

**FIRST COMMUNITY CORPORATION AND
FIRST COMMUNITY BANK OF EAST TENNESSEE**

Rogersville, Tennessee

CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2022 and 2021



FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
Rogersville, Tennessee

AUDITED CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Senior Management
First Community Corporation and
First Community Bank of East Tennessee
Rogersville, Tennessee

Opinion

We have audited the consolidated financial statements of First Community Corporation and First Community Bank of East Tennessee (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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



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Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Pugh & Company, P.C.

Certified Public Accountants
Knoxville, Tennessee
March 21, 2023

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
CONSOLIDATED BALANCE SHEETS

	As of December 31,	2022	2021
ASSETS			
Cash and Due from Banks	\$	4,039,684	\$ 8,114,752
Interest-Bearing Deposits in Financial Institutions		27,104,172	43,266,881
Total Cash and Cash Equivalents		31,143,856	51,381,633
Securities Available for Sale, at Fair Value		17,854,427	18,744,234
Loans, Net		142,747,506	114,367,723
Premises and Equipment, Net		3,263,561	4,224,618
Accrued Interest Receivable		435,327	304,834
Restricted Equity Investment, at Cost		1,513,100	2,330,600
Cash Surrender Value of Life Insurance		7,795,825	7,586,543
Foreclosed Real Estate		65,000	215,001
Other Real Estate Held for Sale		614,000	0
Deferred Income Tax Benefit		970,505	835,745
Other Assets		515,075	386,401
Total Assets	\$	206,918,182	\$ 200,377,332
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits:			
Noninterest-Bearing	\$	43,321,313	\$ 43,929,092
Interest-Bearing		134,722,564	126,785,282
Total Deposits		178,043,877	170,714,374
Securities Sold Under Agreements to Repurchase		3,064,801	3,070,899
Federal Home Loan Bank Advances		611,718	671,162
Federal Reserve Bank Advances		0	192,197
Subordinated Debentures		5,217,000	5,217,000
Accrued Interest Payable		49,801	56,470
Other Liabilities		2,154,241	2,217,267
Total Liabilities		189,141,438	182,139,369
SHAREHOLDERS' EQUITY			
Preferred Stock Class A, \$8.05 Par Value. Authorized 400,000 Shares; Issued 220,080; Outstanding 211,672		1,776,474	1,776,474
Preferred Stock Class B, \$8.05 Par Value. Authorized 200,000 Shares; Issued 30,071; Outstanding 29,846		242,072	242,072
Common Stock, No Par Value. Authorized 10,000,000 Shares; Issued 1,699,244; Outstanding 1,650,812		5,772,593	5,743,705
Treasury Stock, at Cost		(946,998)	(946,998)
Retained Earnings		12,407,567	11,399,895
Accumulated Other Comprehensive Income (Loss)		(1,474,964)	22,815
Total Shareholders' Equity		17,776,744	18,237,963
Total Liabilities and Shareholders' Equity	\$	206,918,182	\$ 200,377,332

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

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,	2022	2021
INTEREST INCOME			
Loans, Including Fees	\$	5,968,696	\$ 5,349,852
Securities			
Taxable		353,980	257,443
Non-taxable		17,876	30,148
Other		651,478	106,133
Total Interest Income		<u>6,992,030</u>	<u>5,743,576</u>
INTEREST EXPENSE			
Deposits		226,031	253,574
Federal Home Loan Bank Advances		33,047	36,190
Subordinated Debentures		187,311	106,094
Other		4,629	17,964
Total Interest Expense		<u>451,018</u>	<u>413,822</u>
NET INTEREST INCOME		6,541,012	5,329,754
PROVISION FOR LOAN LOSSES		125,000	0
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES		<u>6,666,012</u>	<u>5,329,754</u>
NONINTEREST INCOME			
Service Charges on Deposit Accounts		305,401	294,891
Increase in Cash Surrender Value of Life Insurance		209,282	204,890
Other		474,909	475,896
Total Noninterest Income		<u>989,592</u>	<u>975,677</u>
NONINTEREST EXPENSE			
Salaries and Employee Benefits		3,374,679	3,290,146
Occupancy		450,774	512,724
Data Processing		332,907	336,524
Furniture and Equipment		153,369	123,589
Advertising and Public Relations		46,908	49,259
Professional Services		201,429	138,855
Foreclosed Real Estate, Net		(142,656)	(137,890)
Operating Supplies		48,823	39,628
Computer Software Depreciation		1,999	1,528
Software Maintenance		76,143	76,793
Telephone and Data Communications		100,286	90,590
Director and Committee Fees		126,078	124,200
FDIC and State Assessments		69,380	70,468
Cybersecurity		108,814	99,776
Loss on Sales and Writedowns of Premises and Equipment		295,430	0
Other		531,471	480,042
Total Noninterest Expense		<u>5,775,834</u>	<u>5,296,232</u>
INCOME BEFORE INCOME TAXES		1,879,770	1,009,199
INCOME TAX EXPENSE		<u>(395,623)</u>	<u>(216,600)</u>
NET INCOME	\$	<u>1,484,147</u>	\$ <u>792,599</u>
EARNINGS PER COMMON SHARE	\$	<u>0.86</u>	\$ <u>0.44</u>
EARNINGS PER COMMON SHARE, ASSUMING DILUTION	\$	<u>0.78</u>	\$ <u>0.42</u>

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

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,	<u>2022</u>	<u>2021</u>
NET INCOME		\$ <u>1,484,147</u>	\$ <u>792,599</u>
OTHER COMPREHENSIVE INCOME (LOSS)			
Unrealized Gains (Losses) on Investment Securities Available for Sale		(2,027,862)	(438,461)
Income Taxes Related to Items of Other Comprehensive Income		<u>530,083</u>	<u>114,614</u>
Other Comprehensive Income (Loss), Net of Income Taxes		<u>(1,497,779)</u>	<u>(323,847)</u>
COMPREHENSIVE INCOME (LOSS)		\$ <u><u>(13,632)</u></u>	\$ <u><u>468,752</u></u>

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

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2022 and 2021

	Preferred Stock A	Preferred Stock B	Common Stock	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
BALANCES, JANUARY 1, 2021	\$ 1,776,474	\$ 242,072	\$ 5,629,202	\$ (946,998)	\$ 11,083,573	\$ 346,662	\$ 18,130,985
Preferred Stock Dividends Paid	0	0	0	0	(63,574)	0	(63,574)
Common Stock Dividends Paid	0	0	0	0	(412,703)	0	(412,703)
Net Income	0	0	0	0	792,599	0	792,599
Other Comprehensive Income (Loss)	0	0	0	0	0	(323,847)	(323,847)
Stock Options Exercised	0	0	95,000	0	0	0	95,000
Stock-Based Compensation	0	0	19,503	0	0	0	19,503
BALANCES, DECEMBER 31, 2021	1,776,474	242,072	5,743,705	(946,998)	11,399,895	22,815	18,237,963
Preferred Stock Dividends Paid	0	0	0	0	(63,772)	0	(63,772)
Common Stock Dividends Paid	0	0	0	0	(412,703)	0	(412,703)
Net Income	0	0	0	0	1,484,147	0	1,484,147
Other Comprehensive Income (Loss)	0	0	0	0	0	(1,497,779)	(1,497,779)
Stock-Based Compensation	0	0	28,888	0	0	0	28,888
BALANCES, DECEMBER 31, 2022	<u>\$ 1,776,474</u>	<u>\$ 242,072</u>	<u>\$ 5,772,593</u>	<u>\$ (946,998)</u>	<u>\$ 12,407,567</u>	<u>\$ (1,474,964)</u>	<u>\$ 17,776,744</u>

