407	$ 6,383	$ 2,552	$ 2,781	$ 79	$ 14,202

Direct finance leases

The Company originates direct finance leases through two automobile dealerships. The carrying amount of the Company's lease receivables, net of unearned income, was $7.9 million and $7.7 million as of December 31, 2022 and 2021, respectively. The residual value of the direct finance leases is fully guaranteed by the dealerships. Residual values amounted to $23.6 million and $17.1 million at December 31, 2022 and 2021, respectively, and are included in the carrying value of direct finance leases.

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

(dollars in thousands)	Amount
2023	$ 10,838
2024	10,035
2025	10,889
2026	1,433
2027	28
2028 and thereafter	-
Total future minimum lease payments receivable	33,223
Less: Unearned income	(1,746)
Undiscounted cash flows to be received	$ 31,477

6. BANK PREMISES AND EQUIPMENT

Components of bank premises and equipment are summarized as follows:

	As of December 31,	
(dollars in thousands)	**2022**	2021
Land	**$ 3,421**	$ 3,915
Bank premises	**19,105**	20,460
Furniture, fixtures and equipment	**15,919**	15,833
Leasehold improvements	**10,659**	9,851
Construction in process	**4,234**	494
Total	**53,338**	50,553
Less accumulated depreciation and amortization	**(22,031)**	(21,243)
Bank premises and equipment, net	**$ 31,307**	$ 29,310

Depreciation expense, which includes amortization of leasehold improvements, was $2.3 million, $2.2 million and $1.9 million for the years ended December 31, 2022, 2021 and 2020. The estimated useful life was 40 years for bank premises, 3 to 7 years for furniture and fixtures and for leasehold improvements was the term of the lease.

During the first quarter of 2014, the Company received through foreclosure the deed that secured the collateral for a non-owner occupied commercial real estate loan that was on non-accrual status. The loan, in the amount $1.0 million, was transferred from loans to foreclosed assets held-for-sale and then to bank premises. Currently the building is being used for administrative offices and the ground floor is being remodeled to use the property for a future branch.

7. DEPOSITS

The scheduled maturities of certificates of deposit as of December 31, 2022 were as follows:

(dollars in thousands)	Amount	Percent
2023	$ 76,685	65.5%
2024	24,831	21.2
2025	9,490	8.1
2026	3,663	3.1
2027	1,804	1.5
2028 and thereafter	721	0.6
Total	$ 117,194	100.0%

Certificates of deposit of $250,000 or more aggregated $21.1 million and $23.0 million at December 31, 2022 and 2021, respectively.

As of December 31, 2022 and 2021, $0.3 million and $0.6 million of overdraft deposits have been reclassified as loan balances.

As of December 31, 2022, investment securities with a combined fair value of $608.1 million were available to be pledged as qualifying collateral to secure public deposits and trust funds. The Company required $510.9 million of the qualifying collateral to secure such deposits as of December 31, 2022 and the balance of $97.2 million was available for other pledging needs.

8. SHORT-TERM BORROWINGS

The components of short-term borrowings are summarized as follows:

(dollars in thousands)	As of December 31, **2022**	2021
Overnight borrowings	**$ 12,930**	$ -
Other short-term borrowings	**10**	-
Total	**$ 12,940**	$ -

The maximum and average amounts of short-term borrowings outstanding and related interest rates as of the periods indicated are as follows:

(dollars in thousands)	Maximum outstanding at any month end	Average outstanding	Weighted-average rate during the year	Rate at year-end
December 31, 2022				
Overnight borrowings	**$ 12,930**	**$ 1,025**	**4.39%**	**4.45%**
Other short-term borrowings	**10**	**6**	**-**	**-**
Total	**$ 12,940**	**$ 1,031**		
December 31, 2021				
Overnight borrowings	$ -	$ 97	1.06%	-%
Total	$ -	$ 97		
December 31, 2020				
Overnight borrowings	$ 9,159	$ 4,175	2.13%	-%
Paycheck Protection Program Liquidity Facility	152,791	44,990	0.35%	-
Total	$ 161,950	$ 49,165		

Overnight borrowings may include Fed funds purchased from correspondent banks, open repurchase agreements with the FHLB and borrowings at the Discount Window from the Federal Reserve Bank of Philadelphia (FRB). During the first half of 2020, the Company utilized the Paycheck Protection Program Liquidity Facility (PPPLF) to fund PPP lending. The PPPLF borrowings were paid off during the third quarter of 2020.

FHLB borrowings are collateralized by a blanket lien on all commercial and residential real estate loans. At December 31, 2022, the Company had approximately $602.2 million available to borrow from the FHLB, $31.0 million from correspondent banks and approximately $112.0 million that it could borrow at the FRB.

9. FHLB ADVANCES AND OTHER BORROWINGS

The Company had no FHLB advances as of December 31, 2022 and 2021.

As of December 31, 2022 and 2021, the Company had secured borrowings with a fair value of $7.6 million and $10.6 million related to certain sold loan participations that did not qualify for sales treatment acquired from Landmark. The fair value includes a $53 thousand and $176 thousand purchase accounting fair value adjustment as of December 31, 2022 and 2021.

The maturity and weighted-average interest rate of secured borrowings as of the periods indicated is as follows:

	As of December 31, 2022	
(dollars in thousands)	Amount	Rate
2023	**$ 853**	**7.50%**
2024	**20**	**8.50**
2025	**-**	**-**
2026	**-**	**-**
2027	**-**	**-**
2028 and thereafter	**6,693**	**5.53**
Total	**$ 7,566**	**5.76%**

10. STOCK PLANS

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

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

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

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

During the first quarter of 2021, the Company approved a LTIP and awarded restricted stock to senior officers and managers in February and March 2021 based on 2020 performance. During the third quarter of 2021, 476 shares of restricted stock were granted to one new employee after the merger.

During the first quarter of 2020, the Company approved a LTIP and awarded restricted stock to senior officers and managers in February and March 2020 based on 2019 performance. During the second quarter of 2020, 500 shares of restricted stock were granted to one new employee after the merger.

The following table summarizes the weighted-average fair value and vesting of restricted stock grants awarded during 2022, 2021 and 2020 under the 2022 and 2012 stock incentive plans:

	2022		2021		2020	
	Shares granted	**Weighted-average grant date fair value**	Shares granted	Weighted-average grant date fair value	Shares granted	Weighted-average grant date fair value
Director plan	**18,000(2)**	**$ 49.85**	12,500(2)	$ 52.00	6,000(2)	$ 56.63
Omnibus plan	**16,520(3)**	**49.85**	13,552(3)	52.00	11,761(3)	55.06
Omnibus plan	**50(1)**	**35.91**	50(1)	58.17	50(1)	57.62
Omnibus plan	**-**		36(3)	58.17	500(2)	34.02
Omnibus plan	**-**		476(2)	52.62	-	-
Total	**34,570**	**$ 49.83**	26,614	$ 52.03	18,311	$ 55.00

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

The fair value of the shares granted in 2022, 2021 and 2020 was calculated using the grant date closing stock price.

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

	2012 & 2022 Stock incentive plans			
	Director	Omnibus	Total	Weighted-average grant date fair value
Non-vested balance at December 31, 2019	11,200	15,961	27,161	$ 49.48
Granted	6,000	12,311	18,311	55.00
Forfeited	-	-	-	
Vested	(7,798)	(7,597)	(15,395)	48.47
Non-vested balance at December 31, 2020	9,402	20,675	30,077	$ 53.36
Granted	12,500	14,114	26,614	52.03
Forfeited	-	(439)	(439)	52.66
Vested	(6,982)	(6,227)	(13,209)	51.23
Non-vested balance at December 31, 2021	14,920	28,123	43,043	$ 53.20
Granted	18,000	16,570	34,570	49.83
Forfeited	-	(3,428)	(3,428)	52.13
Vested	(9,048)	(2,651)	(11,699)	52.83
Non-vested balance at December 31, 2022	**23,872**	**38,614**	**62,486**	**$ 51.46**

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

	Awards	Weighted-average grant date fair value	Weighted-average remaining contractual term (years)
Outstanding December 31, 2019	97,264	$ 9.47	7.5
Granted	-	-	-
Exercised	-	-	-
Forfeited	-	-	-
Outstanding December 31, 2020	97,264	$ 9.47	6.5
Granted	-		
Exercised	(2,932)	3.48	
Forfeited	-		
Outstanding December 31, 2021	94,332	$ 9.66	5.5
Granted	-		
Exercised	(3,608)	4.20	
Forfeited	(3,591)	14.41	
Outstanding December 31, 2022	**87,133**	**$ 9.69**	**4.5**

Of the SSARs outstanding at December 31, 2022, all SSARs vested and were exercisable.

