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**HARLEYSVILLE  
FINANCIAL CORPORATION**

2021  
Annual Report



**HARLEYSVILLE FINANCIAL CORPORATION**  
**2021 ANNUAL REPORT**

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## CORPORATE PROFILE

Harleysville Financial Corporation, (the “Company”) is a Pennsylvania corporation headquartered in Harleysville, Pennsylvania. The Company became the bank holding company for Harleysville Bank, in connection with the holding company reorganization of the Bank in February 2000 (the “Reorganization”). In August 1987, the Bank’s predecessor, Harleysville Savings Association, converted to the stock form of organization. The Bank, whose predecessor was originally, incorporated in 1915, converted from a Pennsylvania chartered, permanent reserve fund savings association to a Pennsylvania chartered stock savings bank in June 1991. The Bank operates from six full-service offices located in Montgomery County and one office located in Bucks County, Pennsylvania. The Bank’s primary market area includes Montgomery County, which has the third largest population and the second highest per capita income in the Commonwealth of Pennsylvania, and, to a lesser extent, Bucks County. As of September 30, 2021, the Company had \$892.6 million of total assets, \$725.9 million of deposits and \$80.7 million of stockholders’ equity. The Company’s stockholders’ equity constituted 9.0% of total assets as of September 30, 2021.

The Bank’s primary business consists of attracting deposits from the general public and business customers through a variety of deposit programs and investing such deposits principally in first mortgage loans secured by residential properties in the Bank’s primary market area. The Bank also originates a variety of consumer loans, predominately home equity loans and lines of credit also secured by residential properties in the Bank’s primary lending area. The Bank is also engaged in the general commercial banking business, and provides a full range of commercial loans and commercial real estate loans to customers in the Bank’s primary market area. The Bank serves its customers through its full-service branch network, the internet, telephone and mobile banking.

Deposits with the Bank are insured to the maximum extent provided by law through the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (“FDIC”). The Bank is subject to examination and comprehensive regulation by the FDIC and the Pennsylvania Department of Banking (“Department”). It is also a member of the Federal Home Loan Bank of Pittsburgh (“FHLB of Pittsburgh” or “FHLB”), which is one of the 11 regional banks comprising the Federal Home Loan Bank System (“FHLB System”). The Bank is also subject to regulations of the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) governing reserves required to be maintained against deposits and certain other matters.

The Company’s principal executive offices are located at 271 Main Street, Harleysville, Pennsylvania 19438 and its telephone number is (215) 256-8828.

### **Competition**

The Company’s most direct competition for deposits has historically come from commercial banks and savings institutions located in its market area. The Company faces additional significant competition for investors’ funds from other financial intermediaries. The Company competes for deposits principally by offering depositors a variety of deposit programs, convenient branch locations, hours and other services. The Company does not rely upon any individual group or entity for a material portion of its deposits.

The Company’s competition for real estate loans comes principally from mortgage banking companies, other savings institutions and commercial banks. The Bank competes for loan originations primarily through the interest rates and loan fees it charges, the efficiency and quality of services it provides borrowers, referrals from real estate brokers and builders, and the variety of its products. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

## STOCK MARKET INFORMATION

Harleysville Financial Corporation's common stock trades on the OTC Bulletin Board under the symbol "HARL". Prices shown below reflect the prices reported on the OTC Bulletin Board during the indicated periods. The closing price of the common stock on September 30, 2021 was \$25.70 per share. There were 3,721,038 shares of common stock outstanding as of September 30, 2021, held by approximately 1,000 stockholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks.

<u>For The Quarter Ended</u>	<u>High</u>	<u>Low</u>	<u>Close</u>	<u>Cash Dividends Declared</u>
<b>September 30, 2021</b>	<b>\$26.00</b>	<b>\$24.15</b>	<b>\$25.70</b>	<b>\$0.28</b>
<b>June 30, 2021</b>	<b>27.00</b>	<b>23.50</b>	<b>25.65</b>	<b>0.28</b>
<b>March 31, 2021</b>	<b>24.25</b>	<b>21.34</b>	<b>23.50</b>	<b>0.28</b>
<b>December 31, 2020</b>	<b>22.74</b>	<b>20.50</b>	<b>21.50</b>	<b>0.27</b>
September 30, 2020	\$23.00	\$20.51	\$21.90	\$0.27
June 30, 2020	24.50	20.05	22.53	0.27
March 31, 2020	27.47	20.00	21.50	0.27
December 31, 2019	24.50	22.75	24.50	0.25

## **Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion is intended to assist in understanding the financial condition, and the results of operations for Harleysville Financial Corporation, and its subsidiary Harleysville Bank, for the fiscal years ended September 30, 2021 and 2020. The information in this section should be read in conjunction with the Company's financial statements and the accompanying notes included elsewhere herein.

### **Overview**

Harleysville Financial Corporation, a bank holding company, of which Harleysville Bank (the "Bank"), is a wholly owned subsidiary, was formed in February 2000. For purposes of this discussion, the Company, including its wholly owned subsidiary, will be referred to as the "Company." The Company's earnings are primarily dependent upon its net interest income, which is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities ("interest rate spread") and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities outstanding. The Company's interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand and deposit flows. The Company, like other institutions, is vulnerable to an increase in interest rates to the extent that interest-bearing liabilities mature or reprice more rapidly than interest-earning assets. To reduce the effect of adverse changes in interest rates on its operations, the Company has adopted certain asset and liability management strategies, described below. The Company's earnings are also affected by, among other factors, other non-interest income, other expenses, and income taxes.

The Company's total assets at September 30, 2021 amounted to \$892.6 million compared to \$854.9 million as of September 30, 2020. The increase in assets was primarily due to an increase in cash and investments of \$101.5 million. The increase was partially offset by a decrease in loans receivable of \$62.2 million. Total liabilities at September 30, 2021 were \$811.9 million compared to \$776.2 million at September 30, 2020. The increase in liabilities was due to an increase in total deposits of \$68.2 million. The increase was partially offset by a decrease in borrowings of \$32.1 million. Stockholders' equity totaled \$80.7 million at September 30, 2021 compared to \$78.6 million at September 30, 2020.

During fiscal 2021, net interest income decreased \$446,000 or 1.9% from the prior fiscal year. This decrease was primarily due to a decrease in the interest rate spread to 2.43% in fiscal year 2021 from 2.70% in fiscal year 2020. There was a 9.4% increase in the average interest-earning assets and a 4.8% increase in average interest-bearing liabilities. Net income for fiscal 2021 was \$7.3 million compared to \$7.1 million for the fiscal year 2020. The Company's return on average assets (net income divided by average total assets) was 0.8% during fiscal 2021 compared to 0.9% during fiscal 2020. Return on average equity (net income divided by average equity) was 9.1% during fiscal 2021 compared to 9.2% during fiscal 2020.

## Results of Operations

The following table sets forth as of the periods indicated, information regarding: (i) the total dollar amounts of interest income from interest-earning assets and the resulting average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resulting average costs; (iii) net interest income; (iv) interest rate spread; (v) net interest-earning assets; (vi) the net yield earned on interest-earning assets; and (vii) the ratio of total interest-earning assets to total interest-bearing liabilities. Average balances are calculated on a monthly basis. Yields on tax-exempt assets have not been calculated on a fully tax-exempt basis.