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

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	2022	2021
Cash Flows from Operating Activities:			
Net Income	\$	1,484,147	\$ 792,599
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used in) Operating Activities:			
Depreciation and Amortization		218,484	219,137
Net Amortization of Securities		19,227	60,351
Stock Dividends Received		(14,691)	(12,253)
Provision for Loan Losses		(125,000)	0
Stock-Based Compensation		28,888	19,503
(Gain) Loss of Sales of Foreclosed Real Estate and Repossessed Assets		(152,627)	(153,180)
(Gain) Loss of Sales and Writedowns of Premises and Equipment		295,430	0
Deferred Income Taxes (Benefit)		395,323	216,600
(Increase) Decrease in Cash Surrender Value of Company Owned Life Insurance		(209,282)	(204,890)
Change in Accrued Interest Receivable and Other Assets		(255,574)	219,072
Change in Accrued Interest Payable and Other Liabilities		(69,695)	12,736
Net Cash Provided by (Used in) Operating Activities		<u>1,614,630</u>	<u>1,169,675</u>
Cash Flows from Investing Activities:			
Purchases of Securities Available for Sale		(5,650,631)	(6,036,292)
Proceeds from Redemptions of Equity Investments		817,500	0
Proceeds from Maturities, Redemptions, and Paydowns of Securities Available for Sale		4,508,040	3,494,242
Net (Increase) Decrease in Loans		(28,254,783)	(6,677,172)
Proceeds from Sales of Foreclosed Real Estate and Repossessed Assets		299,035	164,175
Purchases of Premises and Equipment		(166,857)	(187,687)
Net Cash Provided by (Used in) Investing Activities		<u>(28,447,696)</u>	<u>(9,242,734)</u>
Cash Flows from Financing Activities:			
Cash Dividends Paid on Preferred Stock		(63,772)	(63,574)
Cash Dividends Paid on Common Stock		(412,703)	(412,703)
Exercise of Stock Options		0	95,000
Repayments of FHLB and FRB Advances		(251,641)	(4,456,095)
Change in Checking, Savings and Money Market Accounts		12,610,932	19,571,659
Increase (Decrease) in Time Deposits		(5,281,429)	1,508,348
Change in Securities Sold under Agreements to Repurchase		(6,098)	235,511
Net Cash Provided by (Used in) Financing Activities		<u>6,595,289</u>	<u>16,478,146</u>
Net Change in Cash and Cash Equivalents		(20,237,777)	8,405,087
Cash and Cash Equivalents at Beginning of Period		51,381,633	42,976,546
Cash and Cash Equivalents at End of Period	\$	<u><u>31,143,856</u></u>	\$ <u><u>51,381,633</u></u>
Supplemental Disclosures of Cash Flow Information:			
Cash Paid During the Year for:			
Interest	\$	457,687	\$ 473,666
Supplemental Noncash Disclosures:			
Sales of Foreclosed Real Estate by Origination of Loans	\$	0	\$ 97,750
Change in Unrealized Gains/Losses on Securities Available for Sale		(2,027,862)	(438,461)
Change in Deferred Income Taxes Associated with Unrealized Gains/Losses on Securities Available for Sale		(530,083)	(114,614)
Change in Unrealized Gains/Losses on Securities Available for Sale, Net of Deferred Income Taxes		(1,497,779)	(323,847)

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

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: First Community Corporation (the Holding Company), through its wholly owned subsidiary, First Community Bank of East Tennessee (the Bank), provides a variety of banking services to individuals and businesses from its banking offices in Rogersville, Church Hill, Surgoinsville and Kingsport, Tennessee. Its primary deposit products are demand and savings deposits and certificates of deposit, and its primary lending products are commercial, residential real estate and consumer loans. The accounting principles followed and the methods of applying those principles conform with accounting principles generally accepted in the United States of America (GAAP) and to general practices in the banking industry. The significant policies are summarized as follows:

Basis of Presentation: The accompanying consolidated financial statements include the accounts of First Community Corporation, a one-bank holding company and its wholly-owned subsidiary, First Community Bank of East Tennessee, together referred to as “the Company”. All material intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates: To prepare consolidated financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, fair values of financial instruments, and the valuation of real estate acquired through foreclosures are particularly subject to change.

Cash Flows: Cash and cash equivalents include cash and due from banks, deposits with other financial institutions with maturities under 90 days, and federal funds sold. Net cash flows are reported for loan, deposit and securities sold under agreements to repurchase transactions.

Cash and Due from Banks and Interest-Bearing Deposits in Other Financial Institutions: The Bank maintains cash deposits with the Federal Reserve Bank, which totaled approximately \$22,530,000 and \$43,181,000 as of December 31, 2022 and 2021, respectively, and with the Federal Home Loan Bank of Cincinnati, which totaled approximately \$65,000 and \$69,000 as of December 31, 2022 and 2021, respectively. As of December 31, 2022 and 2021, balances in correspondent bank accounts in excess of FDIC insurance limits totaled approximately \$4,856,000 and \$4,868,000, respectively.

Investment Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income (loss).

Interest income includes amortization of purchase premium or discount. Gains and losses on sales are based on the amortized cost of the security sold. Securities are written down to fair value when a decline in fair value is not considered temporary (see Note 2).

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in the fair value (see Note 2).

Restricted Equity Investment: The Company's restricted equity investment represents a required investment in the Federal Home Loan Bank (FHLB) of Cincinnati, which is pledged as collateral for FHLB advances (see Note 12). This investment is carried at cost and evaluated for impairment.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of an estimated allowance for loan losses.

Interest income is reported on the simple interest accrual method. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to the accrual basis. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Estimated Allowance for Loan Losses: The estimated allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other trends and conditions. The entire estimated allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the estimated allowance when management believes the uncollectibility of a loan balance is confirmed.

A general reserve is established that evaluates unimpaired loans by category. Each loan within a group has similar risk characteristics. When estimating credit losses on each group of loans, management considers the Company's historical loss experience on the group, adjusted for changes in trends, conditions, and other relevant factors that affect repayment of the loans as of the evaluation date. These loans are collectively evaluated for estimated credit losses.

Another component of the ALLL is an allocated reserve on individually evaluated loans, as judgmentally determined by management to be impaired. A loan is considered impaired when based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. If a loan is impaired, an allocated allowance is established so that the loan is reported at the net present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Premises and Equipment: Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation is computed principally on the straight-line method over the estimated useful lives of the assets, which range as follows: building-40 years, equipment-3 to 15 years. Computer software is amortized using the straight-line method over the useful life of the asset and ranges from 3 to 10 years.

Foreclosed Real Estate: Real estate acquired through or instead of loan foreclosure is initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Costs after acquisition that do not increase the property's value are expensed. The Company's current average holding period for such properties is approximately 83 months.

Cash Surrender Value of Life Insurance: The Company has purchased life insurance policies on certain key executives and bank officers. Company owned life insurance is recorded at its net cash surrender value, or the amount that can be realized if surrendered.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities Sold Under Agreements to Repurchase: Repurchase agreements are treated as financing transactions and are carried at the amounts at which the securities will be subsequently reacquired, as specified in the respective agreements. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Stock-Based Compensation: Compensation cost is recognized for stock options and stock appreciation rights issued to employees and directors. Compensation cost is measured as the fair value of these awards on their date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options and stock appreciation rights at the date of grant. Compensation cost is recognized over the required service period, generally defined as the vesting period for stock option awards. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Earnings Per Common Share: Basic earnings per common share is net income less preferred stock dividends divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the effect of all dilutive potential common shares that were outstanding during the period. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the consolidated financial statements. See Note 18.

Advertising and Public Relations: Advertising and public relations costs are expensed as incurred.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being recognized upon ultimate settlement. The amount of unrecognized tax benefits is adjusted as appropriate for changes in facts and circumstances, such as significant amendments to existing tax law, new regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of an examination.

Employee Benefits: The Company maintains a 401(k) profit-sharing plan that covers substantially all employees. The Company matches a portion of the employee's contribution and records the expense in the period the employee contribution is withheld. The Company has a non-qualified deferred compensation arrangement with certain current and former officers. A contribution may be made or accrued each year based on future benefits to be paid under the arrangement, at the discretion of the Board of Directors if certain financial goals are met.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes net unrealized gains and losses on investment securities available for sale, net of any related tax effects, which is also recognized as a separate component of equity.

Off-Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Leases: All of the Company's leases are classified as operating leases. Right-of-use assets and lease liabilities are recorded based on the present value of future lease payments, and lease expense is recognized on a straight-line basis over the lives of the leases. Rental expense was \$4,400 and \$46,400 for the years ended December 31, 2022 and 2021, respectively.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards: In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in ASC 740 and also clarifies and amends existing guidance to improve consistent application. This ASU became effective for the Company beginning on January 1, 2022. The adoption of ASU 2019-12 does not have a significant impact on the Company's consolidated financial statements.

Recent Accounting Pronouncements: In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which creates a new credit impairment standard for financial assets measured at amortized cost and available-for-sale debt securities. The FASB has also since issued several updates to ASU 2016-13. The ASU requires financial assets measured at amortized cost (including loans and held-to-maturity debt securities) to be presented at the net amount expected to be collected, through an allowance for credit losses that are expected to occur over the remaining life of the asset, rather than incurred losses. The ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct write-down. The measurement of credit losses for newly recognized financial assets (other than certain purchased assets) and subsequent changes in the allowance for credit losses are recorded in the statement of income as the amounts expected to be collected change. The ASU is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

Evaluation of Subsequent Events: The Company's management has evaluated subsequent events through March 21, 2023, which is the date the financial statements were available to be issued and has determined that there are no subsequent events that require disclosure.