During 2022, there were 3,608 SSARs exercised. The intrinsic value recorded for these SSARs was $15,140. The tax deduction realized from the exercise of these SSARs was $56,424 resulting in a tax benefit of $11,849. During 2021, there were 2,932 SSARs exercised. The intrinsic value recorded for these SSARs was $10,190. The tax deduction realized from the exercise of these SSARs was $125,810 resulting in a tax benefit of $26,420. There were no SSARs exercised during 2020.

Share-based compensation expense is included as a component of salaries and employee benefits in the consolidated statements of income. The following tables illustrate stock-based compensation expense recognized on non-vested equity awards during the years ended December 31, 2022, 2021 and 2020 and the unrecognized stock-based compensation expense as of December 31, 2022:

(dollars in thousands)	**2022**	2021	2020
Stock-based compensation expense:			
2012 Director stock incentive plan	**$ 623**	$ 422	$ 434
2012 Omnibus stock incentive plan	**615**	640	740
2022 Omnibus stock incentive plan	**1**	-	-
Employee stock purchase plan	**32**	44	27
Total stock-based compensation expense	**$ 1,271**	$ 1,106	$ 1,201

In addition, during 2021 and 2020 the Company reversed accruals of ($10 thousand) and ($0.1 million) in stock-based compensation expense for restricted stock and SSARs awarded under the 2012 Omnibus Stock Incentive Plan.

(dollars in thousands)	As of **December 31, 2022**
Unrecognized stock-based compensation expense:	
2012 Director stock incentive plan	**$ 773**
2012 Omnibus stock incentive plan	**811**
2022 Omnibus stock incentive plan	**1**
Total unrecognized stock-based compensation expense	**$ 1,585**

The unrecognized stock-based compensation expense as of December 31, 2022 will be recognized ratably over the periods ended February 2025, February 2025 and May 2023 for the 2012 Director Stock Incentive Plan, 2012 Omnibus Stock Incentive Plan and 2022 Omnibus Stock Incentive Plan, respectively.

In addition to the 2022 stock incentive plan, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 165,000 shares of its un-issued capital stock for issuance under the plan. The ESPP was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, participation is voluntary whereby employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement or termination dates, as defined. As of December 31, 2022, 94,533 shares have been issued under the ESPP. The ESPP is considered a compensatory plan and is required to comply with the provisions of current accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased, and it is included as a component of salaries and employee benefits in the consolidated statements of income.

During the second quarter of 2022, the Company announced that the Board of Directors approved a plan to purchase, in open market and privately negotiated transactions, up to 3% of its outstanding common stock. As of December 31, 2022, the Company had repurchased 32,554 shares of common stock at an average price of $38.81 under the treasury stock repurchase plan.

The Company also established the dividend reinvestment plan (the DRP) for its shareholders. The DRP is designed to avail the Company's stock at no transactional cost to its shareholders. Cash dividends paid to shareholders who are enrolled in the DRP plus voluntary cash deposits received can be used to purchase shares, directly from the Company, from shares that become available in the open market or in negotiated transactions with third parties. The Company has reserved 750,000 shares of its un-issued capital stock for issuance under the DRP. As of December 31, 2022, there were 591,730 shares available for future issuance.

11. INCOME TAXES

Pursuant to the accounting guidelines related to income taxes, the Company has evaluated its material tax positions as of December 31, 2022 and 2021. Under the "more-likely-than-not" threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. In periods subsequent to December 31, 2021, determinations of potentially adverse material tax positions will be evaluated to determine whether an uncertain tax position may have previously existed or has been originated. In the event an adverse tax position is determined to exist, penalty and interest will be accrued, in accordance with the Internal Revenue Service (IRS) guidelines, and will be recorded as a component of other expenses in the Company's consolidated statements of income.

As of December 31, 2022, there were no unrecognized tax benefits that, if recognized, would significantly affect the Company's effective tax rate. Also, there were no penalties and interest recognized in the consolidated statements of income in 2022, 2021 and 2020 as a result of management's evaluation of whether an uncertain tax position may exist nor does the Company foresee a change in its material tax positions that would give rise to the non-recognition of an existing tax benefit during the forthcoming twelve months. Tax returns filed with the IRS are subject to review by law under a three-year statute of limitations. The Company has not received notification from the IRS regarding adverse tax issues for the current year or from tax returns filed for tax years 2021, 2020 or 2019.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. The bill reduced the Company's federal corporate income tax rate from 34% to 21% effective January 1, 2018.

The following temporary differences gave rise to the net deferred tax liability, a component of other assets in the consolidated balance sheets, as of the periods indicated:

	As of December 31,	
(dollars in thousands)	**2022**	2021
Deferred tax assets:		
Allowance for loan losses	**$ 3,601**	$ 3,281
Net unrealized losses on available-for-sale securities	**18,914**	-
Deferred interest from non-accrual assets	**226**	251
Operating lease liabilities	**1,965**	2,022
Acquisition accounting	**1,475**	2,087
Other	**1,241**	1,029
Total	**27,422**	8,670
Deferred tax liabilities:		
Net unrealized gains on available-for-sale securities	**-**	(48)
Loan fees and costs	**(1,825)**	(1,397)
Automobile leasing	**(6,635)**	(5,162)
Operating lease right-of-use assets	**(1,815)**	(1,891)
Depreciation	**(1,458)**	(1,594)
Mortgage loan servicing rights	**(341)**	(357)
Total	**(12,074)**	(10,449)
Deferred tax liability, net	**$ 15,348**	$ (1,779)

The components of the total provision for income taxes for the years indicated are as follows:

	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Current	**$ 3,612**	$ 4,904	$ 2,336
Deferred	**1,835**	(903)	(87)
Total provision for income taxes	**$ 5,447**	$ 4,001	$ 2,249

The reconciliation between the expected statutory income tax and the actual provision for income taxes is as follows:

	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Expected provision at the statutory rate	**$ 7,437**	$ 5,873	$ 3,203
Tax-exempt income	**(2,163)**	(1,686)	(865)
Bank owned life insurance	**(242)**	(232)	(167)
Nondeductible interest expense	**175**	87	54
Nondeductible other expenses and other, net	**306**	49	(8)
Tax credits	**(120)**	(135)	-
State income tax	**54**	45	32
Actual provision for income taxes	**$ 5,447**	$ 4,001	$ 2,249

12. RETIREMENT PLAN

The Company has a defined contribution profit sharing 401(k) plan covering substantially all of its employees. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Contributions to the plan approximated $1.0 million, $1.0 million and $0.7 million in 2022, 2021 and 2020.

13. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

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

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

	December 31, 2021				
(dollars in thousands)	Carrying amount	Estimated fair value	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Financial assets:					
Cash and cash equivalents	$ 96,877	$ 96,877	$ 96,877	$ -	$ -
Available-for-sale debt securities	738,980	738,980	-	738,980	-
Restricted investments in bank stock	3,206	3,206	-	3,206	-
Loans and leases, net	1,417,504	1,404,103	-	-	1,404,103
Loans held-for-sale	31,727	32,013	-	32,013	-
Accrued interest receivable	7,526	7,526	-	7,526	-
Financial liabilities:					
Deposits with no stated maturities	2,031,072	2,031,072	-	2,031,072	-
Time deposits	138,793	138,291	-	138,291	-
Secured borrowings	10,620	10,690	-	-	10,690
Accrued interest payable	155	155	-	155	-

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

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

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

Originated loans and leases: The fair value of accruing loans is estimated by calculating the net present value of the future expected cash flows discounted using the exit price notion. The discount rate is based upon current offering rates, with an additional discount for expected potential charge-offs. Additionally, an environmental general credit risk adjustment is subtracted from the net present value to arrive at the total estimated fair value of the accruing loan portfolio.

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

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

Acquired loans: Acquired loans (performing and non-performing) are initially recorded at their acquisition-date fair values using Level 3 inputs. For more information on the calculation of the fair value of acquired loans, see Footnote 21, "Acquisition."

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

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

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

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

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

(dollars in thousands)	**Total carrying value December 31, 2022**	**Quoted prices in active markets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant other unobservable inputs (Level 3)**
Available-for-sale securities:				
Agency - GSE	**$ 31,533**	**$ -**	**$ 31,533**	**$ -**
Obligations of states and political subdivisions	**171,894**	**-**	**171,894**	**-**
MBS - GSE residential	**217,435**	**-**	**217,435**	**-**
Total available-for-sale debt securities	**$ 420,862**	**$ -**	**$ 420,862**	**$ -**

(dollars in thousands)	Total carrying value December 31, 2021	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 117,003	$ -	$ 117,003	$ -
Obligations of states and political subdivisions	364,710	-	364,710	-
MBS - GSE residential	257,267	-	257,267	-
Total available-for-sale debt securities	$ 738,980	$ -	$ 738,980	$ -

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

There were no changes in Level 3 financial instruments measured at fair value on a recurring basis as of and for the periods ending December 31, 2022 and 2021, respectively.

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

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

(dollars in thousands)	Total carrying value at December 31, 2021	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Impaired loans	$ 2,245	$ -	$ -	$ 2,245
Other real estate owned	198	-	-	198
Total	$ 2,443	$ -	$ -	$ 2,443

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

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

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

At December 31, 2022 and December 31, 2021, the range of liquidation expenses and other valuation adjustments applied to impaired loans ranged from -19.61% and -29.58% and from -33.08% to -47.66%, respectively. The weighted average of liquidation expenses and other valuation adjustments applied to impaired loans amounted to -21.77% as of December 31, 2022 and -44.50% as of December 31, 2021, respectively. Due to the multitude of assumptions, many of which are subjective in nature, and the varying inputs and techniques used to determine fair value, the Company recognizes that valuations could differ across a wide spectrum of techniques employed. Accordingly, fair value estimates for impaired loans are classified as Level 3.

For ORE, fair value is generally determined through independent appraisals of the underlying properties which generally include various Level 3 inputs which are not identifiable. Appraisals form the basis for determining the net realizable value from these properties. Net realizable value is the result of the appraised value less certain costs or discounts associated with liquidation which occurs in the normal course of business. Management's assumptions may include consideration of the location and occupancy of the property, along with current economic conditions. Subsequently, as these properties are actively marketed, the estimated fair values may be periodically adjusted through incremental subsequent write-downs. These write-downs usually reflect decreases in estimated values resulting from sales price observations as well as changing economic and market conditions. At December 31, 2022 and December 31, 2021, the discounts applied to the appraised values of ORE ranged from -39.07% and -77.60% and from -20.16% and -77.60%, respectively. As of December 31, 2022, and December 31, 2021, the weighted average of discount to the appraisal values of ORE amounted to -39.61% and -28.21%, respectively.

At December 31, 2022 and 2021, there were no other repossessed assets. The Company refers to the National Automobile Dealers Association (NADA) guide to determine a vehicle's fair value.

Financial Instruments with Off-Balance Sheet Risk

The Company is a party to 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 standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments. Because of the nature of these instruments, the fair values of these off-balance sheet items are not material.

The notional amount of the Company's financial instruments with off-balance sheet risk was as follows:

	December 31,	
(dollars in thousands)	**2022**	2021
Off-balance sheet financial instruments:		
Commitments to extend credit	**$ 390,644**	$ 306,852
Standby letters of credit	**16,634**	6,352

Commitments to Extend Credit and Standby Letters of Credit

The Company's exposure to credit loss from nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. The Company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by the Company on extension of credit, is based on management's credit assessment of the customer.

Financial standby letters of credit are conditional commitments issued by the Company to guarantee performance of a customer to a third party. Those guarantees are issued primarily to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The Company's performance under the guarantee is required upon presentation by the beneficiary of the financial standby letter of credit. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company was not required to recognize any liability in connection with the issuance of these financial standby letters of credit.

The following table summarizes outstanding financial letters of credit as of December 31, 2022:

(dollars in thousands)	Less than one year	More than one year to five years	Over five years	Total
Secured by:				
Collateral	$ 5,680	$ 2,850	$ 1,007	$ 9,537
Bank lines of credit	1,903	3,300	—	5,203
Other	658	—	—	658
	8,241	6,150	1,007	15,398
Unsecured	821	415	—	1,236
Total	$ 9,062	$ 6,565	$ 1,007	$ 16,634

The Company has not incurred losses on its commitments in 2022, 2021 or 2020.

14. EARNINGS PER SHARE

Basic earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but also reflects the potential dilution that could occur from the grant of stock-based compensation awards. The Company maintains one active share-based compensation plan that may generate additional potentially dilutive common shares. For granted and unexercised stock-settled stock appreciation rights (SSARs), dilution would occur if Company-issued SSARs were exercised and converted into common stock. As of the years ended December 31, 2022, 2021 and 2020, there were 19,675, 28,770 and 24,644 potentially dilutive shares related to issued and unexercised SSARs. The calculation did not include 49,296 weighted average unexercised SSARs that could potentially dilute earnings per share but their effect was antidilutive as of December 31, 2022. For restricted stock, dilution would occur from the Company's previously granted but unvested shares. There were 14,865, 12,705 and 5,496 potentially dilutive shares related to unvested restricted share grants as of the years ended December 31, 2022, 2021 and 2020, respectively. The calculation did not include 867 weighted average unvested restricted shares that could potentially dilute earnings per share but their effect was antidilutive as of December 31, 2022.

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

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

		2022		2021		2020
(dollars in thousands except per share data)						
Basic EPS:						
Net income available to common shareholders	**$**	**30,021**	$	24,008	$	13,035
Weighted-average common shares outstanding		**5,644,599**		5,321,687		4,586,224
Basic EPS	**$**	**5.32**	$	4.51	$	2.84
Diluted EPS:						
Net income available to common shareholders	**$**	**30,021**	$	24,008	$	13,035
Weighted-average common shares outstanding		**5,644,599**		5,321,687		4,586,224
Potentially dilutive common shares		**34,540**		41,475		30,140
Weighted-average common and potentially dilutive shares outstanding		**5,679,139**		5,363,162		4,616,364
Diluted EPS	**$**	**5.29**	$	4.48	$	2.82

15. REGULATORY MATTERS

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

Under these guidelines, assets and certain off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets. The guidelines require all banks and bank holding companies to maintain a minimum ratio of total risk-based capital to total risk-weighted assets (Total Risk Adjusted Capital) of 8%, including Tier I common equity to total risk-weighted assets (Tier I Common Equity) of 4.5%, Tier I capital to total risk-weighted assets (Tier I Capital) of 6% and Tier I capital to average total assets (Leverage Ratio) of at least 4%. A capital conservation buffer, comprised of common equity Tier I capital, is also established above the regulatory minimum capital requirements of 2.50%. As of December 31, 2022 and 2021, the Company and the Bank exceeded all capital adequacy requirements to which it was subject.

The following table reflects the actual and required capital and the related capital ratios as of the periods indicated. No amounts were deducted from capital for interest-rate risk in either 2022 or 2021.

