

**FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, DC 20429**

**FORM 10-Q/A
(Amendment No. 1)**

(Mark One)

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

For the quarterly period ended September 30, 2022

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

For the transition period from _____ to _____

FDIC Certificate Number: 19101

HARFORD BANK

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
organization)

52-0799113
(IRS Employer incorporation or
Identification No.)

8 West Bel Air Avenue, Aberdeen, Maryland 21001
(Address of principal executive offices)

(410) 272-5000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None.

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 periods 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 ☐ (Not Applicable)

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

Large accelerated filer ☐

Non-accelerated filer ☒

Accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:
1,467,957 shares of common stock as of October 28, 2022.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A to the Quarterly Report of Harford Bank (the “Bank”) on Form 10-Q for the quarter ended September 30, 2022, which was filed with the Federal Deposit Insurance Corporation (the “FDIC”) on November 2, 2022 (the “Original Report”), amends Item 1 of Part I of the Original Report to: (i) include in the Consolidated Statements of Condition information about bank owned life insurance that was inadvertently omitted therefrom; and (ii) include in the Consolidated Statements of Income information about the provision for (recovery of) loan losses that was inadvertently omitted therefrom. Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, new certifications by the Bank’s principal executive officer and principal financial officer are filed or furnished with this Amendment No. 1 as Exhibits 31.1, 31.2, and 32.1, so Item 6 of Part II of the Original Report is also amended hereby.

Except as expressly provided above, this Amendment No. 1 on Form 10-Q/A speaks as of the date of the Original Report and the Bank has not updated the disclosures contained in any item thereof to speak as of a later date. All information contained in this Amendment No. 1 on Form 10-Q/A is subject to updating and supplementing as provided in the Bank’s reports filed with the FDIC subsequent to the date on which the Original Report was filed.

PART I

Item 1. Financial Statements

The information required by this item can be found beginning on page F-1 immediately following the signatures to this report and is incorporated herein by reference.

AVAILABLE INFORMATION

The Bank maintains an internet website at www.HarfordBank.com on which it makes available its most recent periodic report filed with the FDIC pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All of the periodic and other reports filed by the Bank with the FDIC pursuant to the Exchange Act are available through the FDIC's website at: <https://efr.fdic.gov/fcxweb/efr/index.html>, and are also available for public inspection at: Federal Deposit Insurance Corporation, Accounting and Securities Disclosure Section, Division of Supervision and Consumer Protection, 550 17th Street, NW, Washington, DC 20429.

PART II - OTHER INFORMATION

Item 6. Exhibits

The exhibits filed or furnished herewith are listed in the following Exhibit Index:

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 10.1	Employment Agreement, dated as of September 1, 2022, by and between Harford Bank and Neil L. Christ (incorporated by reference to Exhibit 10.1 to the Bank's Current Report on Form 8-K filed on September 6, 2022).
Exhibit 31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 31.2	Certifications of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 32.1	Certification of the Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

SIGNATURES

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

HARFORD BANK

Date: November 3, 2022

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: November 3, 2022

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer & Principal Accounting Officer)

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CONDITION

At:	September 30, 2022	December 31, 2021
ASSETS	(Unaudited)	
Cash and due from banks	\$ 3,291,335	\$ 3,798,293
Federal Reserve Bank deposit	93,812,050	78,615,598
Federal funds sold and Federal Home Loan Bank deposit	21,346	17,068
Cash and cash equivalents	97,124,731	82,430,959
Time deposits in other banks	2,804,894	2,832,409
Investment securities held to maturity (fair value of \$105,019,527 in 2022 and \$105,141,946 in 2021)	117,759,191	105,890,521
Federal Home Loan Bank stock, at cost	330,100	285,500
Total loans, including deferred fees net of costs	402,118,968	368,101,119
Less: Allowance for loan losses	(4,879,900)	(5,080,143)
Net loans	397,239,068	363,020,976
Bank premises and equipment, net	9,950,931	10,167,594
Income taxes refundable	112,876	7,441
Accrued interest receivable	1,248,047	1,355,966
Deferred income taxes	994,192	994,192
Bank owned life insurance	6,372,022	6,272,657
Other assets	1,575,853	1,916,897
Total assets	\$ 635,511,905	\$ 575,175,112
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 170,771,457	\$ 153,557,695
Interest-bearing	409,816,736	368,766,783
Total deposits	580,588,193	522,324,478
Accrued interest payable	77,928	130,139
Other liabilities	2,278,612	3,173,960
Total liabilities	582,944,733	525,628,577
Stockholders' equity		
Common stock, par value \$10 per share; authorized 5,000,000 shares; issued and outstanding 1,467,957 shares in 2022, and 1,451,175 shares in 2021	14,679,570	14,511,750
Surplus	17,618,404	17,367,493
Undivided profits	20,269,198	17,667,292
Total stockholders' equity	52,567,172	49,546,535
Total liabilities and stockholders' equity	\$ 635,511,905	\$ 575,175,112

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2022	2021	2022	2021
Interest revenue				
Loans, including fees	\$ 4,467,261	\$ 4,714,259	\$ 12,706,642	\$ 13,670,507
Investment securities held to maturity	436,951	160,518	1,102,766	479,796
Federal funds sold and Federal Home Loan Bank deposit	106	-	137	-
Federal Reserve Bank deposit	423,933	26,592	648,164	50,204
Time deposits in other banks	2,809	5,876	10,358	21,429
Other	3,622	2,639	9,343	8,392
Total interest revenue	<u>5,334,682</u>	<u>4,909,884</u>	<u>14,477,410</u>	<u>14,230,328</u>
Interest expense				
Deposits	241,909	364,998	808,605	1,202,810
Total interest expense	<u>241,909</u>	<u>364,998</u>	<u>808,605</u>	<u>1,202,810</u>
Net interest income	<u>5,092,773</u>	<u>4,544,886</u>	<u>13,668,805</u>	<u>13,027,518</u>
Provision for (recovery of) loan losses	<u>(150,000)</u>	<u>-</u>	<u>(275,000)</u>	<u>-</u>
Net interest income after provision for (recovery of) loan losses	<u>5,242,773</u>	<u>4,544,886</u>	<u>13,943,805</u>	<u>13,027,518</u>
Noninterest revenue				
Service charges on deposit accounts	163,381	147,681	484,987	398,341
Earnings on bank owned life insurance	33,727	34,650	99,364	100,215
Recovery on restricted stock previously written off	-	-	4,356	-
Other fees and commissions	258,427	317,827	787,652	983,947
Total noninterest revenue	<u>455,535</u>	<u>500,158</u>	<u>1,376,359</u>	<u>1,482,503</u>
Noninterest expense				
Salaries and benefits	2,309,078	1,858,688	6,503,307	5,127,024
Occupancy	276,493	245,120	849,814	765,668
Furniture and equipment	251,371	160,924	632,400	459,242
Data processing expense	232,345	292,188	733,712	721,528
Professional fees	86,029	93,315	360,485	387,912
Director and committee fees	160,392	58,600	292,992	231,618
Stationery and supplies	14,265	27,408	70,017	89,171
FDIC and state assessments	92,941	58,857	266,229	176,310
Advertising	64,883	42,238	175,254	133,346
Loss on disposal of fixed assets	1,949	-	18,837	-
Net expenses, losses and write-downs on repossessed assets and foreclosed real estate	-	-	-	(191)
Other operating	318,706	292,350	878,220	881,814
Total noninterest expense	<u>3,808,452</u>	<u>3,129,688</u>	<u>10,781,267</u>	<u>8,973,442</u>
Income before income taxes	<u>1,889,856</u>	<u>1,915,356</u>	<u>4,538,897</u>	<u>5,536,579</u>
Income taxes	<u>458,529</u>	<u>497,732</u>	<u>1,105,682</u>	<u>1,434,819</u>
Net income	<u>\$ 1,431,327</u>	<u>\$ 1,417,624</u>	<u>\$ 3,433,215</u>	<u>\$ 4,101,760</u>
Basic net income per share	\$ 0.98	\$ 0.98	\$ 2.35	\$ 2.85
Diluted net income per share	\$ 0.97	\$ 0.97	\$ 2.34	\$ 2.84