NOTE 2 - SECURITIES

The fair values of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2022				
U.S. Treasury Securities	\$ 6,940,907	\$ 0	\$ (438,017)	\$ 6,502,890
Small Business Admin. Securities	816,896	3,318	(58,469)	761,745
U.S. Government Agency Securities	4,528,289	0	(601,190)	3,927,099
Residential Mortgage-Backed Securities	5,190,387	533	(569,742)	4,621,178
Taxable Municipal Securities	966,602	0	(222,816)	743,786
Tax-Exempt Municipal Securities	1,408,318	0	(110,589)	1,297,729
Total	<u>\$ 19,851,399</u>	<u>\$ 3,851</u>	<u>\$ (2,000,823)</u>	<u>\$ 17,854,427</u>
2021				
U.S. Treasury Securities	\$ 2,969,909	\$ 41,279	\$ (38,417)	\$ 2,972,771
Small Business Admin. Securities	1,123,734	14,420	0	1,138,154
U.S. Government Agency Securities	6,817,842	90,817	(71,510)	6,837,149
Residential Mortgage-Backed Securities	5,204,522	51,418	(20,287)	5,235,653
Taxable Municipal Securities	966,163	0	(38,174)	927,989
Tax-Exempt Municipal Securities	1,631,174	3,917	(2,573)	1,632,518
Total	<u>\$ 18,713,344</u>	<u>\$ 201,851</u>	<u>\$ (170,961)</u>	<u>\$ 18,744,234</u>

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
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NOTE 2 - SECURITIES (Continued)

The amortized cost and fair value of securities at December 31, 2022, by contractual maturity, is shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due through One Year	\$ 1,274,337	\$ 1,262,427
Due after One through Five Years	5,953,649	5,687,719
Due after Five through Ten Years	6,616,130	5,521,358
Residential Mortgage-backed and SBA Securities	<u>6,007,283</u>	<u>5,382,923</u>
Total	<u>\$ 19,851,399</u>	<u>\$ 17,854,427</u>

For purposes of the above maturity table, mortgage-backed securities and Small Business Administration securities, which are not due at a single maturity date, are presented on a separate line item.

There were no proceeds from sales during the years ended December 31, 2022 and 2021. The Company recognized no gross gains or losses from the sales of investment securities in either year.

Securities pledged to secure public deposits and repurchase agreements at December 31, 2022 and 2021 had a carrying amount of approximately \$17,854,000 and \$18,744,000, respectively.

The following table shows securities with unrealized losses and their fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2022 and 2021:

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>
	<u>Value</u>	<u>Loss</u>	<u>Value</u>	<u>Loss</u>	<u>Value</u>	<u>Loss</u>
<u>2022</u>						
U.S. Treasury Securities	\$ 4,811,950	\$ (151,852)	\$ 1,690,940	\$ (286,165)	\$ 6,502,890	\$ (438,017)
Small Business Admin. Securities	540,774	(58,469)	0	0	540,774	(58,469)
U.S. Government Agency Securities	1,577,050	(110,854)	2,350,050	(490,336)	3,927,100	(601,190)
Residential Mortgage-backed Securities	3,416,446	(353,336)	920,108	(216,406)	4,336,554	(569,742)
Taxable Municipal Securities	0	0	743,786	(222,816)	743,786	(222,816)
Tax-Exempt Municipal Securities	<u>274,847</u>	<u>(842)</u>	<u>1,022,881</u>	<u>(109,747)</u>	<u>1,297,728</u>	<u>(110,589)</u>
Total	<u>\$ 10,621,067</u>	<u>\$ (675,353)</u>	<u>\$ 6,727,765</u>	<u>\$ (1,325,470)</u>	<u>\$ 17,348,832</u>	<u>\$ (2,000,823)</u>
<u>2021</u>						
U.S. Treasury Securities	\$ 1,934,570	\$ (38,417)	\$ 0	\$ 0	\$ 1,934,570	\$ (38,417)
U.S. Government Agency Securities	1,805,330	(32,433)	943,730	(39,077)	2,749,060	(71,510)
Residential Mortgage-backed Securities	1,203,295	(20,287)	0	0	1,203,295	(20,287)
Taxable Municipal Securities	927,989	(38,174)	0	0	927,989	(38,174)
Tax-Exempt Municipal Securities	<u>1,153,792</u>	<u>(2,573)</u>	<u>0</u>	<u>0</u>	<u>1,153,792</u>	<u>(2,573)</u>
Total	<u>\$ 7,024,976</u>	<u>\$ (131,884)</u>	<u>\$ 943,730</u>	<u>\$ (39,077)</u>	<u>\$ 7,968,706</u>	<u>\$ (170,961)</u>

Unrealized losses on securities have not been recognized into income because the issuer(s) securities are of higher credit quality (rated A3 or higher), management has the intent and ability to hold them for the foreseeable future, and the decline in fair value is largely due to changes in market interest rates. The fair value is expected to recover as the securities approach their maturity date and/or market rates change.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
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NOTE 2 - SECURITIES (Continued)

At December 31, 2022, the 38 investment securities with unrealized losses have depreciated 10% from the Company's amortized cost basis. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the security is issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

NOTE 3 - LOANS

A summary of loans outstanding by category at December 31, 2022 and 2021 follows:

	2022	2021
Secured by Real Estate:		
Commercial - Owner-Occupied	\$ 13,009,497	\$ 13,223,173
Commercial - Other	35,568,815	32,846,978
Construction, Land Development and Vacant Land	11,803,878	8,544,145
Residential Properties	59,946,418	41,896,497
Commercial, Financial and Agricultural	19,710,196	17,452,865
Consumer	4,401,885	2,202,836
	144,440,689	116,166,494
Less: Allowance for Loan and Lease Losses	(1,693,183)	(1,798,771)
Loans, Net	<u>\$ 142,747,506</u>	<u>\$ 114,367,723</u>

NOTE 4 - LOAN QUALITY

Management performs a quarterly evaluation of the adequacy of the allowance for loan and lease losses (ALLL). Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' actual or perceived financial and managerial strengths, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. It is management's general practice to obtain a new appraisal or asset valuation for any loan that it has rated as substandard or lower, including loans on nonaccrual of interest. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on other factors including, but not limited to, the economy, maintenance and general condition of the collateral, industry, type of property/equipment/vehicle, and the knowledge management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated when determining the realizable value to the Company.

Certain factors involved in the evaluation are inherently subjective, as they require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

For financial statement presentation, the Company segregates its loan portfolio into the following segments based primarily on the type of supporting collateral: commercial – owner-occupied; commercial – other; construction; residential; commercial, financial and agricultural; and consumer loans. The construction and land development segment contains loans to individuals to construct their own homes as well as loans to contractors and developers to construct homes or buildings for resale or develop residential or commercial real estate. This segment has its own unique risk characteristics including the need to periodically inspect the property during construction to ensure the funds disbursed are used properly and the real estate held for collateral maintains its value in relation to the amount owed on it. The construction and land development segment also has risk characteristics related to the probability of eventual sale of the finished project or the ability to generate sufficient rental income to service the debt. The residential real estate segment is segregated from the commercial real estate segment due to the obvious differences in inherent risks in each of these types of properties and borrower types. Consumer loans have risk characteristics including the volatility of the collateral's value and the inherent risk of loaning on collateral that is mobile and subject to damage without proper insurance coverage.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
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NOTE 4 - LOAN QUALITY (Continued)

The analysis for determining the ALLL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has two components: specific and general allocations. The specific component addresses specific reserves established for loans that were individually evaluated and deemed to be impaired. For these impairment evaluations, the Company assesses loan relationships with balances exceeding \$100,000 that show signs of possible impairment based on the payment status, internal risk ratings, or other credit quality factors. A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement.

Expected cash flow or collateral values discounted for market conditions and selling costs are used to establish specific allocations. Loans measured for the ALLL under the specific allocation method normally tend to be impaired construction, real estate, vehicle or unsecured loans.

The general component addresses the reserves established for pools of homogenous loans, including primarily non-classified loans. The general component includes a quantitative and qualitative analysis. The quantitative analysis includes the Company's historical loan loss experience (weighted towards most recent periods) and other factors derived from economic and market conditions that have been determined to have an effect on the probability and magnitude of a loss. The qualitative analysis utilizes factors such as: loan volume, loan collateral, management characteristics, levels of nonperforming loans, results of the loan review process, specific credit concentrations, and legal and regulatory issues. Input for these factors is determined on the basis of management's observation, judgment and experience. As a result of this input, additional loss percentages can be assigned to each pool of loans.