	Actual		For capital adequacy purposes		For capital adequacy purposes with capital conservation buffer*		To be well capitalized under prompt corrective action provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2022								
Total capital (to risk-weighted assets)								
Consolidated	**$230,133**	**14.4%**	**≥ $128,325**	**8.0%**	**≥ $ 168,427**	**10.5%**	**N/A**	**N/A**
Bank	**$229,803**	**14.3%**	**≥ $128,308**	**8.0%**	**≥ $ 168,405**	**10.5%**	**≥ $ 160,385**	**10.0%**
Tier 1 common equity (to risk-weighted assets)								
Consolidated	**$212,935**	**13.3%**	**≥ $ 72,183**	**4.5%**	**≥ $ 112,285**	**7.0%**	**N/A**	**N/A**
Bank	**$212,605**	**13.3%**	**≥ $ 72,173**	**4.5%**	**≥ $ 112,270**	**7.0%**	**≥ $ 104,251**	**6.5%**
Tier I capital (to risk-weighted assets)								
Consolidated	**$212,935**	**13.3%**	**≥ $ 96,244**	**6.0%**	**≥ $ 136,346**	**8.5%**	**N/A**	**N/A**
Bank	**$212,605**	**13.3%**	**≥ $ 96,231**	**6.0%**	**≥ $ 136,328**	**8.5%**	**≥ $ 128,308**	**8.0%**
Tier I capital (to average assets)								
Consolidated	**$212,935**	**8.7%**	**≥ $ 97,960**	**4.0%**	**≥ $ 97,960**	**4.0%**	**N/A**	**N/A**
Bank	**$212,605**	**8.7%**	**≥ $ 97,951**	**4.0%**	**≥ $ 97,951**	**4.0%**	**≥ $ 122,439**	**5.0%**
As of December 31, 2021								
Total capital (to risk-weighted assets)								
Consolidated	$205,667	14.5%	≥ $113,421	8.0%	≥ $ 148,866	10.5%	N/A	N/A
Bank	$205,726	14.5%	≥ $113,406	8.0%	≥ $ 148,845	10.5%	≥ $ 141,757	10.0%
Tier 1 common equity (to risk-weighted assets)								
Consolidated	$189,980	13.4%	≥ $ 63,800	4.5%	≥ $ 99,244	7.0%	N/A	N/A
Bank	$190,039	13.4%	≥ $ 63,791	4.5%	≥ $ 99,230	7.0%	≥ $ 92,142	6.5%
Tier I capital (to risk-weighted assets)								
Consolidated	$189,980	13.4%	≥ $ 85,066	6.0%	≥ $ 120,510	8.5%	N/A	N/A
Bank	$190,039	13.4%	≥ $ 85,054	6.0%	≥ $ 120,493	8.5%	≥ $ 113,406	8.0%
Tier I capital (to average assets)								
Consolidated	$189,980	7.9%	≥ $ 95,688	4.0%	≥ $ 95,688	4.0%	N/A	N/A
Bank	$190,039	7.9%	≥ $ 95,680	4.0%	≥ $ 95,680	4.0%	≥ $ 119,600	5.0%

* The minimums under Basel III increased to include the capital conservation buffer of 2.50%.

The Company's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations and Pennsylvania law limit the amount of dividends that may be paid from the Bank to the Company without prior approval of regulatory agencies. Accordingly, at December 31, 2022, approximately $136.7 million was available for dividend distribution from the Bank to the Company in 2022.

16. RELATED PARTY TRANSACTIONS

During the ordinary course of business, loans are made to executive officers, directors, greater than 5% shareholders and associates of such persons. These transactions are executed on substantially the same terms and at the rates prevailing at the time for comparable transactions with others. These loans do not involve more than the normal risk of collectability or present other unfavorable features. A summary of loan activity with officers, directors, associates of such persons and shareholders who own more than 5% of the Company's outstanding shares is as follows:

	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Balance, beginning	**$ 11,505**	$ 9,885	$ 6,765
Adjustments for changes in position	**(75)**	1,022	(1,063)
Additions	**1,608**	7,228	7,156
Collections	**(2,394)**	(6,630)	(2,973)
Balance, ending	**$ 10,644**	$ 11,505	$ 9,885

As of December 31, 2022, 2021 and 2020, deposits from executive officers and directors approximated $24.8 million, $39.0 million and $27.9 million, respectively.

17. CONTINGENCIES

The nature of the Company's business generates litigation involving matters arising in the ordinary course of business. However, in the opinion of management of the Company after consulting with the Company's legal counsel, no legal proceedings are pending, which, if determined adversely to the Company or the Bank, would have a material effect on the Company's shareholders' equity or results of operations. No legal proceedings are pending other than ordinary routine litigation incident to the business of the Company and the Bank. In addition, to management's knowledge, no government authorities have initiated or contemplated any material legal actions against the Company or the Bank.

18. RECENT ACCOUNTING PRONOUNCEMENTS

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

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

The Company will adopt ASU 2016-13 and all of the subsequent amendments using the modified-retrospective approach and will record a cumulative-effect adjustment to retained earnings. Upon adoption, the change in this accounting guidance could require the Company to record loan losses more rapidly. The Company has engaged the services of a qualified third-party service provider to assist management in estimating credit allowances under this standard. Starting in the 3rd quarter of 2022, the Company ran its CECL model parallel to the current allowance for loan losses calculation to gain a better understanding of the effects of the change. During the fourth quarter of 2022, a third-party service provider ran a model validation with no substantial findings. Upon adoption of CECL on January 1, 2023, the Company estimated an adjustment for the allowance for credit losses (ACL) which resulted in an increase in the allowance for loan losses of approximately $0.7 million and reserve for unfunded commitments of approximately $1.1 million. The Company has also run a CECL analysis on its held-to-maturity investment securities as of December 31, 2022 and the estimated CECL reserve is immaterial. The Company will finalize the adoption during the first quarter of 2023.

In March 2022, the FASB issued ASU 2022-02, *Financial Instruments-Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures*. The amendments in this update eliminate the accounting guidance for TDRs by creditors in Subtopic 310-40, *Receivables-Troubled Debt Restructurings by Creditors*, while enhancing disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty. The amendments in this update also require that an entity disclose current-period gross writeoffs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, *Financial Instruments-Credit Losses-Measured at Amortized Cost*. The amendments in this update are effective for the Company upon adoption of ASU 2016-13. The amendments in this update should be applied prospectively, except as provided in the next sentence. For the transition method related to the recognition and measurement of TDRs, the Company has the option to apply a modified retrospective transition method, resulting in a cumulative-effect adjustment to retained earnings in the period of adoption.

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

In December 2022, the FASB issued ASU 2022-06, *Reference Rate Reform (Topic 848) - Deferral of the Sunset Date of Topic 848*. The amendments in this update defer the sunset date of Topic 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The Company expects to apply the amendments prospectively for applicable loan and other contracts within the effective period of ASU 2022-06. As of December 31, 2022, the Company had approximately $40 million in loans with rates tied to LIBOR. The Company is working on modifying each of these existing contracts.