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

	Common stock			Undivided	Total
	<u>Shares</u>	<u>Par value</u>	<u>Surplus</u>	<u>profits</u>	<u>Stockholders' Equity</u>
Three months ended:					
September 30, 2022					
Balance at beginning of period	1,460,538	\$ 14,605,380	\$ 17,494,615	\$ 19,115,683	\$ 51,215,678
Net income				1,431,327	1,431,327
Cash dividends, \$0.19 per share				(277,812)	(277,812)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	7,408	74,080	67,890	-	141,970
Stock sold and dividend reinvestment plan (DRIP)	2,313	23,130	50,886	-	74,016
Stock-based compensation expense			55,659	-	55,659
Stock acquired for DRIP administration	(2,302)	(23,020)	(50,646)	-	(73,666)
Balance at end of period	<u>1,467,957</u>	<u>\$ 14,679,570</u>	<u>\$ 17,618,404</u>	<u>\$ 20,269,198</u>	<u>\$ 52,567,172</u>
September 30, 2021					
Balance at beginning of period	1,441,261	\$ 14,412,610	\$ 17,191,965	\$ 15,977,956	\$ 47,582,531
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	565	5,650	8,364	-	14,014
Stock sold and dividend reinvestment plan (DRIP)	2,415	24,150	50,718	-	74,868
Stock-based compensation expense			-	-	-
Stock acquired for DRIP administration	-	-	-	-	-
Balance at end of period	<u>1,444,241</u>	<u>\$ 14,442,410</u>	<u>\$ 17,251,047</u>	<u>\$ 17,136,136</u>	<u>\$ 48,829,593</u>
Nine months ended:					
September 30, 2022					
Balance at beginning of period	1,451,175	\$ 14,511,750	\$ 17,367,493	\$ 17,667,292	\$ 49,546,535
Net income				3,433,215	3,433,215
Cash dividends, \$0.57 per share				(831,309)	(831,309)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	12,433	124,330	102,898	-	227,228
Stock sold and dividend reinvestment plan (DRIP)	7,371	73,710	157,804	-	231,514
Stock-based compensation expense			55,659	-	55,659
Stock acquired for DRIP administration	(3,022)	(30,220)	(65,450)	-	(95,670)
Balance at end of period	<u>1,467,957</u>	<u>\$ 14,679,570</u>	<u>\$ 17,618,404</u>	<u>\$ 20,269,198</u>	<u>\$ 52,567,172</u>
September 30, 2021					
Balance at beginning of period	1,433,781	\$ 14,337,810	\$ 17,062,149	\$ 13,796,538	\$ 45,196,497
Net income				4,101,760	4,101,760
Cash dividends, \$0.53 per share				(762,162)	(762,162)
Common stock issued:					
Shares issued under stock-based compensation					
plans and related tax effects	4,506	45,060	41,021	-	86,081
Stock sold and dividend reinvestment plan (DRIP)	8,441	84,410	139,252	-	223,662
Stock-based compensation expense			43,169	-	43,169
Stock acquired for DRIP administration	(2,487)	(24,870)	(34,544)	-	(59,414)
Balance at end of period	<u>1,444,241</u>	<u>\$ 14,442,410</u>	<u>\$ 17,251,047</u>	<u>\$ 17,136,136</u>	<u>\$ 48,829,593</u>

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For the Nine Months Ended September 30,	2022	2021
Cash flows provided by (used in) operating activities		
Interest received	\$ 13,859,283	\$ 16,150,443
Fees and commissions received	2,003,203	2,348,909
Interest paid	(860,816)	(1,263,425)
Cash paid to suppliers and employees	(10,946,940)	(8,700,175)
Income taxes paid	(1,211,117)	(1,908,324)
Net cash provided by (used in) operating activities	<u>2,843,613</u>	<u>6,627,428</u>
Cash flows provided by (used in) investing activities		
Proceeds from maturities of time deposits in other banks	-	1,500,000
Purchases of time deposits in other banks	-	(2,602,085)
Proceeds from calls and maturities of investment securities	10,686,174	15,694,350
Purchases of investment securities	(23,111,133)	(56,515,846)
Redemption (purchase) of FHLB stock	(44,600)	96,600
Loans originated, net of principal repayments	(33,277,121)	(994,144)
Net (decrease) increase in deferred loan fees and costs	17,035	(1,497,537)
Proceeds from sale of bank premises and equipment	-	1,800
Purchases of bank premises and equipment	(215,674)	(1,167,299)
Net cash provided by (used in) investing activities	<u>(45,945,319)</u>	<u>(45,484,161)</u>
Cash flows provided by (used in) financing activities		
Net (decrease) increase in time deposits	(25,197,229)	(4,228,342)
Net (decrease) increase in other deposits	83,460,944	78,143,813
Dividends paid	(831,309)	(762,162)
Dividends reinvested	231,514	223,662
Shares issued under stock-based compensation plans and related tax effects	227,228	86,081
Stock acquired for DRIP administration	(95,670)	(59,414)
Net cash provided by (used in) financing activities	<u>57,795,478</u>	<u>73,403,638</u>
Net increase (decrease) in cash and cash equivalents	14,693,772	34,546,905
Cash and cash equivalents at beginning of period	<u>82,430,959</u>	<u>55,599,966</u>
Cash and cash equivalents at end of period	\$ 97,124,731	\$ 90,146,871

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

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited - continued)

For the Nine Months Ended September 30,	2022	2021
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 3,433,215	\$ 4,101,760
Adjustments to reconcile net income to net cash provided by operating activities		
Net amortization and accretion on loan fees and costs	(683,006)	1,924,085
Net amortization and accretion on time deposits in other banks	27,515	10,445
Net amortization and accretion on investment securities	556,289	466,777
Depreciation and amortization on fixed assets and software	409,413	383,527
Earnings on bank owned life insurance	(99,364)	(100,215)
Provision for (recovery of) loan losses	(275,000)	-
Loss (gain) on disposition of bank premises and equipment	18,837	(1,800)
Stock-based compensation expense	55,659	43,169
Accrued interest receivable	107,919	9,237
Income taxes refundable	(105,435)	-
Other assets	345,130	(324,899)
Increase (decrease) in		
Accrued interest payable	(52,211)	(60,615)
Income taxes payable	-	(473,505)
Other liabilities	(895,348)	649,462
	<u>\$ 2,843,613</u>	<u>\$ 6,627,428</u>

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Nature of operations

Harford Bank (the “Bank”) provides a full range of banking services to customers located in Harford and Cecil Counties and surrounding areas of northeastern Maryland.

Basis of presentation

The accounting and reporting policies reflected in the consolidated financial statements conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry, and, in the opinion of management, the consolidated financial statements reflect all adjustments necessary for a fair presentation of the Bank's financial position and results of operations. Management has evaluated subsequent events for potential recognition and/or disclosure through the date of issuance of the consolidated financial statements.

Principles of consolidation

The consolidated financial statements include the accounts of Harford Bank and its subsidiary, HB Trust, a Maryland Statutory Trust. Intercompany accounts and entries have been eliminated in the consolidated financial statements.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. These estimates and assumptions may affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to the 2021 consolidated financial statement presentation to conform to the current year's format. Total equity and net income are unchanged due to these reclassifications.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, deposits with other financial institutions that have an initial maturity of less than 90 days when acquired, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Time deposits in other banks

Negotiable time deposits in other banks are carried at cost and are placed in amounts of \$250,000 or less to qualify for Federal Deposit Insurance Corporation (“FDIC”) deposit insurance coverage. Non-negotiable time deposits placed with correspondent banks may exceed the \$250,000 limit.

Investment securities

Management has classified all investment securities as held to maturity. Management has the intent and ability to hold all investment securities to maturity. These investment securities are recorded at amortized cost which is cost adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are recognized in interest revenue using the interest method over the term of the securities, except that premiums on callable securities are amortized to the call price at the first call date.

Credit declines in the fair value of individual held to maturity investment securities below their amortized cost that are determined to be other than temporary result in write-downs of the individual securities to their fair value. The related write downs are included in earnings as realized losses. Factors that management considers in determining if other than temporary impairment has been incurred include the length of time and the extent to which the fair value has been less than amortized cost, the financial condition and prospects of the issuer, and the intent and ability of the Bank to hold the investment securities for a period of time sufficient to allow for recovery in fair value.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Restricted equity securities

As a member of the Federal Home Loan Bank of Atlanta ("FHLBA"), the Bank is required to hold FHLBA stock as a condition of membership as well as in relation to the Bank's use of products and services. FHLBA stock is not publicly-traded and is sold and redeemed by the FHLBA at par. The Bank views its investment in FHLBA stock as a long-term investment and as a restricted equity security, which is carried at cost, because there is a minimal market for the stock. Therefore, when evaluating FHLBA stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Bank does not consider this investment to be other-than-temporarily impaired as of September 30, 2022, and no impairment has been recognized.

Loans and allowance for loan losses

Loans are stated at unpaid principal balance adjusted for any amounts partially charged-off, the allowance for loan losses, and deferred origination fees and costs.

Interest on loans is accrued based on the principal amounts outstanding. Origination fees and costs are recognized as an adjustment to the related loan yield using an approximate interest method. The accrual of interest is discontinued when any portion of the principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full. Non-accrual loans may be considered for return to accrual status after a minimum six-month period of on-time payment performance provided that no amount of the loan has been charged-off. Past due status is based on the contractual terms of the loan. If collection of principal is evaluated as doubtful, all payments are applied to principal.