	For The Year Ended September 30,					
	2021			2020		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
Interest-earning assets:						
Mortgage loans (2)(3)	\$263,159	\$ 11,443	4.35%	\$311,119	\$ 13,881	4.46%
Mortgage-backed securities	73,354	1,258	1.71%	99,132	1,851	1.87%
Commercial loans (3)	260,961	11,904	4.56%	222,770	9,915	4.45%
Consumer and other loans (3)	71,430	2,094	2.93%	87,244	3,018	3.46%
Cash and investments	<u>203,321</u>	<u>624</u>	<u>0.31%</u>	<u>77,031</u>	<u>955</u>	<u>1.24%</u>
Total interest-earning assets	<u>872,225</u>	<u>27,323</u>	<u>3.13%</u>	<u>797,296</u>	<u>29,620</u>	<u>3.72%</u>
Interest-bearing liabilities:						
Savings and money market	275,712	579	0.21%	230,375	1,174	0.51%
Checking	163,280	10	0.01%	128,648	20	0.02%
Certificates of deposit	<u>163,950</u>	<u>2,245</u>	<u>1.37%</u>	<u>185,600</u>	<u>3,132</u>	<u>1.69%</u>
Total deposits	602,942	2,834	0.47%	544,623	4,326	0.79%
Borrowings	<u>83,385</u>	<u>1,999</u>	<u>2.40%</u>	<u>110,554</u>	<u>2,358</u>	<u>2.13%</u>
Total interest-bearing liabilities	<u>686,327</u>	<u>4,833</u>	<u>0.70%</u>	<u>655,177</u>	<u>6,684</u>	<u>1.02%</u>
Net interest income/interest rate spread		\$ <u>22,490</u>	<u>2.43%</u>		\$ <u>22,936</u>	<u>2.70%</u>
Net interest-earning assets/net yield on interest-earning assets(1)	<u>\$ 185,898</u>		<u>2.58%</u>	<u>\$ 142,119</u>		<u>2.88%</u>
Ratio of average interest-earning assets to average interest-bearing liabilities			<u>127.1%</u>			<u>121.7%</u>

(1) Net interest income divided by average interest-earning assets.

(2) Loan fee income is immaterial to this analysis.

(3) There were 35 non-accruing loans totaling \$7.3 million at September 30, 2021 and 38 non-accruing loans totaling \$7.6 million at September 30, 2020.



## **Net Interest Income**

Net interest income decreased by \$446,000 or 1.94% in fiscal 2021, over the prior year. The decrease in the net interest income in fiscal 2021 was due to a decrease in the interest rate spread between interest earning assets and interest bearing liabilities in spite of an increase in the balance sheet. The driving factors are further explained below under “- Interest Income” and “- Interest Expense.”

### **Interest Income**

Interest income on mortgage loans decreased by \$2.4 million or 17.6% in fiscal 2021 from the prior year. During fiscal 2021, the average balance of mortgage loans decreased \$48.0 million or 15.4% and the yield decreased by 11 basis points. The majority of loans during the year were fixed rate mortgages. The decrease in interest on mortgage-backed securities reflects a decrease in the yield of 16 basis points and a decrease in the average balance of \$25.8 million in fiscal 2021. During fiscal 2021, the consumer and other loan average balance decreased \$15.8 million or 18.1% and the yield decreased by 53 basis points.

Interest income on commercial loans increased \$2.0 million or 20.1% in fiscal 2021 from the prior year. The increase in interest on commercial loans during fiscal 2021 reflected an increase in the average balance of \$38.2 million and an increase in yield of 11 basis points. Approximately \$1.2 million was primarily due to the recognition of accelerated deferred fees from the Payment Protection Program (“PPP”) loans being forgiven through the Small Business Association (“SBA”).

Interest and dividends on cash and investments decreased by \$331,000 or 34.7% in fiscal 2021 from fiscal 2020. During fiscal 2021, the decrease in income resulted from a decrease in the yield of 93 basis points despite an increase in the average balance of \$126.3 million or 163.9%. The increase in the average balance was due to an increase in cash of \$90.5 million in fiscal 2021 from the prior year.

### **Interest Expense**

Interest expense on deposits decreased \$1.5 million or 34.5% in fiscal 2021 as compared to the prior year. In fiscal 2021, the average balance of deposits increased by \$58.3 million. The average rate paid on deposits decreased to 0.5% for the year ended September 30, 2021 compared to 0.8% for year ended September 30, 2020. The average rate paid on deposits is a direct reflection of the falling interest rate environment.

Interest expense on borrowings decreased by \$359,000 or 15.2% in fiscal 2021 compared to the prior year. The decrease in fiscal 2021 was primarily the result of a decrease in the average balance of borrowings of \$27.2 million or 24.6%.

### **Provision for Loan Losses**

Management establishes reserves for losses on loans when it determines that losses are probable. The adequacy of loan loss reserves is based upon a regular monthly review of loan delinquencies and “classified assets”, as well as local and national economic trends. The allowance for loan losses totaled \$5.5 million at September 30, 2021, compared to \$5.3 million for fiscal year ended September 30, 2020 or 1.0% and 0.9% of total loans at September 30, 2021 and 2020 respectively. The Company recorded a provision for loan losses of \$385,000 in fiscal 2021 compared to \$811,000 in fiscal 2020. The provision for loan loss reflects the Company’s analysis and review of its loan portfolio and assessment of the underlying risks associated with delinquent loans as well as loans classified for regulatory purposes. For additional analysis of the allowance refer to Note 4 – Loans Receivable in the Consolidated Financial Statements.

### **Other Income**

The Company’s total other income increased to \$3.2 million in fiscal 2021 compared to \$2.5 million in fiscal 2020. The increase in fiscal 2021 was primarily due to re-instatement of Federal Home Loan Bank (Mortgage Participation Finance) program. Income from sales of loans in fiscal 2021 was \$252,000.

Customer service fees and debit card income were \$1.5 million and \$1.4 million in fiscal 2021 and 2020, respectively.

Other, which consists primarily of loan servicing fees, the sale of non-deposit products, and insurance commissions, increased by \$255,000 or 33.5% during fiscal 2021. The fees, which comprise other income, are set by the Company at a level that is intended to cover the cost of providing the related services and expenses to customers.

### **Other Expenses**

Salaries and employee benefits decreased by \$235,000 or 2.7% in fiscal 2021 as compared to fiscal 2020. The decreased expenses of salaries and employee benefits during the periods are attributable to a decrease in staffing and due to the COVID-19 pandemic.

Occupancy and equipment expense decreased \$23,000 or 1.6% in fiscal year 2021 as compared to fiscal 2020.

Data processing costs decreased by \$117,000 in fiscal 2021.

Other expenses, which consist primarily of advertising expenses, directors' fees, ATM network fees, professional fees, checking account costs, rewards expenses, REO expenses, stockholders expense and other operating expenses increased by \$124,000 or 3.4% in fiscal 2021 compared to fiscal 2020. The increase in other expenses in 2021 was attributable to the prepayment of two Federal Home Loan Bank advances prior to the maturity date. The cost associated with the prepayment totaled \$522,000.

Deposit insurance premiums for the fiscal year 2021 increased \$160,000 or 219.2% from fiscal 2020 due to an increase in the assessment base.

### **Income Taxes**

The Company recorded income tax provisions of \$2.6 million in fiscal year 2021 and \$2.3 million in 2020. The effective tax rate was 26.1% in fiscal 2021 compared to 24.1% in fiscal 2020. See Note 8 of the Consolidated Financial Statements which provides an analysis of the provision for income taxes.

## INDEPENDENT AUDITOR'S REPORT

Audit Committee  
Harleysville Financial Corporation  
Harleysville, Pennsylvania

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Harleysville Financial Corporation and subsidiaries, which comprise the consolidated statements of financial condition as of September 30, 2021 and 2020; the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Harleysville Financial Corporation and subsidiaries as of September 30, 2021 and 2020, 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.