19. PARENT COMPANY ONLY

The following is the condensed financial information for Fidelity D & D Bancorp, Inc. on a parent company only basis as of and for the years indicated:

Condensed Balance Sheets	As of December 31,	
(dollars in thousands)	**2022**	2021
Assets:		
Cash	**$ 634**	$ 515
Investment in subsidiary	**162,620**	211,788
Other assets	**214**	198
Total	**$ 163,468**	$ 212,501
Liabilities and shareholders' equity:		
Liabilities	**$ 518**	$ 772
Capital stock and retained earnings	**235,365**	211,550
Treasury stock	**(1,263)**	-
Accumulated other comprehensive income (loss)	**(71,152)**	179
Total	**$ 163,468**	$ 212,501

Condensed Income Statements	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Income:			
Equity in undistributed earnings of subsidiary	**$ 24,128**	$ 19,898	$ 9,934
Dividends from subsidiary	**7,709**	6,608	5,378
Total income	**31,837**	26,506	15,312
Operating expenses	**2,295**	3,016	2,779
Income before taxes	**29,542**	23,490	12,533
Credit for income taxes	**479**	518	502
Net income	**$ 30,021**	$ 24,008	$ 13,035

Statements of Comprehensive Income	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Bancorp net loss	**$ (1,816)**	$ (2,498)	$ (2,277)
Equity in net income of subsidiary	**31,837**	26,506	15,312
Net income	**30,021**	24,008	13,035
Equity in other comprehensive income (loss) of subsidiary	**(71,331)**	(8,773)	5,350
Other comprehensive (loss) income, net of tax	**(71,331)**	(8,773)	5,350
Total comprehensive (loss) income, net of tax	**$ (41,310)**	$ 15,235	$ 18,385

Condensed Statements of Cash Flows	Years ended December 31,		
(dollars in thousands)	**2022**	2021	2020
Cash flows from operating activities:			
Net income	**$ 30,021**	$ 24,008	$ 13,035
Adjustments to reconcile net income to net cash used in operations:			
Equity in earnings of subsidiary	**(31,837)**	(26,506)	(15,312)
Stock-based compensation expense	**1,271**	1,096	1,077
Deferred income tax	**(25)**	(10)	(84)
Changes in other assets and liabilities, net	**(232)**	390	71
Net cash used in operating activities	**(802)**	(1,022)	(1,213)
Cash flows provided by investing activities:			
Dividends received from subsidiary	**7,709**	6,608	5,378
Operating dividend from subsidiary	**700**	1,075	1,129
Net cash (used in) acquired in acquisition	**-**	(64)	58
Purchases of bank premises and equipment	**(11)**	-	-
Net cash provided by investing activities	**8,398**	7,619	6,565
Cash flows used in financing activities:			
Dividends paid, net of dividend reinvestment	**(7,709)**	(6,608)	(5,378)
Withholdings to purchase capital stock	**252**	270	219
Repurchase of shares to cover withholdings	**(20)**	-	-
Net cash used in financing activities	**(7,477)**	(6,338)	(5,159)
Net change in cash	**119**	259	193
Cash, beginning	**515**	256	63
Cash, ending	**$ 634**	$ 515	$ 256

20. ACQUISITION

On July 1, 2021, the Company completed its previously announced acquisition of Landmark. Landmark was a one-bank holding company organized under the laws of the Commonwealth of Pennsylvania and was headquartered in Pittston, PA. Its wholly owned subsidiary, Landmark Community Bank, was an independent community bank chartered under the laws of the Commonwealth of Pennsylvania. Landmark Community Bank conducted full-service commercial banking services through five bank centers located in Lackawanna and Luzerne Counties, Pennsylvania. The acquisition expanded Fidelity Deposit and Discount Bank's full-service footprint in Luzerne County, Pennsylvania. The Company transacted the acquisition to complement the Company's existing operations, while consistent with the Company's strategic plan of enhancing long-term shareholder value. The fair value of total assets acquired as a result of the merger totaled $375.5 million (net of cash consideration), loans totaled $298.9 million and deposits totaled $308.5 million. Goodwill recorded in the merger was $12.6 million.

In accordance with the terms of the Reorganization Agreement, on July 1, 2021 each share of Landmark common stock was converted into the right to receive 0.272 shares of the Company's common stock and $3.26 in cash. As a result of the acquisition, the Company issued 647,990 shares of its common stock, valued at $35.1 million, and $7.8 million in cash based upon $54.10, the determined market price of the Company's common stock in accordance with the Reorganization Agreement. The results of the combined entity's operations are included in the Company's Consolidated Financial Statements from the date of acquisition. The acquisition of Landmark was accounted for as a business combination using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at estimated fair values on the acquisition date.

Effective July 1, 2021, in connection with the merger and pursuant to the terms of the Reorganization Agreement, Paul C. Woelkers was appointed as a Class C Director of Fidelity's Board of Directors. Mr. Woelkers was also appointed as a Director of Fidelity Bank's Board of Directors.

The following table summarizes the consideration paid for Landmark and the fair value of assets acquired, and liabilities assumed as of the acquisition date:

Purchase Price Consideration in Common Stock			
Landmark shares settled for stock			2,382,695
Exchange ratio			0.272
Total FDBC shares issued			647,990
Value assigned to FDBC common share (9/30/2021 closing price)		$	54.10
Purchase price assigned to Landmark common shares exchanged for FDBC common shares		$	35,056,259
Purchase Price Consideration - Cash for Common Stock			
Landmark shares exchanged for cash, excluding fractional shares			2,382,695
Cash consideration (per Landmark share)		$	3.26
Cash portion of purchase price		$	7,767,586
Cash portion of purchase price (cash paid fractional shares)		$	5,559
Cash for outstanding Landmark stock options		$	69,250
Total consideration paid		$	42,898,654

Allocation of Purchase Price	**In thousands**		
Total Purchase Price		$	42,899
Estimated Fair Value of Assets Acquired			
Cash and cash equivalents	4,090		
Investment securities	49,430		
Loans	298,860		
Restricted investments in bank stock	1,186		
Premises and equipment	3,405		
Lease property under finance leases	1,188		
Core deposit intangible asset	597		
Other real estate owned	488		
Other assets	11,629		
Total assets acquired	370,873		
Estimated Fair Value of Liabilities Assumed			
Non-interest bearing deposits	100,472		
Interest bearing deposits	208,057		
Short-term borrowings	2,224		
FHLB borrowings	4,602		
Secured borrowings	20,619		
Finance lease obligation	1,188		
Other liabilities	3,387		
Total liabilities assumed	340,549		
Net Assets Acquired			30,324
Goodwill Recorded in Acquisition		$	12,575

Pursuant to the accounting requirements, the Company assigned a fair value to the assets acquired and liabilities assumed of Landmark. ASC 820 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

The assets acquired and liabilities assumed in the acquisition of Landmark were recorded at their estimated fair values based on management's best estimates using information available at the date of the acquisition and are subject to adjustment for up to one year after the closing date of the acquisition. While the fair values are not expected to be materially different from the estimates, any material adjustments to the estimates will be reflected, retroactively, as of the date of the acquisition. The items most susceptible to adjustment are the fair value adjustments on loans, core deposit intangible and the deferred income tax assets resulting from the acquisition. Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

Investment securities available-for-sale

The estimated fair values of the investment securities available for sale, primarily comprised of U.S. Government agency mortgage-backed securities, U.S. government agencies and municipal bonds, were determined using Level 1 and Level 2 inputs in the fair value hierarchy. The fair values were determined using executable market bids or independent pricing services. The Company's independent pricing service utilized 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 security but rather relying on the security's relationship to other benchmark quoted prices. Management reviewed the data and assumptions used in pricing the securities.

Loans

Acquired loans (performing and non-performing) are initially recorded at their acquisition-date fair values using Level 3 inputs. Fair values are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, expected lifetime losses, environmental factors, collateral values, discount rates, expected payments and expected prepayments. Specifically, the Company has prepared three separate loan fair value adjustments that it believed a market participant might employ in estimating the entire fair value adjustment necessary under ASC 820-10 for the acquired loan portfolio. The three-separate fair valuation methodology employed are: 1) an interest rate loan fair value adjustment, 2) a general credit fair value adjustment, and 3) a specific credit fair value adjustment for purchased credit impaired loans subject to ASC 310-30 procedures. The acquired loans were recorded at fair value at the acquisition date without carryover of Landmark's previously established allowance for loan losses. The fair value of the financial assets acquired included loans receivable with a gross amortized cost basis of $309.8 million.

The table below illustrates the fair value adjustments made to the amortized cost basis in order to present the fair value of the loans acquired. The credit adjustment on purchased credit impaired loans is derived in accordance with ASC 310-30 and represents the portion of the loan balances that has been deemed uncollectible based on the Company's expectations of future cash flows for each respective loan.