Loans are considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms. Generally, loans are reviewed for impairment when rated 4, Special Mention, or 5, Substandard, when 60 or more days past due, when the accrual of interest has been discontinued, and when the loan has been restructured in a troubled debt restructuring ("TDR"). A TDR is the restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty.

The allowance for loan losses represents an amount, which in management's judgment, will be adequate to absorb losses inherent in the loan portfolio. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of 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, overall portfolio quality, and review of specific problem areas. If the current economy or real estate market were to suffer a severe downturn, the estimate for uncollectible accounts would need to be increased. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are individually evaluated for impairment and for which impairment is determined to exist. The general component covers the remaining loan portfolio and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Bank premises and equipment

Land is carried at cost. Buildings and improvements, and furniture and equipment are recorded at cost, less accumulated depreciation computed principally by the straight-line method over the estimated useful lives of the assets. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements. Software is recorded in other assets at cost and amortized using the straight-line method over three years.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Other real estate owned and other repossessed assets

Real estate acquired through foreclosure or by deed in lieu of foreclosure is recorded on the date acquired at the fair value less estimated costs to sell. Loan collateral, other than real estate, acquired through or in lieu of foreclosure is recorded in other assets on the date acquired at the fair value less estimated costs to sell. Losses incurred at the time of acquisition of the real estate property or other collateral are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the real estate property or other collateral are included in noninterest expense.

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Interest and penalties incurred related to income taxes are included in income tax expense.

Management considers the likelihood of changes by taxing authorities in its filed income tax returns and recognizes a liability for or discloses potential changes that management believes are more likely than not to occur upon examination by tax authorities. Management has not identified any uncertain tax positions in filed income tax returns that require recognition or disclosure in the accompanying financial statements. The Bank's income tax returns for the past three years are subject to examination by tax authorities and may change upon examination.

Advertising costs

Advertising costs are expensed as incurred.

Earnings per common share

Basic earnings per common share is determined by dividing net income by the weighted-average number of shares of common stock outstanding after giving retroactive effect to stock dividends for all periods presented. Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

Stock-based compensation

The Bank accounts for employee and director stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock based compensation at the date of grant. The Bank accounts for stock-based compensation in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718, *Stock Compensation*. This standard requires public companies to recognize compensation expense related to stock based compensation awards in their income statements over the period during which an individual is required to provide service in exchange for such award.

Segment reporting

FASB ASC Topic 280, *Segment Reporting*, requires reporting of selected information about operating segments in its financial reports issued to stockholders. Management has performed an analysis and determined that the Bank has only one operating segment, which is commercial banking. The Bank's chief operating decision makers use combined results to make operating and strategic decisions and therefore the Bank is not required to disclose any additional segment information.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

2. Cash and Cash Equivalents

The Bank normally carries balances with other banks that exceed the federally insured limit.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

3. Investment Securities Held to Maturity

The amortized cost and estimated fair value of the investment securities portfolio for the respective periods are shown below. The Bank owns residential mortgage-backed ("RMBS"), commercial mortgage-backed ("CMBS") and collateralized mortgage obligation ("CMO") investment securities which are issued and guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"). The asset-backed investment security holdings are issued and guaranteed by the Small Business Administration ("SBA").

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2022				
U.S. Treasury securities	\$ 20,911,034	\$ -	\$ 1,467,346	\$ 19,443,688
U.S. government agency securities	37,815,218	-	3,726,889	34,088,329
Agency RMBS	37,308,644	-	4,935,129	32,373,515
Agency CMBS	4,254,326	-	238,033	4,016,293
Agency CMO securities	1,330,234	-	238,937	1,091,297
SBA asset-backed securities	12,565,493	52	1,368,792	11,196,753
State and municipal securities	3,574,242	-	764,590	2,809,652
	<u>\$ 117,759,191</u>	<u>\$ 52</u>	<u>\$ 12,739,716</u>	<u>\$ 105,019,527</u>
December 31, 2021				
U.S. Treasury securities	\$ 16,014,182	\$ 14,489	\$ 174,681	\$ 15,853,990
U.S. government agency securities	35,455,575	39,217	305,836	35,188,956
Agency RMBS	36,276,433	175,178	304,842	36,146,769
Agency CMO securities	1,436,183	-	49,114	1,387,069
SBA asset-backed securities	13,122,836	102,780	223,239	13,002,377
State and municipal securities	3,585,312	17,449	39,976	3,562,785
	<u>\$ 105,890,521</u>	<u>\$ 349,113</u>	<u>\$ 1,097,688</u>	<u>\$ 105,141,946</u>

Contractual maturities and the amount of pledged investment securities for the respective periods are shown below. Actual maturities might differ from contractual maturities because the issuers of the securities might have the right to call or prepay obligations with or without call or prepayment penalties. Investment securities are pledged to secure deposits of federal and local governments.

	September 30, 2022		December 31, 2021	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing				
In one year or less	\$ 5,513,689	\$ 5,288,320	\$ 4,467,552	\$ 4,491,411
Over one to five years	42,138,886	38,765,284	36,941,723	36,522,295
Over five to ten years	9,691,232	8,041,769	11,854,566	11,810,367
Greater than ten years	4,956,687	4,246,296	1,791,228	1,781,658
Mortgage-backed, CMO and asset-backed securities	<u>55,458,697</u>	<u>48,677,858</u>	<u>50,835,452</u>	<u>50,536,215</u>
	<u>\$ 117,759,191</u>	<u>\$ 105,019,527</u>	<u>\$ 105,890,521</u>	<u>\$ 105,141,946</u>
Pledged securities	<u>\$ 88,001,271</u>	<u>\$ 77,520,077</u>	<u>\$ 44,797,072</u>	<u>\$ 44,497,990</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

3. Investment Securities Held to Maturity - continued

Investment securities with unrealized losses as of the respective periods are shown below.

	Less than 12 Months		12 Months or Longer		Total	
	Fair	Gross	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized	Value	Unrealized
		Losses		Losses		Losses
September 30, 2022						
U.S. Treasury securities	\$ 6,259,510	\$ 199,218	\$ 13,184,178	\$ 1,268,128	\$ 19,443,688	\$ 1,467,346
U.S. government agency securities	14,565,057	1,860,510	19,523,272	1,866,379	34,088,329	3,726,889
Agency RMBS	13,583,140	1,527,750	18,197,326	3,407,379	31,780,466	4,935,129
Agency CMBS	4,016,293	238,033	-	-	4,016,293	238,033
Agency CMO securities	-	-	1,091,297	238,937	1,091,297	238,937
Asset-backed securities	4,708,642	354,605	6,476,237	1,014,187	11,184,879	1,368,792
State and municipal securities	1,167,412	310,354	1,642,240	454,236	2,809,652	764,590
	<u>\$ 44,300,054</u>	<u>\$ 4,490,470</u>	<u>\$ 60,114,550</u>	<u>\$ 8,249,246</u>	<u>\$ 104,414,604</u>	<u>\$ 12,739,716</u>
December 31, 2021						
U.S. Treasury securities	\$ 14,337,600	\$ 174,681	\$ -	\$ -	\$ 14,337,600	\$ 174,681
U.S. government agency securities	26,620,070	288,496	582,660	17,340	27,202,730	305,836
Agency RMBS	27,361,709	253,301	1,748,895	51,541	29,110,604	304,842
Agency CMO securities	738,433	26,013	648,636	23,101	1,387,069	49,114
SBA asset-backed securities	7,237,425	149,727	2,265,455	73,512	9,502,880	223,239
State and municipal securities	2,482,533	39,976	-	-	2,482,533	39,976
	<u>\$ 78,777,770</u>	<u>\$ 932,194</u>	<u>\$ 5,245,646</u>	<u>\$ 165,494</u>	<u>\$ 84,023,416</u>	<u>\$ 1,097,688</u>

The investment securities experiencing unrealized losses as of September 30, 2022 and December 31, 2021 are considered to be temporarily impaired. Management has the intent and ability to hold and does not believe they will be required to sell these investment securities until maturity. Unrealized losses are primarily due to increases in market interest rates over the yields available at the time the underlying investments were purchased. The fair value is expected to recover as the securities approach their maturity date or if market interest rates for such securities decline. The U.S. Treasury securities the Bank owns are backed by the full faith and credit of the U.S. government. The U.S. government agency securities the Bank owns are issued by FNMA and FHLMC, which the U.S. government has affirmed its commitment to support, and by the FHLB and the Federal Farm Credit system ("FFCB"), which are government-sponsored enterprises. The residential and commercial mortgage-backed and CMO securities owned by the Bank are issued by GNMA, which carry U.S. government guarantees, and FNMA and FHLMC, which the U.S. government has affirmed its commitment to support. The asset-backed securities owned by the Bank are issued by the SBA and carry U.S. government guarantees. The state and municipal securities owned by the Bank are all general obligation bonds, with unlimited and limited taxing authority. Management does not believe that any of the securities are experiencing unrealized losses due to reasons of credit quality, and concludes the unrealized losses detailed in the above table are temporary.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans

The Bank makes loans to customers located primarily in Harford and Cecil Counties and surrounding areas. The performance of the loan portfolio will be influenced by the regional real estate market and economy.