*S. R. Snodgrass, P.C.*

Cranberry Township, Pennsylvania  
December 7, 2021

## Consolidated Statements of Financial Condition

(In thousands, except share data)	September 30,	
	2021	2020
<b>Assets</b>		
Cash and amounts due from depository institutions	\$ 2,909	\$ 3,172
Interest-bearing demand deposits	<u>202,884</u>	<u>112,091</u>
Total cash and cash equivalents	205,793	115,263
Investments and mortgage-backed securities:		
Available for sale (amortized cost – 2021, \$1,128; 2020, \$5,594)	1,140	5,608
Held to maturity (fair value – 2021, \$106,258; 2020, \$92,306)	104,336	88,931
Loans receivable (net of allowance for loan losses - 2021, \$5,520; 2020, \$5,308)	544,706	606,862
Loans held for sale	466	-
Accrued interest receivable	1,606	2,354
Federal Home Loan Bank stock - at cost	3,583	4,463
Office properties and equipment, net	9,343	9,883
Bank-owned life insurance	17,653	17,260
Prepaid expenses and other assets	<u>4,013</u>	<u>4,252</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 892,639</u></b>	<b><u>\$ 854,876</u></b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities:</b>		
Deposits	\$ 725,936	\$ 657,730
Short-term borrowings	18,558	21,423
Long-term debt	59,000	88,261
Accrued interest payable	138	209
Advances from borrowers for taxes and insurance	1,441	1,312
Other liabilities	<u>6,864</u>	<u>7,310</u>
Total liabilities	<u>811,937</u>	<u>776,245</u>
Commitments and contingencies (Notes 13 & 14)	-	-
<b>Stockholders' Equity:</b>		
Preferred Stock: \$.01 par value; 7,500,000 shares authorized; none issued	-	-
Common stock: \$.01 par value; 15,000,000 shares authorized; 3,921,191 shares issued: shares outstanding 2021, 3,721,038; 2020, 3,752,221	39	39
Additional paid-in capital	7,303	7,509
Treasury stock, at cost (2021, 200,153 shares; 2020, 168,970 shares)	(4,282)	(3,442)
Retained earnings - partially restricted	77,636	74,517
Accumulated other comprehensive income	<u>6</u>	<u>8</u>
Total stockholders' equity	<u>80,702</u>	<u>78,631</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$ 892,639</u></b>	<b><u>\$ 854,876</u></b>

See notes to consolidated financial statements.

## Consolidated Statements of Income

Year Ended September 30,

(In thousands, except share and per share data)

	2021	2020
<b>Interest and Dividend Income:</b>		
Interest and fees on mortgage loans	\$ 11,443	\$ 13,881
Interest on commercial loans	11,904	9,915
Interest on consumer and other loans	2,094	3,018
Interest on mortgage-backed securities	1,258	1,851
Interest on taxable investments	436	558
Interest on tax-exempt investments	188	385
Dividends on investment securities	-	12
<b>Total interest and dividend income</b>	<b><u>27,323</u></b>	<b><u>29,620</u></b>
<b>Interest Expense:</b>		
Interest on deposits	2,834	4,326
Interest on short-term borrowings	45	49
Interest on long-term debt	1,954	2,309
<b>Total interest expense</b>	<b><u>4,833</u></b>	<b><u>6,684</u></b>
<b>Net Interest Income</b>	<b>22,490</b>	<b>22,936</b>
<b>Provision for Loan Losses</b>	<b><u>385</u></b>	<b><u>811</u></b>
<b>Net Interest Income, after Provision for Loan Losses</b>	<b><u>22,105</u></b>	<b><u>22,125</u></b>
<b>Other Income:</b>		
Customer service fees and debit card income	1,515	1,373
Realized gains on sale of loans, net	252	-
Income on bank-owned life insurance	393	398
Other income	1,016	761
<b>Total other income</b>	<b><u>3,176</u></b>	<b><u>2,532</u></b>
<b>Other Expenses:</b>		
Salaries and employee benefits	8,452	8,687
Occupancy and equipment	1,378	1,401
Deposit insurance premiums	233	73
Data processing	1,564	1,447
Other	3,804	3,680
<b>Total other expenses</b>	<b><u>15,431</u></b>	<b><u>15,288</u></b>
<b>Income before Income Tax Expense</b>	<b>9,850</b>	<b>9,369</b>
Income tax expense	<u>2,566</u>	<u>2,258</u>
<b>Net Income</b>	<b><u>\$ 7,284</u></b>	<b><u>\$ 7,111</u></b>
<b>Earnings Per Share:</b>		
Basic	<u>\$ 1.95</u>	<u>\$ 1.89</u>
Diluted	<u>\$ 1.93</u>	<u>\$ 1.87</u>
<b>Weighted Average Shares Outstanding:</b>		
Basic	<u>3,744,566</u>	<u>3,759,909</u>
Diluted	<u>3,780,450</u>	<u>3,800,492</u>

See notes to consolidated financial statements.

## Consolidated Statements of Comprehensive Income

(In thousands)	Year Ended September 30,	
	2021	2020
Net Income	\$ 7,284	\$ 7,111
Other Comprehensive (Loss) Income:		
Unrealized (losses) gains on available for sale securities	(2)	1
Income tax effect	=	=
Other comprehensive (loss) income, net of tax	<u>(2)</u>	<u>1</u>
Comprehensive income	<u>\$ 7,282</u>	<u>\$ 7,112</u>

*See notes to consolidated financial statements.*

## Consolidated Statements of Stockholders' Equity

(In thousands, except share and per share data)

	<b>Common Stock Shares Outstanding</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings- Partially Restricted</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Treasury Stock</b>	<b>Total Stockholders' Equity</b>
Balance at September 30, 2019	3,764,057	\$ 39	\$ 7,882	\$ 71,400	\$ 7	\$ (3,081)	\$ 76,247
Net income				7,111			7,111
Dividends - \$1.06 per share				(3,994)			(3,994)
Restricted stock awards	5,232		(106)			106	-
Stock based compensation			251				251
Treasury stock delivered under 401k	902		3			18	21
Treasury stock purchase	(56,950)					(1,268)	(1,268)
Treasury stock delivered under dividend reinvestment plan	9,272		24			188	212
Employee options exercised	29,708		(545)			595	50
Other comprehensive income					1		1
Balance at September 30, 2020	3,752,221	39	7,509	74,517	8	(3,442)	78,631
Net income				7,284			7,284
Dividends - \$1.11 per share				(4,165)			(4,165)
Restricted stock awards	4,868		(101)			101	-
Stock based compensation			50				50
Treasury stock delivered or received under 401k			(27)			(196)	(223)
Treasury stock purchase	(52,433)					(1,281)	(1,281)
Treasury stock delivered under dividend reinvestment plan	5,257		41			305	346
Employee options exercised	11,125		(169)			231	62
Other comprehensive loss					(2)		(2)
Balance at September 30, 2021	<u>3,721,038</u>	<u>\$ 39</u>	<u>\$ 7,303</u>	<u>\$ 77,636</u>	<u>\$ 6</u>	<u>\$ (4,282)</u>	<u>\$ 80,702</u>

See notes to consolidated financial statements.



## Consolidated Statements of Cash Flows

(In thousands)	Year Ended September 30,	
	2021	2020
<b>Operating Activities:</b>		
Net Income	\$ 7,284	\$ 7,111
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	675	700
Provision for loan losses	385	811
Deferred income taxes	(143)	(182)
Realized gains on sale of loans, net	(252)	-
Origination of mortgage loans held for sale	(11,099)	-
Proceeds from sale of mortgage loans held for sales	10,885	
Amortization of deferred fees	1,180	(117)
Increase in cash surrender value of bank owned life insurance	(393)	(398)
Stock based compensation	50	251
Changes in assets and liabilities which provided (used) cash:		
(Decrease) increase in other liabilities	(446)	328
Decrease in prepaid expenses and other assets	382	426
Decrease (increase) in accrued interest receivable	748	(275)
Decrease in accrued interest payable	(71)	(14)
Net cash provided by operating activities	<u>9,185</u>	<u>8,641</u>
<b>Investing Activities:</b>		
Purchase of mortgage-backed securities held to maturity	(55,729)	(23,460)
Purchase of investment securities available-for-sale	(58,951)	(65,432)
Purchase of FHLB stock	(372)	(9)
Redemption of FHLB stock	1,252	604
Principal collected on securities available for sale	141	93
Proceeds from the redemption of investment securities available-for-sale	63,277	62,967
Proceeds from maturities of investment securities held for sale	4,330	10,901
Principal collected on mortgage-backed securities held for sale	35,994	38,043
Decrease (increase) in loans, net	60,591	(2,772)
Purchase of premises and equipment	(136)	(298)
Net cash provided by investing activities	<u>50,397</u>	<u>20,637</u>
<b>Financing Activities:</b>		
Net increase in demand deposits, NOW accounts and savings accounts	89,395	93,498
Net decrease in certificates of deposit	(21,189)	(22,110)
Cash dividends	(4,165)	(3,994)
(Decrease) increase in short term borrowings	(2,865)	12,593
Repayment of long-term debt	(29,261)	(14,034)
Acquisition of treasury stock	(1,281)	(1,268)
Sale of treasury stock delivered under employee stock plans	185	283
Net increase (decrease) in advances from borrowers for taxes and insurance	129	(270)
Net cash provided by financing activities	<u>30,948</u>	<u>64,698</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>90,530</b>	<b>93,976</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b><u>115,263</u></b>	<b><u>21,287</u></b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b><u>\$ 205,793</u></b>	<b><u>\$ 115,263</u></b>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the period for:		
Interest	\$ 4,904	\$ 6,698
Income taxes	2,637	2,934
Adoption of lease accounting standard	-	3,123

See notes to consolidated financial statements

## Notes to Consolidated Financial Statements

### 1. Nature of Operations and Organizational Structure

Harleysville Financial Corporation, (the “Company”) is a bank holding company that is regulated by the Federal Reserve Bank of Philadelphia. Harleysville Bank, (the “Bank”) is a wholly owned subsidiary and is regulated by the FDIC and the Pennsylvania Department of Banking. The Bank is principally in the business of attracting deposits through its branch offices and investing those deposits, together with funds from borrowings and operations, primarily in single family residential, commercial, consumer loans and investments. The Bank’s customers are primarily in southeastern Pennsylvania.