Dollars in thousands		
Gross amortized cost basis at December 31, 2021	$	309,767
Interest rate fair value adjustment on pools of homogeneous loans		(1,855)
Credit fair value adjustment on pools of homogeneous loans		(7,915)
Credit fair value adjustment on purchased credit impaired loans		(1,137)
Fair value of acquired loans at December 31, 2021	$	298,860

For loans acquired without evidence of credit quality deterioration, the Company prepared the interest rate loan fair value and credit fair value adjustments. Loans were grouped into homogeneous pools by characteristics such as loan type, term, collateral, and rate. Market rates for similar loans were obtained from various internal and external data sources and reviewed by management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value discount of $1.9 million. Additionally, for loans acquired without credit deterioration, a credit fair value adjustment was calculated using a two-part credit fair value analysis: 1) expected lifetime credit migration losses; and 2) estimated fair value adjustment for certain qualitative factors. The expected lifetime losses were calculated using historical losses observed by the Company, Landmark and peer banks. The Company also estimated an environmental factor to apply to each loan type. The environmental factor represents the potential discount which may arise due to general credit and economic factors. A credit fair value discount of $7.9 million was determined. Both the interest rate and credit fair value adjustments relate to loans acquired with evidence of credit quality deterioration will be substantially recognized as interest income on a level yield amortization method over the expected life of the loans.

The following table presents the acquired purchased credit impaired loans receivable at the acquisition date:

Dollars in thousands	
Contractual principal and interest at acquisition	$ 5,306
Non-accretable difference	(1,691)
Expected cash flows at acquisition	3,615
Accretable yield	(588)
Fair value of purchased impaired loans	$ 3,027

Premises and Equipment

The Company assumed leases on 2 branch facilities of Landmark. The Company compared the lease contract obligations to comparable market rental rates determined by third-party licensed appraisers. The Company believed that the leased contract rates were in a reasonable range of market rental rates and concluded that no fair market value adjustment related to leasehold interest was necessary. The fair value of Landmark's premises, including land, buildings and improvements, was determined based upon independent third-party appraisals performed by licensed appraisers or sales agreements.

Core Deposit Intangible

The fair value of the core deposit intangible was determined based on a discounted cash flow (present value) analysis using a discount rate commensurate with market participants. To calculate cash flows, deposit account servicing costs (net of deposit fee income) and interest expense on deposits were compared to the higher cost of alternative funding sources available through national brokered CD offering rates and FHLB advance rates. The projected cash flows were developed using projected deposit attrition rates based on the average rate experienced by both institutions. The core deposit intangible will be amortized over ten years using the sum-of-years digits method.

Time Deposits

The fair value adjustment for time deposits represents a discount from the value of the contractual repayments of fixed maturity deposits using prevailing market interest rates for similar-term time deposits. The time deposit premium is being amortized into income on a level yield amortization method over the contractual life of the deposits.

Secured Borrowings

The Company identified 19 sold participations acquired from Landmark that did not meet the criteria for sales treatment under ASC 860-10-40 and should be recorded as obligations from secured borrowing arrangements. The Company has estimated the fair value of these obligations using an income approach based on the expected cash flows method on a pooled basis using Level 3 assumptions.

FHLB Borrowings

The Company assumed FHLB borrowings in connection with the merger. The fair value of FHLB Borrowings was determined by using FHLB prepayment penalty as a proxy for the fair value adjustment. The Company decided to pay off the borrowing post acquisition date therefore no amortization is warranted.

Merger-related expenses

The Company did not incur any merger-related expenses for the year ended December 31, 2022. For the year ended December 31, 2021, the Company incurred $3.0 million in merger-related expenses related to the merger with Landmark, primarily consisting of data processing, salaries and employee benefits, and professional fee expenses. For the year ended December 31, 2020, the Company incurred merger-related expenses related to the merger with MNB totaling $2.5 million, primarily consisting of professional fees, salaries and employee benefits and data processing fees.

21. EMPLOYEE BENEFITS

Bank-Owned Life Insurance (BOLI)

The Company has purchased single premium BOLI policies on certain officers. The policies are recorded at their cash surrender values. Increases in cash surrender values are included in non-interest income in the consolidated statements of income. As a result of the acquisition of Landmark, the Company added BOLI with a value of $7.2 million during 2021. The policies' cash surrender value totaled $54.0 million and $52.7 million, respectively, as of December 31, 2022 and 2021 and is reflected as an asset on the consolidated balance sheets. For the years ended December 31, 2022 and 2021, the Company has recorded income of $1.3 million and $1.2 million, respectively.

Officer Life Insurance

In 2017, the Bank entered into separate split dollar life insurance arrangements (Split Dollar Agreements) with eleven officers. This plan provides each officer a specified death benefit should the officer die while in the Bank's employ. The Bank paid the insurance premiums in March 2017 and the arrangements were effective in March 2017. In March 2019, the Bank entered into a new Split Dollar Agreement with one officer. In January 2021, the Bank entered into Split Dollar Agreements with fifteen officers. The Bank owns the policies and all cash values thereunder. Upon death of the covered employee, the agreed-upon amount of death proceeds from the policies will be paid directly to the insured's beneficiary. As of December 31, 2022, the policies had total death benefits of $54.0 million of which $8.8 million would have been paid to the officer's beneficiaries and the remaining $45.2 million would have been paid to the Bank. In addition, four executive officers have the opportunity to retain a split dollar benefit equal to two times their highest base salary after separation from service if the vesting requirements are met. As of December 31, 2022 and 2021, the Company accrued expenses of $269 thousand and $200 thousand for the split dollar benefit.

Supplemental Executive Retirement plan (SERP)

On March 29, 2017, the Bank entered into separate supplemental executive retirement agreements (individually the "SERP Agreement") with five officers, pursuant to which the Bank will credit an amount to a SERP account established on each participant's behalf while they are actively employed by the Bank for each calendar month from March 1, 2017 until retirement. On March 20, 2019, the Bank entered into a SERP Agreement with one officer, pursuant to which the Bank will credit an amount to a SERP account established for the participant's behalf while they are actively employed by the Bank for each calendar month from March 1, 2019 until normal retirement age. As a result of the acquisition of Landmark, the Company added $1.0 million in accrued SERP expenses to the consolidated balance sheets. As of December 31, 2022 and 2021, the Company accrued expenses of $4.0 million and $3.6 million in connection with the SERP.

22. REVENUE RECOGNITION

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

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

- Service charges on deposit accounts – Deposit service charges represent fees charged by the Company for the performance obligation of providing services to a customer's deposit account. The transaction price for deposit services includes both fixed and variable amounts based on the Company's fee schedules. Revenue is recognized and payment is received either at a point in time for transactional fees or on a monthly basis for non-transactional fees.
- Interchange fees – Interchange fees represent fees charged by the Company for customers using debit cards. The contract is between the Company and the processor and the performance obligation is the ability of customers to use debit cards to make purchases at a point in time. The transaction price is a percentage of debit card usage and the processor pays the Company and revenue is recorded throughout the month as the performance obligations are being met.
- Fees from trust fiduciary activities – Trust fees represent fees charged by the Company for the management, custody and/or administration of trusts. These are mostly monthly fees based on the market value of assets in the trust account at the prior month end. Payment is generally received a few weeks after month end through a direct charge to customers' accounts. Estate fees are recognized and charged as the Company reaches each of six different stages of the estate administration process.
- Fees from financial services – Financial service fees represent fees charged by the Company for the performance obligation of providing various services for an investment account. Revenue is recognized twice monthly for fees on sales transactions and on a monthly basis for advisory fees and quarterly for trail fees.
- Gain/loss on ORE sales – Gain/loss on the sale of ORE is recognized at the closing date when the sales proceeds are received. In seller-financed ORE transactions, the contract is made subject to our normal underwriting standards and pricing. The Company does not have any obligation or right to repurchase any sales of ORE.