Major classifications of loans are as follows for the periods indicated:

At:	September 30, 2022	December 31, 2021
Real estate		
Construction, development and other land	\$ 23,209,293	\$ 13,597,178
Secured by farmland	9,315,201	7,730,157
Commercial	209,999,459	202,068,811
Residential	120,672,882	101,000,867
Commercial and industrial		
Commercial	25,983,254	17,877,822
Paycheck Protection Program	1,852,502	19,301,845
Mobile home	2,608,035	3,011,002
Other consumer	8,909,575	4,592,221
Overdrafts	33,886	52,307
Gross loans	402,584,087	369,232,210
Net deferred (fees) costs	(465,119)	(1,131,091)
Allowance for loan losses	(4,879,900)	(5,080,143)
Net loans	<u>\$ 397,239,068</u>	<u>\$ 363,020,976</u>
Principal balance of pledged loans	<u>\$ 169,420,465</u>	<u>\$ 150,460,364</u>

Substantial portions of the Bank's loans are secured by residential and commercial real estate. Loans secured by commercial real estate and farmland generally involve larger principal amounts and a higher degree of risk than loans secured by residential one- to four-family mortgages. Repayment of loans secured by commercial real estate and farmland is often dependent on the successful operation or management of the properties, making collectability of such loans subject to adverse economic or real estate market conditions. The Bank seeks to mitigate these risks through its underwriting standards which require that loans be qualified on the basis of the property's value and debt service coverage ratios, and additional collateral may be required under certain circumstances. The Bank will generally obtain personal guarantees.

The Bank originates one- to four-family residential mortgage loans in amounts typically up to 80% of the lower of the appraised value or purchase price of the property securing the loan. The predominance of the Bank's residential mortgage portfolio consists of fixed-rate mortgages with original maturities ranging from 10 to 30 years. Fixed-rate lending can expose the Bank to interest rate risk in a rising rate environment.

Construction lending is generally considered to present a higher degree of credit risk than other types of real estate lending. Risks of loss include the accuracy of the borrower's estimate of construction costs, timing, and ultimate completion value, and the borrower's ability to complete the project in a workmanlike manner. These risks may result in a project whose value is insufficient to ensure full repayment.

Commercial loans are generally secured by inventories, equipment and other assets of the business. Personal guarantees of the borrowers are generally required. In the second quarter of 2020, the Bank began making loans to small businesses under the SBA's Paycheck Protection Program ("PPP") for, among other things, payroll, group health care benefit costs and qualifying mortgage, rent and utility payments. These loans carry an SBA guarantee, and the borrower may receive forgiveness of the loan if the loan's proceeds are used in a manner that qualifies the borrower for forgiveness.

The Bank makes mobile home loans in amounts up to 90% of the lower of the purchase price or the National Appraisal Guides value with original maturities of up to 20 years. To mitigate the risk of loss, the Bank makes loans only for mobile homes located in a mobile home park or sited on land owned by the borrower.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Eligible consumer installment loans are pledged to secure borrowing facilities at the Federal Reserve Bank ("FRB") Discount Window. The Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans are pledged to secure borrowing facilities at the FHLBA.

The maturity distribution of the loan portfolio is as follows for the periods indicated:

At:	September 30, 2022	December 31, 2021
<i>Maturing</i>		
In one year or less	\$ 20,902,630	\$ 16,943,319
Over one to five years	25,372,405	42,609,931
Over five to fifteen years	127,954,984	125,498,922
Over fifteen years	228,354,068	184,180,038
Gross loans	<u>\$ 402,584,087</u>	<u>\$ 369,232,210</u>
Variable rate loans included above	<u>\$ 287,460,572</u>	<u>\$ 257,647,958</u>

The following table analyzes the payment status of loans for the periods indicated:

	30-59 Days	60-89 Days	90 Days	Total		Total	Loans over
	Past Due	Past Due	and Over	Past Due	Current	Loans	90 Days and
September 30, 2022			Past Due				Accruing
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 23,209,293	\$ 23,209,293	\$ -
Commercial real estate and farmland	101,326	-	2,700,476	2,801,802	216,512,858	219,314,660	-
Residential real estate	36,159	-	766	36,925	120,635,957	120,672,882	-
Commercial and industrial	238,133	-	-	238,133	27,597,623	27,835,756	-
Mobile homes	157,102	23,122	-	180,224	2,427,811	2,608,035	-
Other consumer and overdrafts	-	-	-	-	8,943,461	8,943,461	-
Total	<u>\$ 532,720</u>	<u>\$ 23,122</u>	<u>\$ 2,701,242</u>	<u>\$ 3,257,084</u>	<u>\$ 399,327,003</u>	<u>\$ 402,584,087</u>	<u>\$ -</u>
December 31, 2021							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 13,597,178	\$ 13,597,178	\$ -
Commercial real estate and farmland	108,934	-	2,780,280	2,889,214	206,909,754	209,798,968	-
Residential real estate	41,691	-	-	41,691	100,959,176	101,000,867	-
Commercial and industrial	20,100	-	-	20,100	37,159,567	37,179,667	-
Mobile homes	45,746	-	-	45,746	2,965,256	3,011,002	-
Other consumer and overdrafts	4,528	-	-	4,528	4,640,000	4,644,528	-
Total	<u>\$ 220,999</u>	<u>\$ -</u>	<u>\$ 2,780,280</u>	<u>\$ 3,001,279</u>	<u>\$ 366,230,931</u>	<u>\$ 369,232,210</u>	<u>\$ -</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Credit Quality Indicators. As part of the on-going monitoring of the quality of the Bank's loan portfolio management tracks certain credit quality indicators.

The Bank does not credit score new loans but does utilize a risk grading system for non-consumer loans. Loans are risk rated on the scale listed below:

Grade 1, 2 and 3A – These grades include “pass grade” loans to borrowers of acceptable credit quality and risk.

Grade 3W – This grade includes loans that are on management's “watch list” and are classified as “Pass Watch”. It is management's intent to utilize this rating on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near future.

Grade 4 – This grade is for “Other Assets Especially Mentioned” or “Special Mention” in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation. This grade may include loans not fully secured where a specific valuation allowance may be warranted.

Grade 5 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which accrual of interest may have stopped. This grade includes loans that are past due or not fully secured where a specific valuation allowance may be warranted.

The following table presents loans rated Risk Grades 3W, 4, and 5.

	Pass Watch Grade 3W	Special Mention Grade 4	Substandard Grade 5	Total
September 30, 2022				
Construction, development and other land	\$ 1,222,162	\$ 149,522	\$ 29,716	\$ 1,401,400
Commercial real estate and farmland	20,010,710	4,624,366	9,416,590	34,051,666
Residential real estate	5,803,435	-	472,126	6,275,561
Commercial and industrial	1,217,848	25	134,402	1,352,275
Mobile home	-	-	46,148	46,148
Other consumer and overdrafts	78,434	-	-	78,434
	<u>\$ 28,332,589</u>	<u>\$ 4,773,913</u>	<u>\$ 10,098,982</u>	<u>\$ 43,205,484</u>
December 31, 2021				
Construction, development and other land	\$ 1,493,723	\$ 152,115	\$ 49,189	\$ 1,695,027
Commercial real estate and farmland	20,951,410	5,087,899	10,590,812	36,630,121
Residential real estate	6,994,003	-	562,896	7,556,899
Commercial and industrial	1,835,367	25	160,226	1,995,618
Mobile home	-	-	58,685	58,685
Other consumer and overdrafts	124,184	-	-	124,184
	<u>\$ 31,398,687</u>	<u>\$ 5,240,039</u>	<u>\$ 11,421,808</u>	<u>\$ 48,060,534</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table provides a comprehensive view of the allowance for loan losses activity including the periodic activity of charge-offs and recoveries allocated by loan class for the three- and nine-month periods ended September 30, 2022 and 2021. No allowance for loan losses has been recognized for PPP loans as such loans are fully guaranteed by the SBA.