### 2. Summary of Significant Accounting Policies

**Principles of Consolidation** - The accompanying consolidated financial statements include the accounts of the Company, the Bank, and the Bank’s wholly owned subsidiary, HSB Inc., a Delaware subsidiary which was formed in order to accommodate the transfer of certain assets, Freedom Financial Solutions LLC that allows the Company to offer non-deposit products and HARL, LLC that allows the Bank to invest in equity investments. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates in Preparation of the Consolidated Financial Statements** - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Statement of Financial Condition and the reported amounts of income and expenses during the reporting period. The most significant of these estimates and assumptions in the Company’s consolidated financial statements is the allowance for loan losses and other-than-temporary impairment of investments. Actual results could differ from those estimates.

**Significant Group Concentrations of Credit Risk** - Most of the Company’s activities are with customers located within the southeastern region of Pennsylvania. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations to any one industry or customer.

**Cash and Cash Equivalents** - For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and amounts due from depository institutions, including interest-bearing demand deposits in banks with original maturities of less than 90 days.

**Investment and Mortgage-Backed Securities** - The Company classifies and accounts for debt securities as follows:

**Held to Maturity** - Debt securities that management has the positive intent and ability to hold until maturity are classified as held to maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

**Available for Sale** - Debt securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as available for sale. These assets are carried at fair value. Unrealized gains and losses are excluded from earnings and are reported net of tax in other comprehensive income. Realized gains and losses on the sale of investment securities are recorded as of the trade date, reported in the Consolidated Statements of Income and determined using the amortized cost of the specific security sold.

For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent

to which the security's fair value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intent and ability to hold the security and whether it is more likely than not that it will be required to sell the security before its fair value has recovered to a level at least equal to the amortized cost.

For debt securities, accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held to maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

When the Company determines that a security's unrealized loss is other-than-temporary, an impairment loss is recognized in the period in which the decline in value is determined to be other-than-temporary.

**Loans** - The Company grants commercial, mortgage and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southeastern Pennsylvania. The ability of the Company's debtors to honor their contracts is dependent upon the general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans.

**Loans Held For Sale** - Loans originated and intended for sale in the secondary market are carried at the lower of cost or market. Gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan.

**Interest Income on Loans** - Interest income is accrued on the unpaid principal balance. Interest on loans is recognized as income when earned. The accrual of interest on 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 collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Deferred Loan Fees** - Loan origination fees, net of certain direct origination costs, are deferred and the balance is amortized to income as an adjustment over the life of the loan using the interest method.

**Allowance for Loan Losses** - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. An allowance for loan losses is maintained at a level that management considers adequate to provide for losses based upon evaluation of known and inherent risks in the loan portfolio. The loan loss reserves are established as an allowance for estimated losses based on the probable losses of the loan portfolio. In assessing risk, management considers historical experience, volume and composition of lending conducted by the Company, industry standards, and status of nonperforming loans, general economic

conditions as they relate to the Company's market area, and other factors related to the collectibility of the Company's loan portfolio.

The allowance for loan losses consists of three elements: (1) specific allowances for impaired loans; (2) a general valuation allowance on all classified loans which are not impaired; and (3) a general valuation allowance on the remainder of the loan portfolio. This is consistent with the regulatory method of classifying reserves. Although the amount of each element of the allowance is determined separately, the entire allowance for loan losses is available for the entire portfolio. An allowance for impaired loans is established in the amounts by which the discounted cash flows (or collateral value or observable market price) are lower than the carrying value of the loan. A general allowance is established for classified loans that are not impaired. These loans are segregated by loan category, and allowance percentages are assigned to each category based on inherent losses associated with each type of lending and consideration that these loans, in the aggregate, represent an above-average credit risk and that more of these loans will prove to be uncollectible compared to loans in the general portfolio.

**Foreclosed Real Estate** - Real estate acquired through, or in lieu of, loan foreclosures are carried at the lesser of cost or fair value of the property, based on an appraisal less cost to sell. Costs relating to the development and improvement of the property are capitalized, and those relating to holding the property are charged to expense. The Company had no foreclosed real estate as of September 30, 2021 and 2020, respectively.

**Office Properties and Equipment** - Land is carried at cost. Office properties and equipment are recorded at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the expected useful lives of the assets that range from four to forty years. The costs of maintenance and repairs are expensed as they are incurred, and renewals and betterments are capitalized.

**Federal Home Loan Bank Stock** - Federal law requires a member institution of the Federal Home Loan Bank (FHLB) to hold stock of its district FHLB according to a predetermined formula. The restricted stock is carried at cost.

Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

**Cash Surrender Value of Bank-Owned Life Insurance (BOLI)** - The Bank funded the purchase of insurance policies on the lives of officers and employees of the Bank. The Company has recognized any increase in cash surrender value of life insurance, net of insurance costs, in the Consolidated Statements of Income as income on BOLI. The cash surrender value of the insurance policies is recorded as an asset in other assets in the Consolidated Statements of Financial Condition and amounted to \$17.7 million and \$17.3 million at September 30, 2021 and 2020, respectively.

**Income Taxes** - Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. The Company and its subsidiary file a consolidated federal income tax return.

The Company analyzes each tax position taken in its tax returns and determines the likelihood that the position will be realized. Only tax positions that are "more likely than not" to be realized can be recognized in the Company's financial statements. For tax positions that do not meet this recognition threshold, the Company

will record an unrecognized tax benefit for the difference between the position taken on the tax return and the amount recognized in the financial statements. The Company does not have any material unrecognized tax benefits or accrued interest or penalties at September 30, 2021 and 2020, or during the years then ended. No unrecognized tax benefits are expected to arise within the next twelve months. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expenses. The Company and its subsidiaries are subject to U.S. Federal income tax as well as income tax of the Commonwealth of Pennsylvania. The Company is no longer subject to examination by taxing authorities for the years before October 1, 2017.

**Transfers of Financial Assets** - Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Treasury Stock** - The Company records treasury stock purchases at cost. Gains and losses on subsequent reissuance of shares are credited or charged to additional paid-in capital using the average-cost method.

**Stock Based Compensation** - The Company currently has several stock based compensation plans in place for employees and directors of the Company. The Company recognizes the cost of employee services received in exchange for an award of equity investment based on grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Stock-based compensation expense for the years ended September 30, 2021 and 2020 was \$50,000 and \$251,000, respectively. The tax benefit recognized related to the compensation expense for the years ended September 30, 2021 and 2020 was \$5,000 and \$23,000, respectively.