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

The following table presents, by loan segment, the ALLL and changes to the ALLL for the years ended December 31, 2022 and 2021 with the ALLL allocated based on the segment loan volumes:

	Secured by Real Estate				Commercial, Financial and Agricultural	Consumer	Unallocated	Total
	Commercial - Owner- Occupied	Commercial - Other	Construction, Land Dev. and Vacant Land	Residential Properties				
Allowance at								
December 31, 2020	\$ 244,238	\$ 354,142	\$ 193,076	\$ 614,549	\$ 330,979	\$ 48,923	\$ 0	\$ 1,785,907
Provision	(44,310)	132,033	(63,892)	7,918	(67,311)	(13,021)	48,583	0
Charge-offs	0	0	0	0	(9,911)	(2,855)	0	(12,766)
Recoveries	0	10,456	0	9,406	5,509	259	0	25,630
Allowance at								
December 31, 2021	199,928	496,631	129,184	631,873	259,266	33,306	48,583	1,798,771
Provision	(49,018)	(97,456)	7,741	59,977	(29,784)	17,756	(34,216)	(125,000)
Charge-offs	0	0	0	0	(4,661)	0	0	(4,661)
Recoveries	0	13,423	0	7,200	3,450	0	0	24,073
Allowance at								
December 31, 2022	\$ 150,910	\$ 412,598	\$ 136,925	\$ 699,050	\$ 228,271	\$ 51,062	\$ 14,367	\$ 1,693,183

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 4 - LOAN QUALITY (Continued)

The following tables present, by loan segment, loans that were evaluated for the ALLL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) as of December 31, 2022 and 2021:

	Secured by Real Estate							
	Commercial - Owner- Occupied	Commercial - Other	Construction, Land Dev. and Vacant Land	Residential Properties	Commercial, Financial and Agricultural	Consumer	Unallocated	Total
December 31, 2022								
Loans Evaluated for								
Allowance:								
Individually	\$ 0	\$ 0	\$ 0	\$ 455,956	\$ 31,694	\$ 0	\$ 0	\$ 487,650
Collectively	13,009,497	35,568,815	11,803,878	59,490,462	19,678,502	4,401,885	0	143,953,039
Total	<u>\$ 13,009,497</u>	<u>\$ 35,568,815</u>	<u>\$ 11,803,878</u>	<u>\$ 59,946,418</u>	<u>\$ 19,710,196</u>	<u>\$ 4,401,885</u>	<u>\$ 0</u>	<u>\$ 144,440,689</u>
Allowance Established								
for Loans Evaluated:								
Individually	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively	150,910	412,598	136,925	699,050	228,271	51,062	14,367	1,693,183
Allowance at								
December 31, 2022	<u>\$ 150,910</u>	<u>\$ 412,598</u>	<u>\$ 136,925</u>	<u>\$ 699,050</u>	<u>\$ 228,271</u>	<u>\$ 51,062</u>	<u>\$ 14,367</u>	<u>\$ 1,693,183</u>
December 31, 2021								
Loans Evaluated for								
Allowance:								
Individually	\$ 0	\$ 0	\$ 0	\$ 104,717	\$ 305,094	\$ 0	\$ 0	\$ 409,811
Collectively	13,223,173	32,846,978	8,544,145	41,791,780	17,147,771	2,202,836	0	115,756,683
Total	<u>\$ 13,223,173</u>	<u>\$ 32,846,978</u>	<u>\$ 8,544,145</u>	<u>\$ 41,896,497</u>	<u>\$ 17,452,865</u>	<u>\$ 2,202,836</u>	<u>\$ 0</u>	<u>\$ 116,166,494</u>
Allowance Established								
for Loans Evaluated:								
Individually	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Collectively	199,928	496,631	129,184	631,873	259,266	33,306	48,583	1,798,771
Allowance at								
December 31, 2021	<u>\$ 199,928</u>	<u>\$ 496,631</u>	<u>\$ 129,184</u>	<u>\$ 631,873</u>	<u>\$ 259,266</u>	<u>\$ 33,306</u>	<u>\$ 48,583</u>	<u>\$ 1,798,771</u>

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
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NOTE 4 - LOAN QUALITY (Continued)

The following tables show additional information about those loans considered to be impaired at December 31, 2022 and 2021:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<u>For the Year Ended December 31, 2022</u>					
Impaired Loans with No Specific Allowance:					
Loans Secured by Real Estate:					
Residential:					
Other	\$ 455,956	\$ 455,956	\$ 0	\$ 456,803	\$ 18,391
Other Loans:					
Commercial, Financial and Agricultural	31,694	31,694	0	181,494	8,899
Total Impaired Loans with No Specific Allowance	<u>\$ 487,650</u>	<u>\$ 487,650</u>	<u>\$ 0</u>	<u>\$ 638,297</u>	<u>\$ 27,290</u>
Total Impaired Loans with Specific Allowance	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Impaired Loans	<u>\$ 487,650</u>	<u>\$ 487,650</u>	<u>\$ 0</u>	<u>\$ 638,297</u>	<u>\$ 27,290</u>
<u>For the Year Ended December 31, 2021</u>					
Impaired Loans with No Specific Allowance:					
Loans Secured by Real Estate:					
Residential:					
Other	\$ 104,717	\$ 104,717	\$ 0	\$ 106,855	\$ 4,864
Other Loans:					
Commercial, Financial and Agricultural	305,094	305,094	0	330,395	19,195
Total Impaired Loans with No Specific Allowance	<u>\$ 409,811</u>	<u>\$ 409,811</u>	<u>\$ 0</u>	<u>\$ 437,250</u>	<u>\$ 24,059</u>
Total Impaired Loans with Specific Allowance	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Impaired Loans	<u>\$ 409,811</u>	<u>\$ 409,811</u>	<u>\$ 0</u>	<u>\$ 437,250</u>	<u>\$ 24,059</u>

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. Loans classified as substandard or management watch are reviewed regularly by the Company to determine if appropriately classified or to determine if the loan is impaired. The Company's loan portfolio is reviewed for credit quality with samples being selected based on loan size, credit grades, etc., to ensure that the Company's management is properly applying credit risk management processes.

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 4 - LOAN QUALITY (Continued)

Loans excluded from the scope of the annual review process are generally classified as pass credit until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the customer relationship is specifically evaluated for potential classification as to special mention, substandard or doubtful, or could even be considered for charge-off. The Company uses the following definitions for risk ratings:

Pass – Strong credit with no existing or known potential weaknesses deserving management’s close attention.

Management Watch – Loans included in this category are currently protected but are potentially weak. These loans constitute an undue and unwarranted credit risk but do not presently expose the Company to a sufficient degree of risk to warrant adverse classification. As a general rule, for the purpose of calculating a loan loss reserve, loans in this category will have the historical loss reserve percentage applied and will remain in a pool with loans that are considered acceptable or better when determining the general valuation reserves. Loans classified as management watch have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution’s credit position at some future date.

Substandard – Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or of the collateral pledged, if any. The borrower or guarantor is unwilling or unable to meet loan terms or loan covenants for the foreseeable future.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full highly questionable or improbable, based on currently existing facts, condition, and values.

Loss – Loans classified as losses are uncollectible or no longer a bankable asset. This classification does not mean that the asset has absolutely no recoverable value. Certain salvage value is inherent in these loans. Nevertheless, it is not practical or desirable to defer writing off a portion or whole of a perceived asset even though partial recovery may be collected in the future.

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NOTE 4 - LOAN QUALITY (Continued)

The following table shows the Company's credit quality indicators by type of loan as of December 31, 2022 and 2021:

	Pass	Management Watch	Substandard	Doubtful	Total Loans
As of December 31, 2022					
Loans Secured by Real Estate:					
Commercial - Owner-Occupied	\$ 12,317,542	\$ 691,955	\$ 0	\$ 0	\$ 13,009,497
Commercial - Other	35,568,815	0	0	0	35,568,815
Construction, Land Development & Vacant Land	11,761,342	0	42,536	0	11,803,878
Residential:					
1 - 4 Family	56,003,252	1,044,029	557,395	0	57,604,676
Other	2,049,325	292,417	0	0	2,341,742
Other Loans:					
Commercial, Financial and Agricultural	19,639,649	70,547	0	0	19,710,196
Consumer	4,401,885	0	0	0	4,401,885
Total Loans	\$ 141,741,810	\$ 2,098,948	\$ 599,931	\$ 0	\$ 144,440,689
As of December 31, 2021					
Loans Secured by Real Estate:					
Commercial - Owner-Occupied	\$ 12,897,466	\$ 325,707	\$ 0	\$ 0	\$ 13,223,173
Commercial - Other	29,834,630	3,012,348	0	0	32,846,978
Construction, Land Development & Vacant Land	8,544,145	0	0	0	8,544,145
Residential:					
1 - 4 Family	39,050,725	736,150	314,285	0	40,101,160
Other	1,795,337	0	0	0	1,795,337
Other Loans:					
Commercial, Financial and Agricultural	17,133,039	0	319,826	0	17,452,865
Consumer	2,202,836	0	0	0	2,202,836
Total Loans	\$ 111,458,178	\$ 4,074,205	\$ 634,111	\$ 0	\$ 116,166,494

FIRST COMMUNITY CORPORATION AND FIRST COMMUNITY BANK OF EAST TENNESSEE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2022 and 2021

NOTE 4 - LOAN QUALITY (Continued)

The following table provides an aging analysis of the Company's loans as of December 31, 2022 and 2021:

	Current	30-89 Days Past Due	Greater Than 90 Days	Nonaccrual	Total Past Due and Nonaccrual	Total Loans
As of December 31, 2022						
Loans Secured by Real Estate:						
Commercial - Owner-Occupied	\$ 13,009,497	\$ 0	\$ 0	\$ 0	\$ 0	\$ 13,009,497
Commercial - Other	35,568,815	0	0	0	0	35,568,815
Construction, Land Development & Vacant Land	11,761,342	0	0	42,536	42,536	11,803,878
Residential:						
1 - 4 Family	56,904,655	245,632	0	454,389	700,021	57,604,676
Other	2,049,325	292,417	0	0	292,417	2,341,742
Other:						
Commercial, Financial and Agricultural	19,710,196	0	0	0	0	19,710,196
Consumer	4,401,137	748	0	0	748	4,401,885
Total Loans	\$ 143,404,967	\$ 538,797	\$ 0	\$ 496,925	\$ 1,035,722	\$ 144,440,689
As of December 31, 2021						
Loans Secured by Real Estate:						
Commercial - Owner-Occupied	\$ 13,223,173	\$ 0	\$ 0	\$ 0	\$ 0	\$ 13,223,173
Commercial - Other	32,846,978	0	0	0	0	32,846,978
Construction, Land Development & Vacant Land	8,544,145	0	0	0	0	8,544,145
Residential:						
1 - 4 Family	39,899,290	90,766	0	111,104	201,870	40,101,160
Other	1,795,337	0	0	0	0	1,795,337
Other:						
Commercial, Financial and Agricultural	17,133,039	0	305,093	14,733	319,826	17,452,865
Consumer	2,202,836	0	0	0	0	2,202,836
Total Loans	\$ 115,644,798	\$ 90,766	\$ 305,093	\$ 125,837	\$ 521,696	\$ 116,166,494

Certain loan modifications are considered troubled debt restructurings (TDRs) when the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The Company uses various restructuring techniques, including, but not limited to, deferral of past due interest or principal, implementing A/B note structure, redeeming past due taxes, reduction of interest rates, extending maturities and modification of amortization schedules. The Company typically does not forgive principal balances or past due interest prior to pay off or surrender of the collateral. Loans considered to be TDRs are classified as impaired loans for purposes of determination of the allowance for loans losses, until the Company determines the loans are performing based on terms specified by the restructuring agreements. The allowance for these loans is calculated in the same manner as other impaired loans, as described above. As of December 31, 2022 and 2021, the Company had no commitments to lend funds to borrowers whose terms have been modified as TDRs. Additionally, for the years ending December 31, 2022 and 2021, the Company had no loans modified as TDRs within the previous 12 months for which there was a payment default during the period. The Company did not restructure any loans as troubled debt restructuring during the years ending December 31, 2022 and 2021.

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NOTE 5 - PREMISES AND EQUIPMENT

Following is a summary of premises and equipment at December 31:

	2022	2021
Land	\$ 901,470	\$ 1,270,242
Building	6,337,888	6,758,524
Furniture and Equipment	1,431,757	1,538,671
Computer Software	1,099,920	1,099,288
	<u>9,771,035</u>	<u>10,666,725</u>
Less: Accumulated Depreciation and Amortization	<u>(6,507,474)</u>	<u>(6,442,107)</u>
	<u>\$ 3,263,561</u>	<u>\$ 4,224,618</u>

Depreciation and amortization expense totaled \$218,484 and \$219,137 for 2022 and 2021.

In 2022, the Company closed their Colonial Heights branch and listed the property for sale. The property was written down by approximately \$264,000 estimated to market value during 2022 and carried as other real estate held for sale. In February 2023, the property was sold for the estimated market value of \$614,000.

NOTE 6 - FORECLOSED REAL ESTATE

Foreclosed real estate is carried at estimated fair value less costs to sell the property. An analysis of foreclosed real estate for the years ended December 31, 2022 and 2021 follows:

	2022	2021
Balance at Beginning of Year	\$ 215,001	\$ 330,002
Foreclosed Real Estate Sold	<u>(150,001)</u>	<u>(115,001)</u>
Balance at End of Year	<u>\$ 65,000</u>	<u>\$ 215,001</u>

Net expenses (income) applicable to foreclosed real estate for the years ended December 31, 2022 and 2021 include the following:

	2022	2021
Net (Gain) Loss on Sales of Foreclosed Real Estate	\$ (149,034)	\$ (146,924)
Net (Gain) Loss on Repossessions	(3,593)	(6,256)
Operating Expenses	<u>9,971</u>	<u>15,290</u>
Total	<u>\$ (142,656)</u>	<u>\$ (137,890)</u>

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NOTE 7 - DEPOSITS

A summary of deposits at December 31 follows:

	2022	2021
Noninterest-Bearing	\$ 43,321,313	\$ 43,929,092
NOW & MMDA	77,989,720	67,885,218
Savings	34,979,804	31,865,595
Certificates of Deposit of \$250,000 or More	568,549	4,653,133
Other Time Deposits	21,184,491	22,381,336
	<u>\$ 178,043,877</u>	<u>\$ 170,714,374</u>

Scheduled maturities of time deposits for the next five years are as follows at December 31, 2022:

2023	\$ 16,887,183
2024	3,443,085
2025	502,276
2026	212,512
2027	707,984
	<u>\$ 21,753,040</u>

The aggregate amounts of overdrafts reclassified as loans receivable were \$14,184 and \$17,883 at December 31, 2022 and 2021, respectively.

NOTE 8 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are financing arrangements that do not have a stated maturity but may be cancelled by either party with a five-day written notice. Information concerning securities sold under agreements to repurchase is summarized as follows:

	2022	2021
Average Daily Balance during the Year	\$ 3,066,098	\$ 3,132,980
Average Interest Rate during the Year	0.11%	0.10%
Maximum Month-End Balance during the Year	\$ 3,071,908	\$ 5,754,400
Weighted Average Interest Rate at Year-End	0.11%	0.10%

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NOTE 9 - REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within noninterest income except for gains/losses on sales of foreclosed real estate, which are recorded within net foreclosed real estate expense. A description of the Company's revenue streams accounted for under ASC 606 follows:

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

Interchange Income - Interchange income represents fees for standing ready to authorize and providing settlement on credit card and debit card transactions processed through the Visa® interchange network. The levels of service and structure of interchange rates are set by Visa® and can vary based on cardholder purchase volume. The Company recognizes interchange income upon settlement with the interchange network. Based on the Company's underlying contracts, ASC 606 requires reporting network costs associated with debit card and credit card transactions netted against the related fees from such transactions. Interchange network costs reduced interchange income by \$150,208 and \$142,585 for the years ended December 31, 2022 and 2021, respectively. Net interchange fees totaled \$148,715 and \$170,094 for the years ended December 31, 2022 and 2021, respectively, and are reported within other income.

Investment Brokerage Fees - The Company earns fees from investment brokerage services provided to its customers by a third-party service provider. The Company receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The fees are recognized and paid monthly. Because the Company (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers, investment brokerage fees are presented net of related costs. Net brokerage commissions totaled \$53,379 and \$148,320 for the years ended December 31, 2022 and 2021, respectively, and are reported within other income.

Gains/Losses on Sales of Foreclosed Real Estate - The Company records a gain or loss from the sale of foreclosed real estate when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of foreclosed real estate to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed real estate asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

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NOTE 10 - INCOME TAX EXPENSE (BENEFIT)

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to tax examinations by tax authorities for the years before 2019. The Company has not accrued or expensed any amounts for interest or penalties associated with income taxes for the years ended December 31, 2022 and 2021.

Income tax expense (benefit) as shown in the consolidated statements of operations differs from the amount computed using the statutory federal income tax rate follows:

	2022		2021	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Federal Income Tax at Statutory Rate	\$ 394,752	21.0 %	\$ 211,932	21.0 %
State Income Tax, Net	88,545	4.7	46,999	4.7
Tax Exempt Interest	(13,337)	-0.7	(16,536)	-1.6
Other Nontaxable Income	(43,918)	-2.3	(42,992)	-4.3
Nondeductible Expenses	1,617	0.1	1,470	0.1
Credits and Other, Net	(32,036)	-1.7	15,727	1.6
	<u>\$ 395,623</u>	<u>21.0 %</u>	<u>\$ 216,600</u>	<u>21.5 %</u>

	2022	2021
Income Taxes (Benefit) Consist of:		
Current (Benefit)	\$ 300	\$ 0
Deferred (Benefit)	<u>395,323</u>	<u>216,600</u>
	<u>\$ 395,623</u>	<u>\$ 216,600</u>

The deferred tax assets shown below relate primarily to unrealized losses on foreclosed real estate, deferred compensation, and net operating loss carryforwards. The deferred tax liabilities relate primarily to the provision for loan losses, depreciation of fixed assets, FHLB stock dividends and certain prepaid expenses.