Three months ended:		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
September 30, 2022	Unallocated								
Allowance for loan losses:									
Beginning balance	\$ 5,740	\$ 430,587	\$ 3,079,907	\$ 939,974	\$ 373,211	\$ 102,873	\$ 39,570	\$ 19,377	\$ 4,991,239
Charge-offs	-	-	-	-	-	(23,543)	-	(11,316)	(34,859)
Recoveries	-	-	-	1,500	71,105	600	-	315	73,520
Provision or (recovery of provision)	(205)	56,808	(262,642)	1,484	(13,098)	26,081	36,910	4,662	(150,000)
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 106,011</u>	<u>\$ 76,480</u>	<u>\$ 13,038</u>	<u>\$ 4,879,900</u>

September 30, 2021

Allowance for loan losses:									
Beginning balance	\$ 18,338	\$ 240,615	\$ 3,525,188	\$ 827,775	\$ 305,431	\$ 143,525	\$ 32,288	\$ 15,350	\$ 5,108,510
Charge-offs	-	-	(81,045)	-	-	-	-	(14,811)	(95,856)
Recoveries	-	-	-	850	-	800	-	1,919	3,569
Provision or (recovery of provision)	(15,270)	37,885	(40,610)	9,217	7,655	(15,487)	827	15,783	-
Ending balance	<u>\$ 3,068</u>	<u>\$ 278,500</u>	<u>\$ 3,403,533</u>	<u>\$ 837,842</u>	<u>\$ 313,086</u>	<u>\$ 128,838</u>	<u>\$ 33,115</u>	<u>\$ 18,241</u>	<u>\$ 5,016,223</u>

Nine months ended:		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
September 30, 2022	Unallocated								
Allowance for loan losses:									
Beginning balance	\$ 46,680	\$ 292,339	\$ 3,355,417	\$ 883,184	\$ 334,073	\$ 116,912	\$ 35,500	\$ 16,038	\$ 5,080,143
Charge-offs	-	-	-	-	-	(23,543)	-	(30,726)	(54,269)
Recoveries	-	-	44,688	4,500	71,105	1,600	-	7,133	129,026
Provision or (recovery of provision)	(41,145)	195,056	(582,840)	55,274	26,040	11,042	40,980	20,593	(275,000)
Ending balance	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 106,011</u>	<u>\$ 76,480</u>	<u>\$ 13,038</u>	<u>\$ 4,879,900</u>

September 30, 2021

Allowance for loan losses:									
Beginning balance	\$ 7,332	\$ 227,883	\$ 3,526,826	\$ 779,782	\$ 298,577	\$ 174,713	\$ 37,900	\$ 63,684	\$ 5,116,697
Charge-offs	-	-	(81,045)	-	-	-	(259)	(30,155)	(111,459)
Recoveries	-	-	-	2,900	400	2,000	-	5,685	10,985
Provision or (recovery of provision)	(4,264)	50,617	(42,248)	55,160	14,109	(47,875)	(4,526)	(20,973)	-
Ending balance	<u>\$ 3,068</u>	<u>\$ 278,500</u>	<u>\$ 3,403,533</u>	<u>\$ 837,842</u>	<u>\$ 313,086</u>	<u>\$ 128,838</u>	<u>\$ 33,115</u>	<u>\$ 18,241</u>	<u>\$ 5,016,223</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents the allocation of allowance for loan losses and the balances of loans that were individually and collectively evaluated for impairment at September 30, 2022 and December 31, 2021, and the loan balances by loan class for loans that were individually and collectively evaluated for impairment at September 30, 2022 and December 31, 2021.

		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
September 30, 2022	Unallocated								
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 490,000	\$ -	\$ 2,258	\$ -	\$ -	\$ -	\$ 492,258
Collectively evaluated									
for impairment	<u>5,535</u>	<u>487,395</u>	<u>2,327,265</u>	<u>942,958</u>	<u>428,960</u>	<u>106,011</u>	<u>76,480</u>	<u>13,038</u>	<u>4,387,642</u>
	<u>\$ 5,535</u>	<u>\$ 487,395</u>	<u>\$ 2,817,265</u>	<u>\$ 942,958</u>	<u>\$ 431,218</u>	<u>\$ 106,011</u>	<u>\$ 76,480</u>	<u>\$ 13,038</u>	<u>\$ 4,879,900</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ -</u>	<u>\$ 8,520,970</u>	<u>\$ 311,348</u>	<u>\$ 134,402</u>	<u>\$ 46,148</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,012,868</u>
Collectively evaluated									
for impairment		<u>\$ 23,209,293</u>	<u>\$ 210,793,690</u>	<u>\$ 120,361,534</u>	<u>\$ 27,701,354</u>	<u>\$ 2,561,887</u>	<u>\$ 8,909,575</u>	<u>\$ 33,886</u>	<u>\$ 393,571,219</u>
December 31, 2021									
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 730,000	\$ -	\$ 3,012	\$ -	\$ -	\$ -	\$ 733,012
Collectively evaluated									
for impairment	<u>46,680</u>	<u>292,339</u>	<u>2,625,417</u>	<u>883,184</u>	<u>331,061</u>	<u>116,912</u>	<u>35,500</u>	<u>16,038</u>	<u>4,347,131</u>
	<u>\$ 46,680</u>	<u>\$ 292,339</u>	<u>\$ 3,355,417</u>	<u>\$ 883,184</u>	<u>\$ 334,073</u>	<u>\$ 116,912</u>	<u>\$ 35,500</u>	<u>\$ 16,038</u>	<u>\$ 5,080,143</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ -</u>	<u>\$ 8,692,924</u>	<u>\$ 261,643</u>	<u>\$ 160,226</u>	<u>\$ 58,685</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,173,478</u>
Collectively evaluated									
for impairment		<u>\$ 13,597,178</u>	<u>\$ 201,106,044</u>	<u>\$ 100,739,224</u>	<u>\$ 37,019,441</u>	<u>\$ 2,952,317</u>	<u>\$ 4,592,221</u>	<u>\$ 52,307</u>	<u>\$ 360,058,732</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents the recorded investment, and the unpaid principal balance of impaired loans segmented by those with and without a related allowance recorded at September 30, 2022 and December 31, 2021. The average recorded investment and interest income recognized is presented for the time during which the loans were impaired within the nine- and 12-month periods then ended.

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2022					
With no related allowance recorded:					
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate and farmland	5,205,464	4,820,801	-	4,885,411	48,898
Residential real estate	522,701	311,348	-	345,028	5,677
Commercial and industrial	-	-	-	-	-
Mobile home	81,399	46,148	-	52,040	2,034
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	4,081,519	3,700,169	490,000	3,727,190	-
Residential real estate	-	-	-	-	-
Commercial and industrial	134,402	134,402	2,258	148,530	6,857
Mobile home	-	-	-	-	-
Other consumer	-	-	-	-	-
Total:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	9,286,983	8,520,970	490,000	8,612,601	48,898
Residential real estate	522,701	311,348	-	345,028	5,677
Commercial and industrial	134,402	134,402	2,258	148,530	6,857
Mobile home	81,399	46,148	-	52,040	2,034
Other consumer	-	-	-	-	-
	<u>\$ 10,025,485</u>	<u>\$ 9,012,868</u>	<u>\$ 492,258</u>	<u>\$ 9,158,199</u>	<u>\$ 63,466</u>
December 31, 2021					
With no related allowance recorded:					
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate and farmland	5,296,638	4,932,179	-	5,015,600	63,168
Residential real estate	465,525	261,643	-	293,333	2,456
Commercial and industrial	-	-	-	-	-
Mobile home	90,002	58,685	-	67,558	3,079
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	4,081,519	3,760,745	730,000	3,797,731	-
Residential real estate	-	-	-	-	-
Commercial and industrial	160,226	160,226	3,012	167,311	9,376
Mobile home	-	-	-	-	-
Other consumer	-	-	-	-	-
Total:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	9,378,157	8,692,924	730,000	8,813,331	63,168
Residential real estate	465,525	261,643	-	293,333	2,456
Commercial and industrial	160,226	160,226	3,012	167,311	9,376
Mobile home	90,002	58,685	-	67,558	3,079
Other consumer	-	-	-	-	-
	<u>\$ 10,093,910</u>	<u>\$ 9,173,478</u>	<u>\$ 733,012</u>	<u>\$ 9,341,533</u>	<u>\$ 78,079</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Under a TDR, the Bank has granted a concession that it would not otherwise make to a borrower who has experienced financial difficulty. At the time of the restructuring, the borrower is expected to pay the amounts due under the renegotiated terms.

The table below shows troubled debt restructured loans outstanding by classification included in impaired loans at the respective dates. The Bank has no requirement to lend additional funds under a line of credit arrangement to borrowers who have received a TDR.

	September 30, 2022		December 31, 2021	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	<u>4</u>	<u>\$ 4,167,909</u>	<u>4</u>	<u>\$ 4,280,972</u>

The Bank did not record any new TDRs or modify any loans that were classified as TDRs during the nine-month period ended September 30, 2022 or during the 12-month period ended December 31, 2021.

There were no loans that the Bank modified in the 12 months preceding the period ended September 30, 2022 for which there was a payment default during the nine-month period ended September 30, 2022. There were no loans that the Bank modified in the 12 months preceding the period ended December 31, 2021 for which there was a payment default during the 12-month period ended December 31, 2021. Payment default is defined as any time the loan was more than 60 days past due.