**Earnings Per Share** - Basic earnings per common share is computed based on the weighted average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares outstanding, increased by additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and unvested stock awards, and are determined using the treasury stock method. The number of anti-dilutive options that are excluded from the earnings per share calculation for the years ended September 30, 2021 and 2020 were 155,126 and 161,481, respectively. For the years ended September 30, 2021 and 2020, the exercise price for the options representing anti-dilutive shares ranged from \$22.00 to \$25.96. The weighted average shares outstanding used to calculate earnings per share were as follows:

	<u>Year Ended September 30,</u>	
	<u>2021</u>	<u>2020</u>
Weighted average shares outstanding – basic	3,744,566	3,759,909
Increase in shares due to dilutive potential common shares	<u>35,884</u>	<u>40,583</u>
Weighted average shares outstanding – diluted	<u><u>3,780,450</u></u>	<u><u>3,800,492</u></u>

**Other Comprehensive Income (Loss)** - The Company presents, as a component of comprehensive income, amounts from transactions and other events, which are currently excluded from the Consolidated Statements of Income and are recorded directly to stockholders' equity. The Company's other comprehensive income (loss) consists of net unrealized holding gains or losses on securities available for sale, net of income taxes.

**Reclassifications** - Certain amounts in the prior period's financial statements have been reclassified to conform with the current year classifications. The reclassifications had no effect on net income.

**Recently Issued Accounting Standards** - In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management’s current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. With certain exceptions, transition to the new requirements will be through a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. In November 2019, the FASB issued ASU 2019-10, *Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*. This Update defers the effective date of ASU 2016-13 for SEC filers that are eligible to be smaller reporting companies, non-SEC filers, and all other companies, to fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. We expect to recognize a one-time cumulative-effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326)*, which allows entities to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost upon adoption of the new credit losses standard. To be eligible for the transition election, the existing financial asset must otherwise be both within the scope of the new credit losses standard and eligible for applying the fair value option in ASC 825-10.3. The election must be applied on an instrument-by-instrument basis and is not available for either available-for-sale or held-to-maturity debt securities. For entities that elect the fair value option, the difference between the carrying amount and the fair value of the financial asset would be recognized through a cumulative-effect adjustment to opening retained earnings as of the date an entity adopted ASU 2016-13. Changes in fair value of that financial asset would subsequently be reported in current earnings. For entities that have not yet adopted the credit losses standard, the ASU is effective when they implement the credit losses standard. For entities that already have adopted the credit losses standard, the ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is not an SEC filer and does not expect to early adopt ASU 2016-13.

In November 2019, the FASB issued ASU 2019-10, *Financial Instruments – Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*. The Update defers the effective dates of ASU 2016-13 for SEC filers that are eligible to be smaller reporting companies, non-SEC filers, and all other companies, to fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. This Update also amends the mandatory effective date for the elimination of Step 2 from the goodwill impairment test under ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (Goodwill)*, to align with those used for credit losses. Furthermore, the ASU provides a one-year deferral of the effective dates of the ASUs on derivatives and hedging and leases for companies that are not public business entities. The Company qualifies as a smaller reporting company and does not expect to early adopt these ASUs.

In November 2019, the FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*, to clarify its new credit impairment guidance in ASC 326, based on implementation issues raised by stakeholders. This Update clarified, among other things, that expected recoveries are to be included in the allowance for credit losses for these financial assets; an accounting policy election can be made to adjust the effective interest rate for existing troubled debt restructurings based on the prepayment assumptions instead of the prepayment assumptions applicable immediately prior to the

restructuring event; and extends the practical expedient to exclude accrued interest receivable from all additional relevant disclosures involving amortized cost basis. The effective dates in this Update are the same as those applicable for ASU 2019-10. The Company qualifies as a smaller reporting company and does not expect to early adopt these ASUs.

In March 2020, the FASB issued ASU 2020-03, *Codification Improvements to Financial Instruments*. This ASU was issued to improve and clarify various financial instruments topics, including the current expected credit losses (CECL) standard issued in 2016. The ASU includes seven issues that describe the areas of improvement and the related amendments to GAAP; they are intended to make the standards easier to understand and apply and to eliminate inconsistencies, and they are narrow in scope and are not expected to significantly change practice for most entities. Among its provisions, the ASU clarifies that all entities, other than public business entities that elected the fair value option, are required to provide certain fair value disclosures under ASC 825, *Financial Instruments*, in both interim and annual financial statements. It also clarifies that the contractual term of a net investment in a lease under Topic 842 should be the contractual term used to measure expected credit losses under Topic 326. Amendments related to ASU 2019-04 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is not permitted before an entity's adoption of ASU 2016-01. Amendments related to ASU 2016-13 for entities that have not yet adopted that guidance are effective upon adoption of the amendments in ASU 2016-13. Early adoption is not permitted before an entity's adoption of ASU 2016-13. Amendments related to ASU 2016-13 for entities that have adopted that guidance are effective for fiscal years beginning after December 15, 2019, including interim periods within those years. Other amendments are effective upon issuance of this ASU. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting, March 2020*, to provide temporary optional expedients and exceptions to the U.S. GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from LIBOR and other interbank offered rates to alternative reference rates, such as Secured Overnight Financing Rate. Entities can elect not to apply certain modification accounting requirements to contracts affected by what the guidance calls reference rate reform, if certain criteria are met. An entity that makes this election would not have to remeasure the contracts at the modification date or reassess a previous accounting determination. Also, entities can elect various optional expedients that would allow them to continue applying hedge accounting for hedging relationships affected by reference rate reform, if certain criteria are met, and can make a one-time election to sell and/or reclassify held-to-maturity debt securities that reference an interest rate affected by reference rate reform. The amendments in this ASU are effective for all entities upon issuance through December 31, 2022. It is too early to predict whether a new rate index replacement and the adoption of the ASU will have a material impact on the Company's financial statements.

In October 2020, the FASB issued ASU 2020-08, *Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*, which clarifies that, for each reporting period, an entity should reevaluate whether a callable debt security is within the scope of ASC 310-20-35-33. For public business entities, ASU 2020-08 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application is not permitted. For all other entities, ASU 2020-08 is effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2021, the FASB issued ASU 2021-01, *Reference Rate Reform (Topic 848)*, which provides optional temporary guidance for entities transitioning away from the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs) to new reference rates so that derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions within Topic 848. ASU 2021-

01 clarifies that the derivatives affected by the discounting transition are explicitly eligible for certain optional expedients and exceptions in Topic 848. ASU 2021-01 is effective immediately for all entities. Entities may elect to apply the amendments on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the issuance of a final update, up to the date that financial statements are available to be issued. The amendments in this update do not apply to contract modifications made, as well as new hedging relationships entered into, after December 31, 2022, and to existing hedging relationships evaluated for effectiveness for periods after December 31, 2022, except for certain hedging relationships existing as of December 31, 2022, that apply certain optional expedients in which the accounting effects are recorded through the end of the hedging relationship. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.



### 3. INVESTMENT AND MORTGAGE-BACKED SECURITIES

The amortized cost and fair value of the Company's securities with gross unrealized gains and losses, as of September 30, 2021 and 2020 are as follows:

#### Available for sale securities:

		September 30, 2021			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Collateralized mortgage obligations	\$ 532	\$ 12	\$ -	\$ 544	
U.S. Government money market funds	<u>596</u>	<u>-</u>	<u>-</u>	<u>596</u>	
Total Available for Sale Securities	\$ <u>1,128</u>	\$ <u>12</u>	\$ <u>-</u>	\$ <u>1,140</u>	

		September 30, 2020			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Collateralized mortgage obligations	\$ 672	\$ 14	\$ -	\$ 686	
U.S. Government money market funds	<u>4,922</u>	<u>-</u>	<u>-</u>	<u>4,922</u>	
Total Available for Sale Securities	\$ <u>5,594</u>	\$ <u>14</u>	\$ <u>-</u>	\$ <u>5,608</u>	

#### Held to maturity securities:

		September 30, 2021			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Mortgage-backed securities- U.S. Government Sponsored Enterprises (GSE'S)	\$ 82,250	\$ 1,997	\$ (175)	\$ 84,072	
Collateralized mortgage obligations	618	26	-	644	
Municipal bonds	3,521	77	-	3,598	
U.S. Government Agencies	<u>17,947</u>	<u>-</u>	<u>(3)</u>	<u>17,944</u>	
Total Held to Maturity Securities	\$ <u>104,336</u>	\$ <u>2,100</u>	\$ <u>(178)</u>	\$ <u>106,258</u>	

		September 30, 2020			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	
Mortgage-backed securities- U.S. Government Sponsored Enterprises (GSE'S)	\$ 80,287	\$ 3,151	\$ -	\$ 83,438	
Collateralized mortgage obligations	878	31	-	909	
Municipal bonds	<u>7,766</u>	<u>193</u>	<u>-</u>	<u>7,959</u>	
Total Held to Maturity Securities	\$ <u>88,931</u>	\$ <u>3,375</u>	\$ <u>-</u>	\$ <u>92,306</u>	

All the Company's mortgage-backed securities and collateralized mortgage obligations are residential. At September 30, 2021 and 2020, the Bank held \$1.2 million and \$1.6 million, respectively in Collateralized Mortgage Obligations (CMOs) of which all were issued by Government Sponsored Enterprises and none were privately issued.