	2022	2021
Deferred Tax Assets	\$ 1,663,808	\$ 1,480,591
Deferred Tax Liabilities	<u>(693,303)</u>	<u>(644,846)</u>
Net Deferred Tax Assets (Liabilities)	<u>\$ 970,505</u>	<u>\$ 835,745</u>

Included in the 2022 deferred tax assets above is \$522,009 of deferred tax effect on the net unrealized loss on securities available for sale (\$8,074 in deferred tax liabilities on the net unrealized gain in 2021).

Federal net operating loss carry-forwards are approximately \$1.6 million, which expire at various dates from 2034 to 2035, and state net operating loss carry-forwards are approximately \$1.7 million at December 31, 2022, which expire at various dates from 2028 to 2030.

NOTE 11 - RELATED PARTY TRANSACTIONS

Loans to principal officers, directors, or their affiliates at December 31, 2022 and 2021 were approximately \$480,000 and \$0, respectively.

Deposit account balances owned by principal officers, directors, and their affiliates at December 31, 2022 and 2021 were approximately \$2,672,000 and \$2,915,000, respectively.

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NOTE 12 - FEDERAL HOME LOAN BANK ADVANCES

The following table is a maturity schedule of advances from the Federal Home Loan Bank as of December 31, 2022:

<u>Date of Advance</u>	<u>Interest Rate</u>	<u>Final Maturity Date</u>	<u>Amount Outstanding at 12/31/22</u>
12/21/05	5.17%	01/01/31	\$ 611,718

Interest expense associated with the advances from the FHLB totaled \$33,047 for the year ended December 31, 2022 (\$36,190 in 2021). Pursuant to collateral agreements with the FHLB, the advances are secured by the Company's FHLB stock and certain qualifying residential first mortgage loans totaling approximately \$46,852,000 as of December 31, 2022 (\$32,200,000 in 2021), and commercial real estate loans totaling approximately \$13,778,000 as of December 31, 2022 (\$14,200,000 in 2021). All of the fixed rate advances have a prepayment penalty. The prepayment penalty would be based on the market rates and the length of time remaining until maturity at the time of payoff.

Additionally, the Company maintains a line of credit advance agreement with the FHLB which allows borrowings up to \$13,000,000. This line was undrawn as of December 31, 2022 and 2021. The Company also maintains a letter of credit line for the collateralization of public unit deposits up to \$30,000,000, for which balances outstanding as of December 31, 2022 and 2021 were \$13,000,000 and \$11,000,000, respectively.

NOTE 13 - FEDERAL RESERVE BANK ADVANCES

During 2020, the Company borrowed funds from the Federal Reserve Bank through the Paycheck Protection Program Liquidity Facility (PPPLF) in order to facilitate the extension of Paycheck Protection Program (PPP) loans to their customers. The advances are secured by the underlying PPP loans. The PPPLF advances bear interest at 0.35% and mature on the maturity dates of the PPP loans pledged as collateral. Interest expense associated with the advances from the FRB totaled \$1,248 for the year ended December 31, 2022 (\$14,830 in 2021). The outstanding balance of advances as of December 31, 2022 is \$0 (\$192,197 in 2021).

NOTE 14 - SUBORDINATED DEBENTURES AND OTHER DEBT

On September 20, 2004, the Company borrowed \$3,000,000 of floating rate mandatory redeemable securities through a special purpose entity, Rogersville Statutory Trust II, as part of a private offering. The rate, which varies quarterly with LIBOR, was 5.81% at December 31, 2022. The securities mature on September 20, 2034; however, the maturity may be shortened on a quarterly basis, subject to approval of a repayment or refinancing plan by the Federal Reserve. Outstanding securities as of December 31, 2022 and 2021 were \$2,000,000.

On December 14, 2006, the Company borrowed \$4,000,000 of floating rate mandatory redeemable securities through a special purpose entity, Rogersville Statutory Trust III, as part of a private offering. The rate, which varies quarterly with LIBOR, was 4.98% at December 31, 2022. The securities mature on December 14, 2036; the maturity may be shortened on a quarterly basis, subject to approval of a repayment or refinancing plan by the Federal Reserve. Outstanding securities as of December 31, 2022 and 2021 were \$3,000,000.

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NOTE 14 - SUBORDINATED DEBENTURES AND OTHER DEBT (CONTINUED)

The Company has provided a full, irrevocable, and unconditional guarantee on a subordinated basis of the obligations of the Trusts under the preferred securities in the event of a default, as defined in such guarantees. These subordinated debentures allow the Company to defer the payment of quarterly interest payments for up to 20 consecutive quarters without creating an event of default. Pursuant to the debentures, the Company and its affiliates cannot declare or pay any dividends or distributions on their capital stock (other than the payment of dividends or distributions from the Bank to the Holding Company), or repurchase, redeem, or acquire their capital stock during an interest deferred period until the unpaid interest payments have been paid. Accrued but unpaid interest totaled \$14,437 at December 31, 2022 (\$6,060 at December 31, 2021).

These securities are presented as liabilities on the Company's balance sheet and count as Tier 1 and Tier 2 capital for regulatory capital purposes. In accordance with GAAP, the Trusts are not consolidated with the Company. Accordingly, the Company reports as liabilities the subordinated debentures issued by the Company and held by the Trusts. The Company's equity investment in the Trusts (\$217,000) is included in other assets at year-end 2022 and 2021.

The Company also has available federal funds lines (or equivalent thereof) with correspondent banks totaling \$22,100,000 as of December 31, 2022 and 2021. None of these lines had balances outstanding as of December 31, 2022 and 2021. No collateral was pledged related to these lines as of December 31, 2022 and 2021.

NOTE 15 - SHAREHOLDERS' EQUITY

As of December 31, 2022 and 2021, the Company's charter authorized the issuance of up to 10,000,000 shares of common stock, no par value, 1,000,000 shares of preferred stock, no par value, and 400,000 shares of Series A and 200,000 shares of Series B Preferred Stock, at a par value of \$8.05.

The Series A and Series B preferred stock are noncumulative, have no voting rights, have a dividend and liquidation preference to the common stock, and participate equally with the common stock in a sale or change in control of the Company. Preferred Series A shareholders are entitled to receive a dividend that is 105% of the dividend paid on the common stock. Preferred Series B shareholders are entitled to receive a dividend that is 110% of the dividend paid on the common stock. In the event of a change of control of the corporation, each share of Series A and Series B preferred stock is convertible into one share of common stock. Series A and Series B preferred stock have no redemption rights.

Treasury stock includes 48,432 shares of common stock at a cost of \$809,687; 8,408 shares of Series A preferred stock at a cost of \$133,742; and 225 shares of Series B preferred stock at a cost of \$3,569 at December 31, 2022 and 2021.

NOTE 16 - REGULATORY CAPITAL REQUIREMENTS

The Bank and Holding Company are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's and Holding Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank and Holding Company must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's and Holding Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank and Holding Company to maintain minimum amounts and ratios. Management believes, as of December 31, 2022 and 2021, that the Bank and Holding Company meet all capital adequacy requirements to which they are subject.

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NOTE 16 - REGULATORY CAPITAL REQUIREMENTS (CONTINUED)

As of December 31, 2022 and 2021, the Bank is categorized as *well capitalized* under the regulatory framework for prompt corrective action. There are no conditions or events since that date that management believes have changed the Bank's category.

In November 2019, the Office of the Comptroller, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the agencies) jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio (CBLR) framework, for qualifying community banking organizations, consistent with section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank and Holding Company for the year ending December 31, 2020.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a leverage ratio (equal to tier 1 capital divided by average total assets). Qualifying banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the risk-based and leverage capital requirements in the agencies' generally applicable capital rule and will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rules, the community bank leverage ratio minimum requirement is 8% as of December 31, 2020, 8.5% for 2021, and 9% for 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the banking organization maintains a leverage ratio of 7% as of December 31, 2020, 7.5% for 2021, and 8% for 2022 and beyond.

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2022 and 2021, both the Bank and Holding Company were qualifying community banking organizations as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

The Holding Company's and Bank's actual capital amounts and ratios as of December 31, 2022 and 2021 are presented in the following table. All dollar amounts are in thousands of dollars.

			To Be Well Capitalized Under Prompt Corrective Action Provisions (CBLR Framework)	
	Amount	Ratio	Amount	Ratio
<u>As of December 31, 2022</u>				
Tier I Capital (to Average Assets):				
Holding Company (Consolidated)	\$ 24,010	11.85%	\$ 18,228	9.00%
Bank	\$ 21,975	10.85%	\$ 18,221	9.00%
<u>As of December 31, 2021</u>				
Tier I Capital (to Average Assets):				
Holding Company (Consolidated)	\$ 22,402	11.08%	\$ 17,188	8.50%
Bank	\$ 20,331	10.06%	\$ 17,184	8.50%

The Bank and Holding Company are also subject to federal and state regulations restricting the amount of dividends paid.

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NOTE 17 - STOCK COMPENSATION PLANS

The Company has two stock-based compensation plans, the 2022 Employee Stock Incentive Plan (the Employee Plan), and the 1994 Outside Directors' Stock Option Plan (the Directors' Plan), which are described below. The 2022 Employee Stock Incentive Plan replaced the 1994 Employee Stock Option Plan, which terminated in a prior year.