The following table summarizes non-accrual loans at September 30, 2022 and December 31, 2021.

At:	September 30, 2022	December 31, 2021
Non-accrual loans by class		
Real estate		
Commercial real estate	\$ 7,337,469	\$ 7,543,655
Residential real estate	88,886	217,406
Mobile home	<u>19,922</u>	<u>29,306</u>
Total non-accrual loans	<u>\$ 7,446,277</u>	<u>\$ 7,790,367</u>

The following table presents the amount of gross interest income that would have been recorded during the three- and nine-month periods ended September 30, 2022 and 2021 had the non-accrual loans been current and performing according to terms.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
Interest not accrued on non-accrual loans	<u>\$ 141,259</u>	<u>\$ 60,017</u>	<u>\$ 329,604</u>	<u>\$ 170,813</u>

There were no consumer mortgage loans secured by residential real estate that were in the process of foreclosure as of September 30, 2022.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

5. Credit Commitments

The table below shows outstanding loan commitments, unused lines of credit, and letters of credit.

At:	September 30, 2022	December 31, 2021
Commitments to extend credit		
Loan origination commitments	\$ 26,594,750	\$ 16,964,179
Unused consumer real estate construction	3,367,349	949,725
Unused home equity lines of credit	17,365,904	15,597,761
Unused overdraft lines of credit	6,762,656	6,353,912
Unused commercial lines of credit	50,117,477	45,743,060
	<u>\$ 104,208,136</u>	<u>\$ 85,608,637</u>
Letters of credit	<u>\$ 3,004,742</u>	<u>\$ 3,609,206</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have variable interest rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

The Bank's exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. Management is not aware of any accounting loss to be incurred by funding these commitments.

6. Related Party Transactions

In the normal course of business, the Bank's executive officers and directors and their related parties enter into loan transactions with the Bank. A summary of related party loan activity follows:

Year to Date Through:	September 30, 2022	December 31, 2021
Beginning balance	\$ 17,710,130	\$ 14,901,010
Advances	1,505,603	5,701,118
Change in related party	(289,557)	-
Payments	(2,002,665)	(2,891,998)
Ending balance	<u>\$ 16,923,511</u>	<u>\$ 17,710,130</u>

The change in related party was due to the resignation of a related party that occurred in June 2022.

In addition to the outstanding balances listed above, the Bank's executive officers and directors and their related parties had \$3,002,769 in unused loans committed but not funded as of September 30, 2022. As of December 31, 2021, the Bank's executive officers and directors and their related parties had \$3,177,666 in unused loans committed but not funded.

The Bank obtains goods and services from firms of which owners are also members of the Bank's Board of Directors. Amounts paid to these related parties totaled \$10,534 during the nine months ended September 30, 2022. Amounts paid to these related parties totaled \$10,531 during the nine months ended September 30, 2021.

The Bank has a wealth management referral relationship with the firm of a director. The Bank recognized \$8,931 of income from the referral relationship in the nine months ended September 30, 2022. The Bank recognized no income from the referral relationship in the nine months ended September 30, 2021.

Deposits of the Bank's executive officers and directors and their related parties totaled \$6,919,157 at September 30, 2022. Deposits of the Bank's executive officers and directors and their related parties totaled \$4,990,872 at December 31, 2021.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

7. Bank Premises and Equipment

Bank premises and equipment and the related depreciation are as follows:

	Useful Lives	September 30, 2022	December 31, 2021
Land		\$ 3,632,621	\$ 3,632,621
Building and improvements	15 - 39 years	8,875,014	8,995,247
Leasehold improvements	10 - 19 years	588,014	584,131
Furniture, fixtures, and equipment	3 - 10 years	2,787,740	2,779,714
		15,883,389	15,991,713
Accumulated depreciation		5,932,458	5,824,119
Net bank premises and equipment		\$ 9,950,931	\$ 10,167,594

	For the Three Months Ended September 30, 2022	2021	For the Nine Months Ended September 30, 2022	2021
Depreciation expense	\$ 134,546	\$ 117,498	\$ 405,161	\$ 375,977

Computer software included in other assets and the related amortization expense are as follows:

	Useful Life	September 30, 2022		December 31, 2021	
Computer software	3 years	\$	66,393	\$	273,003
Accumulated amortization			56,639		267,335
Net computer software		\$	9,754	\$	5,668

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
Software amortization expense	\$ 1,641	\$ 2,556	\$ 4,252	\$ 7,550

8. Lease Commitments

The Bank leases certain banking facilities under operating leases expiring on various dates through 2026. At September 30, 2022, the Bank had lease liabilities totaling \$403,611 included in other liabilities and right-of-use lease assets totaling \$403,611 included in other assets related to these leases. At December 31, 2021, the Bank had lease liabilities totaling \$526,930 included in other liabilities and right-of-use lease assets totaling \$526,930 included in other assets related to these leases.

The weighted-average discount rate on operating lease balances outstanding at September 30, 2022 was 2.10%. The weighted-average remaining lease term of operating leases outstanding at September 30, 2022 was 2.7 years. The weighted-average discount rate on operating lease balances outstanding at December 31, 2021 was 2.04%. The weighted-average remaining lease term of operating leases outstanding at December 31, 2021 was 3.4 years.

Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the three months ended September 30, 2022 was \$57,565. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the three months ended September 30, 2021 was \$57,664. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the nine months ended September 30, 2022 was \$168,069. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the nine months ended September 30, 2021 was \$166,048.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

8. Lease Commitments - continued

As of September 30, 2022, future minimum payments, by year and in the aggregate, of operating leases are as follows:

Year	Amount
Remainder of 2022	\$ 43,240
2023	172,960
2024	153,451
2025	47,339
2026	<u>27,614</u>
Total undiscounted lease payments	444,604
Discount on cash flows	<u>(40,993)</u>
Total lease liability	<u><u>\$ 403,611</u></u>

9. Borrowings and Available Lines of Credit

The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the lender. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans. The Bank is required to purchase shares of capital stock in the FHLBA as a condition to obtaining the line of credit. Based on the value of available collateral as of September 30, 2022, the Bank could borrow \$96,697,281 from the FHLBA.

The Bank is eligible to borrow from the FRB Discount Window. This credit line is secured by the Bank's eligible consumer loan portfolio. Based on the value of available collateral as of September 30, 2022, the Bank could borrow \$4,707,874 from the FRB Discount Window.

The Certificate of Deposit Account Registry Service ("CDARS") is a form of brokered deposit program in which the Bank has been a participant since June 2005. In addition to offering depositors enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through their One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes this arrangement would be a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may obtain funds through the One-Way Buy program up to 10% of reported total assets as of September 30, 2022, or \$63,551,190.

The Bank has secured and unsecured credit lines with correspondent banks, which are subject to periodic review. Based on the last review performed in the third quarter of 2022, the amount available under the secured line is \$5,000,000 and the amount available under the unsecured line is \$3,000,000.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

10. Retirement Plan

The Bank has a tax-qualified 401(k) and Profit Sharing Plan (the “401(k) Plan”) which is available to all employees who have reached the age of 21 and have completed at least three months of service as defined by the Plan. In 2021, the Bank made accruals based on a budgeted discretionary amount. Effective January 1, 2022, the Bank makes matching contributions of 100% on the first 3% of compensation deferred, plus 50% on the next 2% of compensation deferred. Participants are immediately vested in the matching contributions made by the Bank, and discretionary profit sharing contributions, if any, will vest ratably over a six-year period beginning in year two.

For the three months ended September 30, 2022, the Bank recognized \$60,132 of expense associated with the 401(k) Plan. For the three months ended September 30, 2021, the Bank accrued \$50,250 of expense associated with the 401(k) Plan. For the nine months ended September 30, 2022, the Bank recognized \$185,349 of expense associated with the 401(k) Plan. For the nine months ended September 30, 2021, the Bank accrued \$150,750 of expense associated with the 401(k) Plan.

In 2006 and in the second quarter of 2017, the Bank entered into agreements under its Supplemental Executive Retirement Plans (“SERP”) with certain executive officers to provide for retirement income benefits. The Bank accrues the present value of these benefits over the remaining number of years to the executives' retirement dates. The Bank has recorded a liability of \$1,169,021 and \$1,152,947 related to these benefits at September 30, 2022 and December 31, 2021, respectively. SERP expense for the three months ended September 30, 2022 was \$25,704. SERP expense for the three months ended September 30, 2021 was \$24,264. SERP expense for the nine months ended September 30, 2022 was \$77,112. SERP expense for the nine months ended September 30, 2021 was \$72,792.