There were no sales of securities during the year ended September 30, 2021 and September 30, 2020, respectively.

A summary of securities with unrealized losses, aggregated by category, as of September 30, 2021 is as follows:

(In thousands)	September 30, 2021					
	Less than 12 Months		12 Months or Longer		Total Fair Value	Total Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		
Mortgage-backed securities- U.S. Government Sponsored Enterprises (GSE'S)	\$ 36,412	\$ (175)	\$ -	\$ -	\$ 36,412	\$ (175)
U.S. Government Agencies	<u>12,945</u>	<u>(3)</u>	<u>-</u>	<u>-</u>	<u>12,945</u>	<u>(3)</u>
Total temporarily impaired securities	<u>\$ 49,357</u>	<u>\$ (178)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 49,357</u>	<u>\$ (178)</u>

At September 30, 2021, debt securities in a gross unrealized loss position consisted of 13 security that at such date had an aggregate depreciation of 0.4% from the Company's amortized cost basis. Management believes that the estimated fair value of the securities disclosed above is primarily dependent upon the movement in market interest rates. Management evaluated the length of time and the extent to which the fair value has been less than cost; the financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer. The Company has the ability and intent to hold these securities until maturity and the Company does not believe it will be required to sell such securities prior to the recovery of the amortized cost basis. Management does not believe any individual unrealized loss on debt securities as of September 30, 2021 represents other-than-temporary impairment.

The following table sets forth the stated maturities of the investment and mortgage-backed securities at September 30, 2021. Money market funds are not included in the table based on lack of maturity.

(In thousands)	September 30, 2021	
	Amortized Cost	Fair Value
Available for sale:		
Due after ten years	\$ 532	\$ 544
Total	<u>\$ 532</u>	<u>\$ 544</u>
Held to maturity:		
Due in one year or less	\$ 11,610	\$ 11,627
Due after one year through five years	12,040	12,309
Due after five years through ten years	24,294	24,976
Due after ten years	<u>56,392</u>	<u>57,346</u>
Total	<u>\$ 104,336</u>	<u>\$ 106,258</u>

Certain of the Company's investment securities, totaling \$21.9 million and \$27.6 million at September 30, 2021 and 2020, respectively, were pledged or restricted for deposit sweep accounts, public deposits, or other purposes as required or permitted by law.

#### 4. LOANS RECEIVABLE

Loans receivable consists of the following:

(In thousands)	September 30,	
	2021	2020
Residential Mortgages	\$ 240,125	\$ 295,221
Construction	8,270	4,845
Home Equity	48,148	61,441
Commercial Mortgages	243,019	221,585
Commercial Business Loans*	15,493	32,820
Consumer Non-Real Estate	<u>434</u>	<u>462</u>
Total	555,489	616,374
Undisbursed portion of loans in process	(5,118)	(3,352)
Deferred loan fees	(145)	(852)
Allowance for loan losses	<u>(5,520)</u>	<u>(5,308)</u>
Loans Receivable - net	\$ <u>544,706</u>	\$ <u>606,862</u>

\*-includes \$7.8 million and \$27.5 million of PPP loans at September 30, 2021 and 2020, respectively

At September 30, 2021 and 2020, the Company was servicing residential mortgage loans for others amounting to approximately \$19.1 million and \$11.0 million, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing. Loan servicing income is recognized over the life of the loan. The Company receives a servicing fee of 0.25% on sold loans, which totaled \$87,000 as of September 30, 2021. These servicing fees are included in prepaid expenses and other assets on the Consolidated Statements of Financial Condition. In connection with the loans serviced for others, the Company held borrowers' escrow balances of approximately \$97,000 and \$55,000 for September 30, 2021 and 2020, respectively. The net gain on the sale of residential mortgage loans was \$252,000 and none for 2021 and 2020, respectively. This \$252,000 increase in the net gain on sale of loans was result of new residential mortgage activity during 2021. Proceeds from the sale of residential mortgages were \$10.9 million and none for 2021 and 2020, respectively.

The Bank has had, and may be expected to have in the future, loan transactions in the ordinary course of business with directors, officers, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans to related parties at September 30, 2021 and 2020, were approximately \$3.0 million and \$13.3 million, respectively. There were \$1.1 million in additional loans and \$11.4 million in repayments for the year ended September 30, 2021 compared to no additional loans and \$409,000 in repayments for the year ended September 30, 2020.

The loans receivable portfolio is segmented into consumer and commercial loans. Consumer loans consist of the following classes: residential mortgage loans, construction loans, home equity loans and non-real estate consumer loans. Commercial loans consist of the following classes: commercial mortgages and commercial business loans. For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans including impaired loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on

contractual due dates for loan payments.

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the Consolidated Statements of Financial Condition date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a monthly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These significant factors may include changes in lending policies and procedures, changes in existing general economic and business conditions affecting our primary lending areas, credit quality trends, collateral value, loan volumes and concentrations, seasoning of the loan portfolio, recent loss experience in particular segments of the portfolio, duration of the current business cycle and bank regulatory examination results. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

Residential mortgage lending generally entails a lower risk of default than other types of lending. Other consumer loans and commercial real estate loans generally involve more risk of collectability because of the type and nature of the collateral and, in certain cases, the absence of collateral. It is the Company's policy to establish specific reserves for losses on delinquent commercial loans when it determines that losses are probable.

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

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. Additionally, all loans modified in a troubled debt restructuring are considered impaired. 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. Impairment is measured on a loan by loan basis for loans by either

the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral. Interest payments on impaired loans and non-accrual loans are applied to principal unless the ability to collect the principal amount is fully secured, in which case interest is recognized on the cash basis.

For residential mortgage loans, home equity loans and commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial business loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of September 30, 2021 and 2020:

**September 30, 2021**

(In thousands)	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Residential Mortgages	\$ 237,336	\$ -	\$ 2,789	\$ -	\$ 240,125
Construction	8,270	-	-	-	8,270
Home Equity	47,565	-	583	-	48,148
Commercial Mortgages	235,283	2,718	5,018	-	243,019
Commercial Business Loans	15,370	-	123	-	15,493
Consumer Non-Real Estate	434	-	-	-	434
Total	<u>\$ 544,258</u>	<u>\$ 2,718</u>	<u>\$ 8,513</u>	<u>\$ -</u>	<u>\$ 555,489</u>

**September 30, 2020**

(In thousands)	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Residential Mortgages	\$ 291,958	\$ -	\$ 3,263	\$ -	\$ 295,221
Construction	4,845	-	-	-	4,845
Home Equity	60,845	-	596	-	61,441
Commercial Mortgages	213,526	3,864	4,195	-	221,585
Commercial Business Loans	32,695	-	125	-	32,820
Consumer Non-Real Estate	462	-	-	-	462
Total	<u>\$ 604,331</u>	<u>\$ 3,864</u>	<u>\$ 8,179</u>	<u>\$ -</u>	<u>\$ 616,374</u>

The following table summarizes information in regards to impaired loans by loan portfolio class as of September 30, 2021 and for the year then ended:

(In thousands)	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:					
Residential Mortgages	\$ 2,789	\$ 2,851	\$ -	\$ 2,888	\$ 77
Construction	-	-	-	-	-
Home Equity	531	636	-	642	8
Commercial Mortgages	3,636	3,844	-	3,921	117
Commercial Business Loans	123	123	-	125	-
Consumer Non-Real Estate	-	-	-	-	-
Subtotal:	<u>7,079</u>	<u>7,454</u>	<u>-</u>	<u>7,576</u>	<u>202</u>
With an allowance recorded:					
Residential Mortgages	-	-	-	-	-
Construction	-	-	-	-	-
Home Equity	88	88	35	88	3
Commercial Mortgages	1,382	1,772	170	1,772	-
Commercial Business Loans	-	-	-	-	-
Consumer Non-Real Estate	-	-	-	-	-
Subtotal:	<u>1,470</u>	<u>1,860</u>	<u>205</u>	<u>1,860</u>	<u>3</u>
Total:					
Residential Mortgages	2,789	2,851	-	2,888	77
Construction	-	-	-	-	-
Home Equity	619	724	35	730	11
Commercial Mortgages	5,018	5,616	170	5,693	117
Commercial Business Loans	123	123	-	125	-
Consumer Non-Real Estate	-	-	-	-	-
Totals:	<u>\$ 8,549</u>	<u>\$ 9,314</u>	<u>\$ 205</u>	<u>\$ 9,436</u>	<u>\$ 205</u>

The following table summarizes information in regards to impaired loans by loan portfolio class as of September 30, 2020 and for the year then ended:

(In thousands)	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
With no related allowance recorded:					
Residential Mortgages	\$ 3,048	\$ 3,110	\$ -	\$ 3,149	\$ 82
Construction	-	-	-	-	-
Home Equity	422	576	-	580	18
Commercial Mortgages	4,195	4,627	-	4,640	92
Commercial Business Loans	125	125	-	143	-
Consumer Non-Real Estate	-	-	-	-	-
Subtotal:	<u>7,790</u>	<u>8,438</u>	<u>-</u>	<u>8,512</u>	<u>192</u>
With an allowance recorded:					
Residential Mortgages	214	214	15	216	2
Construction	-	-	-	-	-
Home Equity	214	214	85	363	11
Commercial Mortgages	-	-	-	-	-
Commercial Business Loans	-	-	-	-	-
Consumer Non-Real Estate	-	-	-	-	-
Subtotal:	<u>428</u>	<u>428</u>	<u>100</u>	<u>579</u>	<u>13</u>
Total:					
Residential Mortgages	3,262	3,324	15	3,365	84
Construction	-	-	-	-	-
Home Equity	636	790	85	943	29
Commercial Mortgages	4,195	4,627	-	4,640	92
Commercial Business Loans	125	125	-	143	-
Consumer Non-Real Estate	-	-	-	-	-
Totals:	<u>\$ 8,218</u>	<u>\$ 8,866</u>	<u>\$ 100</u>	<u>\$ 9,091</u>	<u>\$ 205</u>



The performance and credit quality of the loan portfolio is also monitored by the analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of September 30, 2021 and 2020:

### September 30, 2021

(In thousands)	<u>30-89 Days Past Due</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans Receivable</u>	<u>Loans Receivable &gt; 90 Days and Accruing</u>
Residential Mortgages	\$ 1,914	\$ 2,129	\$ 4,043	\$236,082	\$ 240,125	\$ -
Construction	-	-	-	8,270	8,270	-
Home Equity	399	433	832	47,316	48,148	-
Commercial Mortgages	-	3,916	3,916	239,103	243,019	-
Commercial Business Loans	-	-	-	15,493	15,493	-
Consumer Non-Real Estate	-	-	-	434	434	-
<b>Total</b>	<u>\$ 2,313</u>	<u>\$ 6,478</u>	<u>\$ 8,791</u>	<u>\$546,698</u>	<u>\$ 555,489</u>	<u>\$ -</u>

### September 30, 2020

(In thousands)	<u>30-89 Days Past Due</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans Receivable</u>	<u>Loans Receivable &gt; 90 Days and Accruing</u>
Residential Mortgages	\$ 1,852	\$ 2,560	\$ 4,412	\$290,809	\$ 295,221	\$ -
Construction	-	-	-	4,845	4,845	-
Home Equity	358	600	958	60,483	61,441	89
Commercial Mortgages	-	3,769	3,769	217,816	221,585	-
Commercial Business Loans	-	-	-	32,820	32,820	-
Consumer Non-Real Estate	42	-	42	420	462	-
<b>Total</b>	<u>\$ 2,252</u>	<u>\$ 6,929</u>	<u>\$ 9,181</u>	<u>\$607,193</u>	<u>\$ 616,374</u>	<u>\$ 89</u>

The following table presents nonaccrual loans by classes of the loan portfolio for the years ended September 30, 2021 and 2020:

(In thousands)	<u>September 30, 2021</u>	<u>September 30, 2020</u>
Residential Mortgages	\$ 2,795	\$ 3,262
Construction	-	-
Home Equity	582	597
Commercial Mortgages	3,916	3,769
Commercial Business Loans	-	-
Consumer Non-Real Estate	-	-
<b>Total</b>	<u>\$ 7,293</u>	<u>\$ 7,628</u>

The following table provides the activity in the allowance for loan losses by loan class for the years ended September 30, 2021 and 2020 and the balance in the allowance for loan losses at September 30, 2021 and 2020 disaggregated on the basis of the Company's impairment method by loan class along with the balance of loans receivable by class disaggregated on the basis of the Company's impairment methodology.

<b>September 30, 2021</b>								
(In thousands)	<u>Residential Mortgages</u>	<u>Construction</u>	<u>Home Equity</u>	<u>Commercial Mortgages</u>	<u>Commercial Business Loans</u>	<u>Consumer Non-Real Estate</u>	<u>Unallocated</u>	<u>Totals</u>
Allowance for loan loss:								
Beginning Balance, September 30, 2020	\$ 1,070	\$ -	\$ 359	\$ 2,334	\$ 168	\$ 39	\$ 1,338	\$ 5,308
Charge-offs	-	-	-	(166)	-	(39)	-	(205)
Recoveries	-	-	-	-	-	32	-	32
Provisions	<u>(229)</u>	<u>-</u>	<u>(111)</u>	<u>554</u>	<u>(24)</u>	<u>9</u>	<u>186</u>	<u>385</u>
Ending balance, September 30, 2021	<u>\$ 841</u>	<u>\$ -</u>	<u>\$ 248</u>	<u>\$ 2,722</u>	<u>\$ 144</u>	<u>\$ 41</u>	<u>\$ 1,524</u>	<u>\$ 5,520</u>
Ending balance:								
Individually evaluated for impairment	\$ -	\$ -	\$ 35	\$ 170	\$ -	\$ -	\$ -	\$ 205
Ending balance:								
Collectively evaluated for impairment	\$ 841	\$ -	\$ 213	\$ 2,552	\$ 144	\$ 41	\$ 1,524	\$ 5,315
Loans:								
Ending balance:	\$ 240,125	\$ 8,270	\$ 48,148	\$ 243,019	\$ 15,493	\$ 434		\$555,489
Ending balance:								
Individually evaluated for impairment	\$ 2,789	\$ -	\$ 619	\$ 5,018	\$ 123	\$ -		\$ 8,549
Ending balance:								
Collectively evaluated for impairment	\$ 237,336	\$ 8,270	\$ 47,529	\$ 238,001	\$ 15,370	\$ 434		\$546,940

During the fiscal year ended September 30, 2021 a credit provision was recorded in the residential mortgage, home equity and commercial business loan portfolio while the commercial mortgage and consumer non-real-estate portfolios required provision expense. The credit provision in the residential mortgage, home equity and commercial business loan portfolio was the result of decreased historical loss factors and a decline in the portfolio balance partially offset by an increase in the qualitative factors related to economic risks from COVID-19. The provision expense recorded for the commercial mortgage and consumer non-real-estate portfolios was the result of qualitative factors related to economic risks from Covid-19, an increase in balance and an increase in specific reserves.