Contract balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before the payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity already received payment (or payment is due) from the customer. The Company's non-interest income streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company typically does not enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2022 and 2021, the Company did not have any significant contract balances.

Remaining performance obligations

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

Contract acquisition costs

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

23. LEASES

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

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

The Company's operating leases, where the Company is lessee, include property, land and equipment. As of December 31, 2022, ten of the Company's branch properties, one administrative office and one former branch were leased under operating leases. In four of the branch leases, the Company leases the land from an unrelated third party, and the buildings are the Company's own capital improvement. The Company also leases two standalone ATMs under operating leases. Additionally, the Company has one property lease and four equipment leases classified as finance leases. The Company acquired a leased property classified as a finance lease with a fair value of $1.2 million from the Landmark merger during 2021.

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

(dollars in thousands)		**December 31, 2022**		December 31, 2021
Property and equipment	**$**	**1,695**	$	1,673
Less accumulated depreciation and amortization		**(606)**		(366)
Leased property under finance leases, net	**$**	**1,089**	$	1,307

The following is a schedule of future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of December 31, 2022:

(dollars in thousands)		Amount
2023	$	227
2024		171
2025		161
2026		150
2027		150
2028 and thereafter		313
Total minimum lease payments (a)		1,172
Less amount representing interest (b)		(62)
Present value of net minimum lease payments	$	1,110

(a) The future minimum lease payments have not been reduced by estimated executory costs (such as taxes and maintenance) since this amount was deemed immaterial by management.
(b) Amount necessary to reduce net minimum lease payments to present value calculated at the Company's incremental borrowing rate upon lease inception.

As of December 31, 2022, the Company leased its Green Ridge, Pittston, Peckville, Back Mountain, Mountain Top, Abington, Nazareth, Easton, Bethlehem and Wyoming branches under the terms of operating leases. During 2022, the Company relocated the Bethlehem branch and the lease for the former branch expires in June 2023. During 2022, the Company also entered into a new lease of administrative office space in Scranton. Common area maintenance is included in variable lease payments in the table below. The Abington branch has variable lease payments which are calculated as a percentage of the national prime rate of interest and are expensed as incurred. The Bethlehem and Easton branches have variable lease payments that increase annually and are expensed as incurred.

(dollars in thousands)		**2022**		2021		2020
Lease cost						
Finance lease cost:						
Amortization of right-of-use assets	**$**	**240**	$	164	$	85
Interest on lease liabilities		**21**		16		8
Operating lease cost		**746**		637		540
Short-term lease cost		**149**		59		18
Variable lease cost		**35**		4		(2)
Total lease cost	**$**	**1,191**	$	880	$	649
Other information						
Cash paid for amounts included in the measurement of lease liabilities						
Operating cash flows from finance leases	**$**	**21**	$	16	$	8
Operating cash flows from operating leases (Fixed payments)	**$**	**646**	$	560	$	496
Operating cash flows from operating leases (Liability reduction)	**$**	**389**	$	291	$	250
Financing cash flows from finance leases	**$**	**232**	$	159	$	83
Right-of-use assets obtained in exchange for new finance lease liabilities	**$**	**119**	$	1,188	$	88
Right-of-use assets obtained in exchange for new operating lease liabilities	**$**	**22**	$	2,775	$	1,338
Weighted-average remaining lease term - finance leases (in years)		**6.52**		7.22		3.12
Weighted average remaining lease term - operating leases (in years)		**20.62**		21.42		21.30
Weighted-average discount rate - finance leases		**1.72%**		1.79%		2.52%
Weighted-average discount rate - operating leases		**3.39%**		3.38%		3.56%

During 2022, $1.2 million of the total lease cost was included in premises and equipment expense and $31 thousand was included in other expenses on the consolidated statements of income. During 2021, $845 thousand of the total lease cost was included in premises and equipment expense and $35 thousand was included in other expenses on the consolidated statements of income. Operating lease expense is recognized on a straight-line basis over the lease term. We recognized both the interest expense and amortization expense for finance leases in premises and equipment expense since the interest expense portion was immaterial.

The future minimum lease payments for the Company's branch network and equipment under operating leases that have lease terms in excess of one year as of December 31, 2022 are as follows:

(dollars in thousands)		Amount
2023	$	695
2024		652
2025		633
2026		640
2027		649
2028 and thereafter		10,147
Total future minimum lease payments		13,416
Plus variable payment adjustment		(127)
Less amount representing interest		(3,932)
Present value of net future minimum lease payments	$	9,357

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

(dollars in thousands)		Amount
2023	$	48
2024		51
2025		54
2026		54
2027		27
2028 and thereafter		-
Total lease payments to be received	$	234

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

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

	For the years ended December 31,					
(dollars in thousands)		**2022**		2021		2020
Lease income - direct finance leases						
Interest income on lease receivables	**$**	**1,087**	$	807	$	722
Lease income - operating leases		**188**		257		236
Total lease income	**$**	**1,275**	$	1,064	$	958

24. Derivative Instruments

The Company is a party to interest rate derivatives that are not designated as hedging instruments. The Company enters into interest rate swaps that allow certain commercial loan customers to effectively convert a variable-rate commercial loan agreement to a fixed-rate commercial loan agreement. These interest rate swaps with customers are simultaneously offset by interest rate swaps that the Company executes with a third-party financial institution, such that the Company minimizes its net interest rate risk exposure resulting from such transactions. The interest rate swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated balance sheets (asset positions are included in other assets and liability positions are included in other liabilities). As the interest rate swaps are structured to offset each other, changes to the underlying benchmark interest rates considered in the valuation of these instruments do not result in an impact to earnings; however there may be fair value adjustments related to credit-quality variations between counterparties, which may impact earnings as required by FASB ASC 820. There was no effect on earnings in any periods presented. The Company had $1 million in investment securities pledged as collateral on its interest rate swaps with a third-party financial institution as of December 31, 2022. There were no interest rate swaps as of December 31, 2021.

(dollars in thousands)	Notional Amount	Weighted Average Maturity (Years)	Interest Rate Paid	Interest Rate Received	Fair Value
December 31, 2022					
Classified in Other assets:					
Customer interest rate swaps	$ 1,996	14.91	30 Day SOFR + Margin	Fixed	$ 213
Classified in Accrued interest payable and other liabilities:					
Third party interest rate swaps	$ 1,996	14.91	Fixed	30 Day SOFR + Margin	$ 213

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A: CONTROLS AND PROCEDURES

As of the end of the period covered by this Annual Report on Form 10-K, an evaluation was carried out by the Company's management, with the participation of its President and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and are effective. The Company made no changes in its internal controls over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, these controls during the last fiscal quarter ended December 31, 2022.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's President and Chief Executive Officer and the Chief Financial Officer, and implemented in conjunction with management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements for external purposes in accordance with generally accepted accounting principles.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2022. This assessment was based on criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework," (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management determined that, as of December 31, 2022, the Company maintained effective internal control over financial reporting.

ITEM 9B: OTHER INFORMATION

None

ITEM 9C: DISCLOSURE RELATING TO FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

None

PART III

ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required in this item is incorporated by reference herein to the information presented in the Company's definitive Proxy Statement for its 2023 Annual Meeting of Shareholders to be filed with the SEC.

The Company has made no material changes to the procedures by which security holders may recommend nominees to the Company's board of directors during the fourth quarter of 2022.

Section 16(a) Beneficial Ownership Reporting Compliance

The information required in this item is incorporated by reference herein to the information presented in the Company's definitive Proxy Statement for its 2023 Annual Meeting of Shareholders to be filed with the SEC.

Code of Ethics

Pursuant to Item 406 of Regulation S-K, the Company adopted a written code of ethics that applies to our directors, officers and employees, including our chief executive officer and chief financial officer, which is available on our website at http://www.bankatfidelity.com through the Investor Relations link and then under the headings "Other Information", "Governance Documents." In addition, copies of our code of ethics will be provided to shareholders upon written request to Fidelity D & D Bancorp, Inc., Blakely and Drinker Streets, Dunmore, PA 18512 at no charge.