2022 Employee Stock Incentive Plan - This plan provides for the granting of stock options to purchase up to 250,000 shares of common stock by key employees of the Company. This plan also provides for the granting of stock appreciation rights. No new awards under this plan can be granted after March 30, 2032. 10,000 options were granted under this plan during the year ended December 31, 2022 (none under the 1994 Employee Plan in 2021), as well as stock appreciation rights for 15,000 shares (none in 2021). Options may be granted under this plan subject to such terms and conditions as decided by the Company, subject to the terms and provisions of the plan. The exercise price may be less than the market price of the Company's stock at the date of grant. These option awards vest based on a period of continuous service as decided by the Company and have ten-year contractual terms. As of December 31, 2022, there are 225,000 options remaining to be granted under this plan. Stock appreciation rights granted under this plan vest based on a period of continuous service as decided by the Company and have ten-year contractual terms. In no event shall the appreciation base of the shares of common stock subject to the stock appreciation rights be less than the market price of the Company's stock at the date of grant.

1994 Outside Directors' Stock Option Plan – This plan provides for the granting of options to purchase up to 225,000 shares of common stock by non-employee directors of the Company. This Plan has been amended to extend through June 30, 2026. No options were granted under this plan during the year ended December 31, 2022 or 2021. Under this plan, option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant. These option awards vest based on five years of continuous service and have ten-year contractual terms. As of December 31, 2022, there are 67,500 options remaining to be granted under this plan.

A summary of stock option activity under the Company's stock-based compensation plans as of December 31, 2022 and changes during the year then ended is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2022	55,500	\$ 6.61		
Granted	10,000	6.61		
Exercised	0			
Forfeited	(3,000)	6.61		
Expired	0			
Outstanding at December 31, 2022	<u>62,500</u>	<u>\$ 6.61</u>	<u>5.33</u>	<u>\$ 211,875</u>
Exercisable at December 31, 2022	<u>34,800</u>	<u>\$ 6.61</u>	<u>4.22</u>	<u>\$ 117,972</u>

A summary of the status of the Company's nonvested stock option shares as of December 31, 2022 and changes during the year then ended is presented below:

Options	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2022	33,300	\$ 1.76
Granted	10,000	3.22
Vested	(12,600)	1.76
Forfeited	(3,000)	1.76
Nonvested at December 31, 2022	<u>27,700</u>	<u>\$ 2.29</u>

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NOTE 17 - STOCK COMPENSATION PLANS (Continued)

The weighted-average grant-date fair value of options granted during the year ended December 31, 2022 was \$3.22 (none granted during 2021). No options were exercised during the year ended December 31, 2021. During the year ended December 31, 2021, 20,000 options were exercised from the Employee Stock Option Plan for a cash value of \$95,000. The intrinsic value of each option at the exercise date was \$3.22. The total fair value of stock option shares vested during the year ended December 31, 2022, was \$22,138 (\$19,503 in 2021).

The fair value of each option award is estimated on the date of grant using a Black-Scholes valuation model. Expected volatility is based on historical volatility of the Company's stock over similar terms. The expected term of options granted is based on the contractual terms and estimates of the period that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The significant assumptions used to estimate the fair-value of stock option awards are as follows:

	2022	2021
Expected volatility	30.26%	N/A
Expected dividend rate	2.78%	N/A
Expected term (in years)	10	N/A
Risk-free rate	2.94%	N/A

The Company has granted stock appreciation rights under the Employee Plan. The stock appreciation rights are to be settled in cash and are therefore classified as liabilities. The liability is remeasured at fair value at the end of each year until exercise or expiration, with any adjustments recorded through stock-based compensation cost. Holders of stock appreciation rights are entitled to the right to receive a cash payment from the Company equal to the amount by which the market price of the Company's stock at the exercise date exceeds the award price.

A summary of stock appreciation rights activity under the Company's stock-based compensation plans as of December 31, 2022 and changes during the year then ended is presented below:

Stock Appreciation Rights	Shares	Weighted-Average Award Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2022	0	\$		
Granted	15,000	9.00		
Exercised	0			
Forfeited	0			
Expired	0			
Outstanding at December 31, 2022	15,000	\$ 9.00	9.42	\$ 15,000
Exercisable at December 31, 2022	0	\$ N/A	N/A	\$ N/A

A summary of the status of the Company's nonvested stock appreciation rights as of December 31, 2022 and changes during the year then ended is presented below:

Stock Appreciation Rights	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2022	0	\$
Granted	15,000	3.41
Vested	0	
Forfeited	0	
Nonvested at December 31, 2022	15,000	\$ 3.41

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The weighted-average grant-date fair value of stock appreciation rights granted during the year ended December 31, 2022 was \$3.41 (none granted during 2021). No stock appreciation rights were exercised during the years ended December 31, 2021. No stock appreciation rights vested during the years ended December 31, 2021. The accrued liability for stock appreciation rights is \$14,911 and \$0 as of December 31, 2022, and 2021, respectively.

The fair value of each stock appreciation right award is estimated on the date of grant using a Black-Scholes valuation model. Expected volatility is based on historical volatility of the Company's stock over similar terms. The expected term of stock appreciation rights granted is based on the contractual terms and estimates of the period that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The significant assumptions used to estimate the fair-value of stock appreciation right awards are as follows:

	2022	2021
Expected volatility	30.00%	N/A
Expected dividend rate	2.50%	N/A
Expected term (in years)	10	N/A
Risk-free rate	3.88%	N/A

Stock-based compensation cost charged against income was \$43,799 and \$19,503 for the years ending December 31, 2022 and 2021, respectively. The total related income tax benefit recognized was \$11,449 and \$5,097 for 2022 and 2021, respectively. As of December 31, 2022, there was \$82,992 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under the Company's plans. That cost is expected to be recognized over a weighted-average period of 1.35 years.

NOTE 18 - EARNINGS PER SHARE

The following table illustrates the computation of basic and diluted earnings per share of common stock for the years ended December 31, 2022 and 2021:

	2022			2021		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
Net Income	\$ 1,484,147			\$ 792,599		
Less: Dividends Paid to Preferred Shareholders	<u>(63,772)</u>			<u>(63,574)</u>		
Basic Earnings Per Share						
Net Income Available to Common Shareholders	1,420,375	1,650,812	<u>\$ 0.86</u>	729,025	1,640,511	<u>\$ 0.44</u>
<u>Effect of Dilutive Securities</u>						
Incremental Shares - Exercise of Stock Options		17,052			8,945	
Convertible Preferred Stock	<u>63,772</u>	<u>241,518</u>		<u>63,574</u>	<u>241,518</u>	
Diluted Earnings per Share						
Net Income Available to Common Shareholders						
Plus Assumed Conversions	<u>\$ 1,484,147</u>	<u>1,909,382</u>	<u>\$ 0.78</u>	<u>\$ 792,599</u>	<u>1,890,974</u>	<u>\$ 0.42</u>

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NOTE 19 - EMPLOYEE BENEFITS

The Company maintains a 401(k) plan for all employees who have attained the age of 18 and have at least three months of service. The plan provides for a discretionary employer matching contribution, in which the employee is 100% vested. The Company may also make additional discretionary contributions (qualified non-elective or profit-sharing contributions) as determined by the Board of Directors. For these contributions, employees begin to vest in the second year and are fully vested after six years. The Company's employer matching contribution to the 401(k) plan amounted to \$44,540 in 2022 and \$40,275 in 2021.

The Company is providing post-retirement pension benefits to a former employee. A present value-based charge, which is included in non-interest expense, is made each year based on the future benefits to be paid to the employee (or beneficiary) under the plan. Total amounts paid or accrued during the year under such arrangements amounted to \$21,971 and \$21,256 in 2022 and 2021, respectively.

The Company has a Supplemental Executive Retirement Plan which provides retirement benefits to several retired officers. In addition, the Company also has an Executive Deferred Compensation Plan which provides deferred compensation benefits for certain key officers. The accrued retirement liability for these plans was \$1,611,711 at December 31, 2022 (\$1,713,155 at December 31, 2021). Expense related to these plans was \$147,177 in 2022 and \$205,600 in 2021, and is included in salaries and employee benefits expense.

The Company also provides life insurance benefits to certain employees under split-dollar insurance contracts. The accrued liability was \$265,752 at December 31, 2022 and \$258,631 at December 31, 2021). Expense related to this plan was \$7,120 in 2022 and \$6,106 in 2021, and is included in salaries and employee benefits expense.