11. Interest-Bearing Deposits

Major classifications of interest-bearing deposits at:	September 30, 2022	December 31, 2021
Interest-bearing checking and Money Market	\$ 257,153,092	\$ 197,672,460
Savings	69,762,643	62,996,093
Certificates of deposit	82,901,001	108,098,230
	<u>\$ 409,816,736</u>	<u>\$ 368,766,783</u>

Maturities of certificates of deposit at:	September 30, 2022	December 31, 2021
Maturing within twelve months	\$ 48,460,291	\$ 79,934,374
Maturing over one to three years	29,434,717	23,064,089
Maturing over three to five years	5,005,993	5,099,767
	<u>\$ 82,901,001</u>	<u>\$ 108,098,230</u>

Certificates of deposit over \$250,000 included above:	<u>\$ 23,532,260</u>	<u>\$ 39,564,711</u>
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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Interest expense:	2022	2021	2022	2021
Interest-bearing checking and Money Market	\$ 63,248	\$ 48,586	\$ 168,539	\$ 134,001
Savings	23,444	20,462	67,715	58,404
Certificates of deposit	155,217	295,950	572,351	1,010,405
	<u>\$ 241,909</u>	<u>\$ 364,998</u>	<u>\$ 808,605</u>	<u>\$ 1,202,810</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

12. Income Taxes

The components of income tax expense are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Income tax expense:	2022	2021	2022	2021
Federal	\$ 362,637	\$ 354,890	\$ 854,638	\$ 1,023,749
State	95,892	142,842	251,044	411,070
	<u>\$ 458,529</u>	<u>\$ 497,732</u>	<u>\$ 1,105,682</u>	<u>\$ 1,434,819</u>

The differences between the statutory federal income tax rate in effect during the periods indicated and the effective tax rate for the Bank are reconciled as follows:

Year to date through:	September 30, 2022	September 30, 2021
Statutory federal income tax rate	21.00 %	21.00 %
Increase (decrease) resulting from		
State income taxes, net of federal income tax benefit	4.37	5.87
Tax-exempt income	(1.24)	(1.03)
Nondeductible expenses	0.23	0.08
	<u>24.36 %</u>	<u>25.92 %</u>

13. Stock Option and Stock Purchase Plans

The Bank has adopted stock option plans for directors and officers. Option exercise prices are equal to the fair market value of the stock on the date of grant. Options granted under the director plan fully vest at the time of grant. Options granted under the officer plan vest three years after their grant dates. On April 23, 2018, the officer plan expired, eliminating the Bank's ability to make future grants, although options granted remain outstanding and subject to exercise through April 2028.

The total number of shares originally authorized for active stock option plans and plans with outstanding options was 249,890. At September 30, 2022, a total of 28,003 shares remain available for grant under the director plan.

A summary of activity for stock option activity for the nine months ended September 30, 2022 is as follows:

Options	Number of Shares	Exercise Price	Remaining Contractual Term	Intrinsic Value
Outstanding at January 1, 2022	72,499	\$ 24.39		
Options granted	9,120	\$ 30.99		
Options exercised	(16,791)	\$ 21.88		
Options forfeited or expired	(4,379)	\$ 24.72		
Outstanding at September 30, 2022	<u>60,449</u>	<u>\$ 26.06</u>	<u>5.97</u>	<u>\$ 359,041</u>
Exercisable at September 30, 2022	<u>60,449</u>	<u>\$ 26.06</u>	<u>5.97</u>	<u>\$ 359,041</u>

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The service period generally matches the vesting period.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

13. Stock Option and Stock Purchase Plans - continued

For the three months ended September 30, 2022, the Bank recorded stock-based compensation expense of \$55,659. For the three months ended September 30, 2021, the Bank recorded stock-based compensation expense of \$0. For the nine months ended September 30, 2022, the Bank recorded stock-based compensation expense of \$55,659. For the nine months ended September 30, 2021, the Bank recorded stock-based compensation expense of \$43,169.

The intrinsic value of options exercised during the nine months ended September 30, 2022 was \$159,804. The intrinsic value of options exercised during the nine months ended September 30, 2021 was \$26,723.

At the annual meeting of stockholders held on May 20, 2020, the Bank's stockholders approved the Harford Bank 2020 Employee Stock Purchase Plan (the "2020 ESPP") that allows eligible employees to acquire up to 100,000 shares of the Bank's common stock at a discount through accumulated payroll deductions.

Based on employee withholdings during the nine months ended September 30, 2022, a total of 1,602 shares were granted under the 2020 ESPP at a weighted-average exercise price of \$30.28. At September 30, 2022, a total of 95,080 shares remain available for grant under the 2020 ESPP.

14. Capital Standards

The FRB and the FDIC have adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions.

In July 2013, the Board of Governors of the Federal Reserve System and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and fully phased-in as of January 1, 2019, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new minimum Common Equity Tier 1 capital ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which are now fully phased-in, effectively resulting in a minimum CET1 ratio of 7.0%. Basel III raised the minimum Tier 1 capital ratio from 4.0% to 6.0% which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%. Basel III maintained the minimum Total capital ratio of 8.0%, which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Total capital ratio of 10.5%. Basel III maintains the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall and the institution's "eligible retained income" (that is, four quarter trailing net income, net of distributions and tax effects not reflected in net income).

Under Basel III, Total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of Common equity Tier 1 capital and additional Tier 1 capital. For the Bank, Common equity Tier 1 capital consists of common stock, surplus and undivided profits. The Bank has no additional Tier 1 capital items. The Bank's Tier 2 capital consists of a limited amount of the allowance for loan losses. The Bank's Total capital is the sum of Tier 1 capital plus Tier 2 capital.

The Total capital ratio, the Tier 1 capital ratio and the Common equity Tier 1 capital ratio are calculated using end of period risk-weighted assets. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items based on regulatory requirements. The Tier 1 leverage capital ratio is calculated using quarterly average assets.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

14. Capital Standards - continued

The Bank's actual capital ratios, the required regulatory capital ratios to be considered well capitalized, the regulatory minimum capital ratios, and the regulatory minimum capital ratios with the 2.5% capital conservation buffer added based on the Basel III Capital Rules are as follows for the periods indicated:

(\$ in thousands)	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2022	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 57,447	14.44%	\$ 39,785	10.00%	\$ 31,828	8.00%	\$ 41,774	10.50%
Tier 1 capital	52,567	13.21%	31,828	8.00%	23,871	6.00%	33,817	8.50%
Common equity Tier 1 capital	52,567	13.21%	25,860	6.50%	17,903	4.50%	27,849	7.00%
Tier 1 leverage capital	52,567	8.50%	30,918	5.00%	24,735	4.00%	24,735	4.00%

December 31, 2021	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 53,926	15.43%	\$ 34,959	10.00%	\$ 27,967	8.00%	\$ 36,707	10.50%
Tier 1 capital	49,547	14.17%	27,967	8.00%	20,975	6.00%	29,715	8.50%
Common equity Tier 1 capital	49,547	14.17%	22,723	6.500%	15,732	4.50%	24,471	7.00%
Tier 1 leverage capital	49,547	8.66%	28,606	5.000%	22,885	4.00%	22,885	4.00%

As of September 30, 2022, capital levels at the Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Based on the ratios presented above, capital levels of the Bank exceed the minimum levels necessary to be considered well capitalized.

Failure to meet the capital requirements could affect the Bank's ability to pay dividends and accept deposits and may significantly affect the operations of the Bank.

In its most recent regulatory report, the Bank was categorized as well capitalized under the prompt corrective action regulations. Management knows of no events or conditions that should change this classification.

15. Net Income per Common Share

The calculations of basic and diluted net income per common share are presented in the following table.

	For the Three Months Ended September 30, 2022		For the Nine Months Ended September 30, 2022	
	2022	2021	2022	2021
Basic:				
Net income	\$1,431,327	\$ 1,417,624	\$3,433,215	\$4,101,760
Weighted-average common shares outstanding	<u>1,463,277</u>	<u>1,441,511</u>	<u>1,458,405</u>	<u>1,437,536</u>
Basic net income per common share	<u>\$ 0.98</u>	<u>\$ 0.98</u>	<u>\$ 2.35</u>	<u>\$ 2.85</u>
Diluted:				
Net income	\$1,431,327	\$ 1,417,624	\$3,433,215	\$4,101,760
Weighted-average common shares outstanding	<u>1,463,277</u>	<u>1,441,511</u>	<u>1,458,405</u>	<u>1,437,536</u>
Dilutive common stock equivalents	<u>10,197</u>	<u>12,536</u>	<u>9,198</u>	<u>6,667</u>
Dilutive EPS shares	<u>1,473,474</u>	<u>1,454,047</u>	<u>1,467,603</u>	<u>1,444,203</u>
Diluted net income per common share	<u>\$ 0.97</u>	<u>\$ 0.97</u>	<u>\$ 2.34</u>	<u>\$ 2.84</u>
Anti-dilutive shares	<u>-</u>	<u>-</u>	<u>8,360</u>	<u>38,092</u>

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Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements

FASB ASC Topic 820 defines fair value as the price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date under current market conditions (an exit price) and establishes a framework for measuring fair value and expands disclosures about fair value. FASB ASC Topic 820 also establishes a hierarchy for determining fair value measurement. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities.