ITEM 11: EXECUTIVE COMPENSATION

The information required in this item is incorporated by reference herein to the information presented in the Company's definitive Proxy Statement for its 2023 annual meeting of shareholders to be filed with the SEC.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required in this item is incorporated by reference herein to the information presented in the Company's definitive Proxy Statement for its 2023 annual meeting of shareholders to be filed with the SEC.

Securities authorized for issuance under equity compensation plans

The following table summarizes the Company's equity compensation plans as of December 31, 2022 that have been approved and not approved by Fidelity D & D Bancorp, Inc. shareholders:

	(a)	(b)	(c)
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders:			
2002 Employee Stock Purchase Plan	7,294	$ 52.03	67,558
2012 Omnibus Stock Incentive Plan (Restricted stock)	38,564	$ 51.93	0
2012 Omnibus Stock Incentive Plan (SSARs)	19,959	$ 38.80	0
2012 Director Stock Incentive Plan (Restricted stock)	23,872	$ 50.73	0
2022 Omnibus Stock Incentive Plan	50	$ 35.91	499,950
Equity compensation plans not approved by security holders - none	-	-	-
Total	89,739	$ 48.69	567,508

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required in this item is set forth in Footnote No. 16 “Related Party Transactions”, of Part II, Item 8 “Financial Statements and Supplementary Data”, and the information required by Items 404 and 407(a) of Regulation S-K is incorporated by reference herein to the information presented in the Company’s definitive Proxy Statement for its 2023 annual meeting of shareholders to be filed with the SEC.

ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference herein, to the information presented in the Company’s definitive Proxy Statement for its 2023 annual meeting of shareholders to be filed with the SEC.

PART IV

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements - The following financial statements are included by reference in Part II, Item 8 hereof:

Report of Independent Registered Public Accounting Firm (PCAOB ID: 49)
Consolidated Balance Sheets
Consolidated Statements of Income
Consolidated Statements of Comprehensive Income
Consolidated Statements of Changes in Shareholders' Equity
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

Financial Statement Schedules are omitted because the required information is either not applicable, the data is not significant or the required information is shown in the respective financial statements or in the notes thereto or elsewhere herein.

(3) Exhibits

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

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

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

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

2.2 Agreement and Plan of Reorganization by and among Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank, NEPA Acquisition Subsidiary, LLC, Landmark Bancorp, Inc. and Landmark Community Bank dated as of February 25, 2021. Incorporated by reference to Annex A of the Registrant's Registration Statement No. 333-236453 on Form S-4, filed with the Commission on April 23, 2021. (Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Fidelity agrees to furnish supplementally to the SEC a copy of any omitted schedule upon request.)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

13 Annual Report to Shareholders. Incorporated by reference to the 2022 Annual Report to Shareholders filed with the SEC on Form ARS.

21 Subsidiaries of the Registrant, filed herewith.

23 Consent of RSM US LLP, filed herewith.

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

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

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

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

101 Interactive data files: The following, from Fidelity D&D Bancorp, Inc.'s. Annual Report on Form 10-K for the year ended December 31, 2022, is formatted in iXBRL (Inline eXtensible Business Reporting Language): Consolidated Balance Sheets as of December 31, 2022 and 2021; Consolidated Statements of Income for the years ended December 31, 2022, 2021 and 2020; Consolidated Statements of Comprehensive Income for the years ended December 31, 2022, 2021 and 2020; Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2022, 2021 and 2020; Consolidated Statements of Cash Flows for the years ended December 31, 2022, 2021 and 2020 and the Notes to the Consolidated Financial Statements.

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

(b) The exhibits required to be filed by this Item are listed under Item 15(a) 3, above.

(c) Not applicable.

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* Management contract or compensatory plan or arrangement.

ITEM 16: FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIDELITY D & D BANCORP, INC.
(Registrant)

Date: March 20, 2023	By: /s/ Daniel J. Santaniello Daniel J. Santaniello, President and Chief Executive Officer
Date: March 20, 2023	By: /s/ Salvatore R. DeFrancesco, Jr. Salvatore R. DeFrancesco, Jr., Treasurer and Chief Financial Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following person on behalf of the registrant and in the capacities and on the dates indicated.

	DATE
By: /s/ Daniel J. Santaniello Daniel J. Santaniello, President and Chief Executive Officer and Director	March 20, 2023
By: /s/ Salvatore R. DeFrancesco, Jr. Salvatore R. DeFrancesco, Jr., Treasurer and Chief Financial Officer	March 20, 2023
By: /s/ Brian J. Cali Brian J. Cali, Chairman of the Board of Directors and Director	March 20, 2023
By: /s/ John T. Cognetti John T. Cognetti, Secretary and Director	March 20, 2023
By: /s/ Richard M. Hotchkiss Richard M. Hotchkiss, Director	March 20, 2023
By: /s/ Michael J. McDonald Michael J. McDonald, Vice Chairman of the Board of Directors and Director	March 20, 2023
By: /s/ Paul C. Woelkers Paul C. Woelkers, Director	March 20, 2023
By: /s/ HelenBeth G. Vilcek HelenBeth G. Vilcek, Director	March 20, 2023
By: /s/ Kristin Dempsey O’Donnell Kristin Dempsey O’Donnell, Director	March 20, 2023
By: /s/ William J. Joyce, Sr. William J. Joyce, Sr., Director	March 20, 2023
By: /s/ Alan Silverman Alan Silverman, Director	March 20, 2023

Exhibit 21

Subsidiaries of the Registrant

Subsidiary	State of Incorporation
The Fidelity Deposit and Discount Bank	Pennsylvania

Exhibit 23

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statement (Nos. 333-181489, 333-181488, 333-113339, 333-64356, and 333-265341) on Form S-8 and Registration Statement (Nos. 333-183216 and 333-152806) on Form S-3 of Fidelity D & D Bancorp, Inc. and Subsidiary of our report dated March 20, 2023, relating to the consolidated financial statements of Fidelity D & D Bancorp, Inc. and Subsidiary, appearing in this Annual Report on Form 10-K of Fidelity D & D Bancorp, Inc. and Subsidiary for the year ended December 31, 2022.

/s/ RSM US LLP

Blue Bell, Pennsylvania
March 20, 2023

Exhibit 31.1

CERTIFICATION

I, Daniel J. Santaniello, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: March 20, 2023

By:/s/ Daniel J. Santaniello
Daniel J. Santaniello, President
and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

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

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

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

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

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

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

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

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

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

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

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

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

Date: March 20, 2023

By:/s/ Salvatore R. DeFrancesco, Jr.
Salvatore R. DeFrancesco, Jr.
Treasurer and Chief Financial Officer

Exhibit 32.1

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

In connection with the Annual Report on Form 10-K of Fidelity D & D Bancorp, Inc. (the "Company") for the year ended December 31, 2022, as filed with the Securities and Exchange Commission (the "Report"), I, Daniel J. Santaniello, President and Chief Executive Officer of the Company, certify, pursuant to Title 18 U.S.C. §1350, as added by §906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: March 20, 2023

By:/s/ Daniel J. Santaniello
Daniel J. Santaniello, President
and Chief Executive Officer

Exhibit 32.2

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

In connection with the Annual Report on Form 10-K of Fidelity D & D Bancorp, Inc. (the "Company") for the year ended December 31, 2022, as filed with the Securities and Exchange Commission (the "Report"), I, Salvatore R. DeFrancesco, Jr., Treasurer and Chief Financial Officer of the Company, certify, pursuant to Title 18 U.S.C. §1350, as added by §906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: March 20, 2023

By:/s/ Salvatore R. DeFrancesco, Jr.
Salvatore R. DeFrancesco, Jr.
Treasurer and Chief Financial Officer

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