NOTE 20 - OFF-BALANCE SHEET ACTIVITIES

Certain financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The approximate contractual amounts of financial instruments with off-balance sheet risk were as follows at December 31:

	2022		2021	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to Make Loans	\$ 5,856,000	\$ 13,050,000	\$ 8,943,000	\$ 15,260,000
Unused Letters of Credit	53,000	0	0	518,000

Commitments to make loans are generally made for periods of 1 year or less. The fixed rate loan commitments have interest rates ranging from 3.25% to 10.00% and maturities ranging from 1 year to 16 years. Approximately \$12,953,000 of the commitments to make loans were collateralized, primarily by real estate, at December 31, 2022 (\$13,922,000 at December 31, 2021).

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NOTE 21 - FAIR VALUE DISCLOSURES

GAAP establishes a framework for using fair value. It also defines fair value rules as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Company did not elect to adopt the fair value option for any financial instruments. However, other accounting pronouncements require the Company to measure certain financial instruments at fair value as described below.

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

- Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset and liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2: Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or the liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

A description of valuation methodologies used for assets and liabilities recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is shown below. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Investment Securities Available for Sale - Investment securities available for sale are recorded at fair value in accordance with GAAP on a recurring basis. Fair value measurement for these securities is based upon quoted prices of like or similar securities, utilizing Level 2 inputs. These measurements are obtained from a service provider who considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the securities' terms and conditions, among other things.

Impaired Loans - For impaired loans, a specific allowance is established as a component of the allowance for loan losses based on the present value of expected payments, the loans' observable market price, or the fair value of the collateral less selling costs if the loans are collateral-dependent. Impaired loans are classified within Level 3 of the valuation hierarchy. The Company's impaired loans are considered to be collateral-dependent and are primarily valued using third-party appraisals or other valuations based on sales of similar assets. Collateral is primarily real estate but may sometimes include other business assets, including equipment, inventory, or accounts receivable. The appraisals or other valuations are sometimes further discounted based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value.

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NOTE 21 - FAIR VALUE DISCLOSURES (Continued)

Foreclosed Real Estate - Foreclosed real estate is carried at the lower of the outstanding loan amount at time of foreclosure or estimated fair value less estimated selling costs. Estimated fair value is determined using third-party appraisals based on sales of comparable properties and is classified with Level 3 of the valuation hierarchy. The appraisals are sometimes further discounted based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and management's expertise and knowledge of the customer and the customer's business. Such discounts are typically unobservable inputs for determining fair value.

Assets Recorded at Fair Value on a Recurring Basis

Below is a table that presents information about certain assets measured at fair value:

	Carrying Amount in the Balance Sheet	Fair Value Measurements Using		
		Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>As of December 31, 2022</u>				
U.S. Treasury Securities	\$ 6,502,890	\$ 6,502,890	\$ 0	\$ 0
Small Business Admin. Securities	761,745	0	761,745	0
U.S. Government Agency Securities	3,927,099	0	3,927,099	0
Residential Mortgage-Backed Securities	4,621,178	0	4,621,178	0
Taxable Municipal Securities	743,786	0	743,786	0
Tax Exempt Municipal Securities	1,297,729	0	1,297,729	0
Investment Securities Available for Sale	<u>\$ 17,854,427</u>	<u>\$ 6,502,890</u>	<u>\$ 11,351,537</u>	<u>\$ 0</u>
<u>As of December 31, 2021</u>				
U.S. Treasury Securities	\$ 2,972,771	\$ 2,972,771	\$ 0	\$ 0
Small Business Admin. Securities	1,138,154	0	1,138,154	0
U.S. Government Agency Securities	6,837,149	0	6,837,149	0
Residential Mortgage-Backed Securities	5,235,653	0	5,235,653	0
Taxable Municipal Securities	927,989	0	927,989	0
Tax Exempt Municipal Securities	1,632,518	0	1,632,518	0
Investment Securities Available for Sale	<u>\$ 18,744,234</u>	<u>\$ 2,972,771</u>	<u>\$ 15,771,463</u>	<u>\$ 0</u>

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NOTE 21 - FAIR VALUE DISCLOSURES (Continued)

Assets Recorded at Fair Value on a Nonrecurring Basis (Continued)

Assets measured at fair value on a nonrecurring basis are included in the table below.

		Fair Value Measurements Using		
	Carrying Amount in the Balance Sheet	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>As of December 31, 2022</u>				
Impaired Loans, Net of Specific Allowance	\$ 487,650	\$ 0	\$ 0	\$ 487,650
Foreclosed Real Estate	65,000	0	0	65,000
	<u>\$ 552,650</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 552,650</u>
<u>As of December 31, 2021</u>				
Impaired Loans, Net of Specific Allowance	\$ 409,811	\$ 0	\$ 0	\$ 409,811
Foreclosed Real Estate	215,001	0	0	215,001
	<u>\$ 624,812</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 624,812</u>

The following table presents quantitative information about Level 3 fair value measurements for assets measured at fair value on a non-recurring basis:

	Fair Value	Valuation Technique	Unobservable Inputs	Range	Weighted Average*
<u>As of December 31, 2022</u>					
Impaired Loans, Net of Specific Allowance	\$ 487,650	Appraisal	Appraisal discounts	0%	0%
Foreclosed Real Estate	\$ 65,000	Appraisal	Appraisal discounts	0% - 100%	0%
<u>As of December 31, 2021</u>					
Impaired Loans, Net of Specific Allowance	\$ 409,811	Appraisal	Appraisal discounts	0%	0%
Foreclosed Real Estate	\$ 215,001	Appraisal	Appraisal discounts	0% - 100%	0%

* The weighted averages were calculated based on the relative fair value of the assets.

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NOTE 21 - FAIR VALUE DISCLOSURES (Continued)

The following table presents the carrying amounts, estimated fair value and placement in the fair value hierarchy of the Company's financial instruments that are not carried at fair value at December 31, 2022 and 2021:

			Fair Value Measurements Using		
	Carrying Amount in the Balance Sheet	Estimated Fair Value	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>As of December 31, 2022</u>					
Financial Assets:					
Cash and Cash Equivalents	\$ 31,143,856	\$ 31,143,856	\$ 31,143,856	\$ 0	\$ 0
Loans, Net	142,747,506	133,084,720	0	0	133,084,720
Cash Surrender Value of Life Insurance	7,795,825	7,795,825	0	0	7,795,825
Financial Liabilities:					
Deposits	178,043,877	177,830,877	0	0	177,830,877
Securities Sold Under Agreements to Repurchase	3,064,801	3,064,801	0	0	3,064,801
Federal Home Loan Bank Advances	611,718	611,718	0	0	611,718
Subordinated Debentures	5,217,000	5,217,000	0	0	5,217,000
<u>As of December 31, 2021</u>					
Financial Assets:					
Cash and Cash Equivalents	\$ 51,381,633	\$ 51,381,633	\$ 51,381,633	\$ 0	\$ 0
Loans, Net	114,367,723	116,678,169	0	0	116,678,169
Cash Surrender Value of Life Insurance	7,586,543	7,586,543	0	0	7,586,543
Financial Liabilities:					
Deposits	170,714,374	170,799,374	0	0	170,799,374
Securities Sold Under Agreements to Repurchase	3,070,899	3,070,899	0	0	3,070,899
Federal Home Loan Bank Advances	671,162	671,162	0	0	671,162
Federal Reserve Bank Advances	192,197	192,197	0	0	192,197
Subordinated Debentures	5,217,000	5,217,000	0	0	5,217,000

The methods and assumptions used to estimate fair value are described as follows.

The carrying amount approximates the estimated fair value for cash and cash equivalents, short-term borrowings, demand deposits and securities sold under agreements to repurchase. The fair value of loans is estimated with a discounted cash flow approach using market rates and incorporates a credit risk factor to determine the exit price. For time deposits fair value is based on discounted cash flows using current market rates. Recorded book value of cash surrender value of life insurance is a reasonable estimate of fair value. Fair value of FHLB advances, Federal Reserve Bank and subordinated debentures is based on current rates for similar financing. The fair value of off-balance sheet loan commitments is considered nominal and not disclosed above. Management does not consider it practicable to estimate the fair value of equity investments carried at cost. Therefore, no estimate of fair value for these investments is disclosed.

Much of the information as well as the amounts disclosed above are highly subjective and judgmental in nature. The subjective factors include estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Because the fair value is estimated as of December 31, 2022 and 2021, the amounts which will actually be realized or paid upon settlement or maturity of the various financial instruments could be significantly different.

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NOTE 22 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Most of the Company's business activity is with customers located within East Tennessee. As of December 31, 2022 and 2021, the Company had concentrations of loans in residential real estate, commercial real estate and commercial lending. Generally, these loans are secured by the underlying real estate or commercial assets. The usual risks associated with such concentrations are generally mitigated by being spread over numerous borrowers and by adequate loan to collateral value ratios. The Company has concentrations in U.S. Government agency and residential mortgage-backed securities that are guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Association, the Federal Farm Credit Company and the Federal Home Loan Bank. The Company also has a concentration in municipal bonds, which are issued by instrumentalities across the State of Tennessee.

NOTE 23 - COMMITMENTS AND CONTINGENCIES

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Company.