The fair value hierarchy is as follows:

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

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

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

During the nine- and 12-month periods ended September 30, 2022 and December 31, 2021, respectively, the Bank did not measure any assets or liabilities at fair value on a recurring basis. The following table presents impaired loans measured at fair value on a nonrecurring basis where the outstanding investment in the loan exceeded fair value resulting in an allowance being allocated to the loan.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
September 30, 2022				
Impaired loans (net of impairment)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,805,357</u>	<u>\$ 3,805,357</u>
December 31, 2021				
Impaired loans (net of impairment)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,646,169</u>	<u>\$ 3,646,169</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

The Bank does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses is established. The Bank measures impairment either based on the fair value of the collateral if the loan is collateral dependent or uses the present value of expected future cash flows discounted at the loan's effective interest rate, which is not a fair value measurement. The Bank maintains a valuation allowance to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When an impaired loan is measured at fair value based solely on observable market prices or a current appraisal without further adjustment for unobservable inputs, the Bank records the impaired loan as a nonrecurring fair value measurement classified as Level 2. However, if based on management's review, additional discounts to observed market prices or appraisals are required or if observable inputs are not available, the Bank records the impaired loan as a nonrecurring fair value measurement classified as Level 3. Impaired loans that are measured based on expected future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, are not recorded at fair value and are therefore excluded from fair value disclosure requirements.

The following table present qualitative information about Level 3 fair value measurements for impaired loans at September 30, 2022 and December 31, 2021:

	Fair Value Estimate	Valuation Techniques	Unobservable Inputs	Discount
September 30, 2022				
Impaired loans (net of impairment)	<u>\$ 3,805,357</u>	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	12%
December 31, 2021				
Impaired loans (net of impairment)	<u>\$ 3,646,169</u>	Appraisal (1)	Selling cost	7%
			Discount for lack of marketability	19%

(1) Fair value is generally determined through independent appraisal of underlying collateral, which generally includes various level 3 inputs which are not observable.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

In estimating fair values, the Bank utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. Also, the calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2022					
Financial assets:					
Cash and cash equivalents	\$ 97,124,731	\$ 97,124,731	\$ 97,124,731	\$ -	\$ -
Time deposits in other banks	2,804,894	2,660,894	-	-	2,660,894
Investment securities held to maturity					
U.S. Treasury securities	20,911,034	19,443,688	19,443,688	-	-
U.S. government agencies	37,815,218	34,088,330	-	34,088,330	-
Agency RMBS	37,308,644	32,373,515	-	32,373,515	-
Agency CMBS	4,254,326	4,016,293	-	4,016,293	-
Agency CMO securities	1,330,234	1,091,297	-	1,091,297	-
SBA asset-backed securities	12,565,493	11,196,752	-	11,196,752	-
State and municipal securities	3,574,242	2,809,652	-	2,809,652	-
Loans, net	397,239,068	385,558,494	-	-	385,558,494
Accrued interest receivable	1,248,047	1,248,047	-	1,248,047	-
Bank owned life insurance	6,372,022	6,372,022	-	6,372,022	-
Financial liabilities:					
Deposits	580,588,193	577,695,474	-	-	577,695,474
Accrued interest payable	77,928	77,928	-	77,928	-
December 31, 2021					
Financial assets:					
Cash and cash equivalents	\$ 82,430,959	\$ 82,430,959	\$ 82,430,959	\$ -	\$ -
Time deposits in other banks	2,832,409	2,822,503	-	-	2,822,503
Investment securities held to maturity					
U.S. Treasury securities	16,014,182	15,853,990	15,853,990	-	-
U.S. government agencies	35,455,575	35,188,956	-	35,188,956	-
Agency RMBS	36,276,433	36,146,769	-	36,146,769	-
Agency CMO securities	1,436,183	1,387,069	-	1,387,069	-
SBA asset-backed securities	13,122,836	13,002,377	-	13,002,377	-
State and municipal securities	3,585,312	3,562,785	-	3,562,785	-
Loans, net	363,020,976	370,799,119	-	-	370,799,119
Accrued interest receivable	1,355,966	1,355,966	-	1,355,966	-
Bank owned life insurance	6,272,657	6,272,657	-	6,272,657	-
Financial liabilities:					
Deposits	522,324,478	522,854,982	-	-	522,854,982
Accrued interest payable	130,139	130,139	-	130,139	-

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

17. Legal Proceedings

On January 12, 2021, Sheira Brown filed a complaint against the Bank in the United States District Court for the Northern District of Maryland, docketed as Sheira Brown v. Harford Bank, Case No. 1:21-cv-00096-ELH, in which she alleges that, in refusing to cash a check that was issued to her and holding that check until the next business day, the Bank engaged in conduct that violated 42 U.S.C. § 1981 (racial discrimination) and constituted conversion of her check (the “Brown Litigation”). Ms. Brown has asked for an unspecified amount of damages, including punitive damages, costs, and attorneys’ fees. The Bank believes that Ms. Brown’s claims lack merit and is vigorously defending the Brown Litigation. The Bank maintains insurance coverages that it believes will cover portions of the legal expenses associated with the Brown Litigation and any damages that might be awarded to Ms. Brown. It is not possible at this time for the Bank to assess the likelihood of success of any of its defenses or, thus, the outcome of the Brown Litigation, or the amount of legal fees that it will incur in defending the Brown Litigation.

The Bank is at times, in the ordinary course of business, subject to other legal actions that are normally associated with a financial institution. In management’s opinion, the effect of these other actions will not be material to the financial condition or results of operations of the Bank.

18. Accounting Standard Updates

Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. In July 2019, the FASB proposed changes to the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities. On October 16, 2019, the FASB approved its proposal to delay the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities, and subsequently issued ASU 2019-10 *“Financial Instruments – Credit Losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842): Effective Dates”* which extended the implementation date to 2023 for SEC registered smaller reporting companies and private companies. The Bank is a smaller reporting company. Management has formed an implementation team led by the CFO that also includes other functional areas of the Bank which is currently evaluating the potential impact of ASU 2016-13 on the Bank’s financial statements. Although management is currently unable to reasonably estimate the impact of adopting ASU 2016-13, the Bank expects that the impact of adoption could be significantly influenced by the composition, characteristics and quality of the Bank’s loan portfolio as well as the prevailing economic conditions and forecasts as of the adoption date. As part of management’s evaluation process and implementation process, the Bank has focused on data capture and portfolio segmentation with continued progress toward model validation and testing.

ASU 2019-12, “Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes.” The guidance issued in this update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. ASU 2019-12 also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. ASU 2019-12 became effective for the Bank on January 1, 2021 and did not have a significant impact on the Bank’s financial statements.

ASU 2020-08, “Codification Improvements to Subtopic 310-20, Receivables - Nonrefundable Fees and Other Costs.” ASU 2020-08 clarifies the accounting for the amortization of purchase premiums for callable debt securities with multiple call dates. ASU 2020-08 became effective for the Bank on January 1, 2021 and did not have a significant impact on the Bank’s financial statements.

Harford Bank and Subsidiary
Notes to Consolidated Financial Statements (Unaudited)

18. Accounting Standard Updates - continued

ASU 2022-02, *“Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures.”* ASU 2022-02 eliminates the accounting guidance for troubled debt restructurings in Accounting Standards Codification (“ASC”) 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. Additionally, ASU 2022-02 requires entities to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of ASC Subtopic 3126-20, Financial Instruments - Credit Losses - Measured at Amortized Cost. ASU 2022-02 will be effective for the Bank on January 1, 2023, though early adoption is permitted. The adoption of ASU 2022-02 is not expected to have a significant impact on the Bank’s financial statements.

CERTIFICATIONS OF THE PRINCIPAL EXECUTIVE OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Michael F. Allen, certify that:

1. I have reviewed this quarterly report on Form 10-Q, as amended, of Harford Bank;
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(s) 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; and
 - 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; and
 - 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(s) 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: November 3, 2022

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

CERTIFICATIONS OF THE PRINCIPAL FINANCIAL OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Neil L. Christ, CPA, certify that:

1. I have reviewed this quarterly report on Form 10-Q, as amended, of Harford Bank;
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(s) 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; and
 - 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; and
 - 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(s) 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: November 3, 2022

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION OF THE PERIODIC REPORT
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, each of the undersigned hereby certifies that (i) the Quarterly Report of Harford Bank on Form 10-Q, as amended, for the quarter ended September 30, 2022, filed with the Federal Deposit Insurance Corporation (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Harford Bank.

Date: November 3, 2022

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: November 3, 2022

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)