**September 30, 2020**

(In thousands)	<u>Residential Mortgages</u>	<u>Construction</u>	<u>Home Equity</u>	<u>Commercial Mortgages</u>	<u>Commercial Business Loans</u>	<u>Consumer Non-Real Estate</u>	<u>Unallocated</u>	<u>Totals</u>
Allowance for loan loss:								
Beginning Balance, September 30, 2019	\$ 911	\$ -	\$ 511	\$ 2,064	\$ 147	\$ 34	\$ 1,090	\$ 4,757
Charge-offs	-	-	-	(224)	-	(48)	-	(272)
Recoveries	-	-	-	-	-	12	-	12
Provisions	<u>159</u>	<u>-</u>	<u>(152)</u>	<u>494</u>	<u>21</u>	<u>41</u>	<u>248</u>	<u>811</u>
Ending balance, September 30, 2020	<u>\$ 1,070</u>	<u>\$ -</u>	<u>\$ 359</u>	<u>\$ 2,334</u>	<u>\$ 168</u>	<u>\$ 39</u>	<u>\$ 1,338</u>	<u>\$ 5,308</u>
Ending balance:								
Individually evaluated for impairment	\$ 15	\$ -	\$ 85	\$ -	\$ -	\$ -	\$ -	\$ 100
Ending balance:								
Collectively evaluated for impairment	\$ 1,055	\$ -	\$ 274	\$ 2,334	\$ 168	\$ 39	\$ 1,338	\$ 5,208
Loans:								
Ending balance:	\$ 295,221	\$ 4,845	\$ 61,441	\$ 221,585	\$ 32,820	\$ 462		\$616,374
Ending balance:								
Individually evaluated for impairment	\$ 3,262	\$ -	\$ 636	\$ 4,195	\$ 125	\$ -		\$ 8,218
Ending balance:								
Collectively evaluated for impairment	\$ 291,959	\$ 4,845	\$ 60,805	\$ 217,390	\$ 32,695	\$ 462		\$608,156

During the fiscal year ended September 30, 2020 a credit provision was recorded in the home equity portfolio while the residential mortgage, commercial mortgage, commercial business loan, and consumer non-real-estate portfolios required provision expense. The credit provision in the home equity portfolio was the result of decreased historical loss factors and a decline in the portfolio balance partially offset by an increase in the qualitative factors related to economic risks from COVID-19. The provision expense recorded for the commercial mortgage, commercial business loan, and consumer non-real-estate portfolios was the result of qualitative factors related to economic risks from COVID-19.

Foreclosed assets acquired in settlement of loans are carried at fair value, less estimated costs to sell. As of September 30, 2021, the Company had no foreclosed assets and has initiated formal foreclosure proceeds on \$854,000 of consumer residential mortgages loans, which have not yet been transferred into foreclosed assets.

A troubled debt restructuring (“TDR”) is a formal restructure of a loan when the lender, for economic or legal reasons related to the borrower’s financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, or extension of the maturity date.

The Company had no troubled debt restructuring modifications during the twelve months ended September 30, 2021 and 2020, respectively.

## Paycheck Protection Program

In April 2020, our team in business banking and retail began accepting and processing applications for loans under the Paycheck Protection Program (“PPP”) implemented by the Small Business Association (“SBA”) with support from the Department of Treasury under the recently enacted Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The Company originated 155 and 324 loans from new and existing customers totaling \$37.2 million in PPP loans. We received approximately \$1.2 million and \$245,000 in processing fee income for the years ended September 30, 2021 and 2020, respectively. The processing fee income is deferred and recognized over the contractual life of the loan, or accelerated if the loan is forgiven. The PPP loans have a two-year term and earn interest at 1%. The Company funded these short-term loans primarily from available liquidity through Bank deposits. The SBA fully guarantees the principle and interest, unless the lender violated an obligation under the agreement. The Company did not include the PPP loans in the allowance for loan loss calculation as loan losses, if any, are anticipated to be immaterial.

## Deferral Requests

The Company has worked with the customers impacted by COVID-19 to provide short-term assistance up to six months in accordance with regulatory guidelines. Commercial borrowers requesting assistance have been offered either a 90-day principal and interest deferral or a 90-day interest only with a potential deferral of up to two additional months. These deferrals do not constitute TDR’s under the CARES Act as they met the requirements under section 4013. Section 4013 of the CARES Act, “Temporary Relief from Troubled Debt Restructurings,” provides banks the option to temporarily suspend certain requirements under U.S. GAAP related to TDR’s for a limited period of time to account for the effects of COVID-19. Residential borrowers needing assistance have been offered a 90-day principal and interest deferral with a potential additional 90-day deferral. The Company has processed a total of 217 deferral requests, representing \$74.0 million in total outstanding loans as of September 30, 2020. As of September 30, 2021, the Company has 30 loans remaining in deferral, representing \$5.3 million in total outstanding loans. Management expects deferral requests could continue throughout year end 2021.

The following table provides a breakdown of loans deferred under the payment deferral program by category as of September 30, 2021 and 2020:

	<u>September 30, 2021</u>	<u>September 30, 2020</u>	<u>Total Deferral Requests</u>
(In thousands)			
Residential Mortgages	\$ 4,961	\$ 20,231	\$ 25,227
Home Equity	73	636	1,163
Commercial Mortgages	232	26,161	45,734
Commercial Business Loans	<u>-</u>	<u>-</u>	<u>1,846</u>
Total	<u>\$ 5,266</u>	<u>\$ 47,028</u>	<u>\$ 73,970</u>

## 5. OFFICE PROPERTIES AND EQUIPMENT

Office properties and equipment are summarized by major classifications as follows:

(In thousands)	September 30,	
	2021	2020
Land	\$ 3,277	\$ 3,277
Buildings	10,724	10,695
Fixed assets suspense	31	45
Furniture, fixtures and equipment	6,054	6,003
Data processing	2,434	2,365
Automobiles	<u>92</u>	<u>92</u>
Total	22,612	22,477
Less accumulated depreciation	<u>(13,269)</u>	<u>(12,594)</u>
Net	\$ <u>9,343</u>	\$ <u>9,883</u>

Depreciation expense for the years ended September 30, 2021 and 2020 amounted to approximately \$675,000 and \$700,000, respectively.

## 6. DEPOSITS

Deposits are summarized as follows:

(In thousands)	September 30,			
	2021		2020	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Non-interest-bearing checking accounts	\$ 89,088	0.00%	\$ 81,742	0.00%
NOW accounts	55,888	0.04	48,547	0.04
Interest-bearing checking accounts	128,298	0.20	100,779	0.34
Money market deposit accounts	296,691	0.04	249,407	0.14
Passbook and club accounts	2,615	0.19	2,710	0.72
Certificate of deposit accounts	<u>153,356</u>	<u>1.25</u>	<u>174,545</u>	<u>1.61</u>
Total Deposits	<u>\$725,936</u>	<u>0.32%</u>	<u>\$657,730</u>	<u>0.54%</u>

At September 30, 2021, the amounts of scheduled maturities of certificate of deposit accounts were as follows (in thousands):

For the year ended September 30,	2022	\$ 88,342
	2023	27,595
	2024	9,703
	2025	24,179
	2026	<u>3,537</u>
Total		\$ <u>153,356</u>

The aggregate amount of certificate accounts in denominations of \$250,000 or more at September 30, 2021 and 2020 amounted to approximately \$12.2 million for both years.

## 7. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The Bank's short-term borrowings activities are summarized as follows:

<u>FHLB RepoPlus Advance</u>	<u>2021</u>	<u>2020</u>
	(Dollar in thousands)	
Balance at year-end	\$ 18,558	\$ 21,423
Maximum amount of outstanding at any month-end	20,498	27,028
Average balance outstanding during the year	19,242	14,014
Weighted-average interest rate:		
As of year-end	0.25%	0.24%
Paid during the year	0.23%	0.35%

Average amounts outstanding during the year represent daily average balances, while weighted-average interest rates represent interest expense divided by the related average balance for the period indicated.

The Bank maintains the Repo Plus Advance credit arrangement, which is renewable annually, with the FHLB. The line maintains a variable rate of interest that may be reset daily at the FHLB's discretion. The Bank's maximum borrowing capacity under the credit arrangement with the FHLB as of September 30, 2021, is approximately \$382.4 million. FHLB advances are secured by a blanket security agreement that includes the Company's FHLB stock as well as certain residential mortgage loans and investments.

Long-term debt consists of the following (in thousands):

<u>Description</u>	<u>Maturity Range</u>		<u>Weighted Average Interest Rate</u>	<u>Stated Interest Rate Range</u>		<u>2021</u>	<u>2020</u>
	<u>From</u>	<u>To</u>		<u>From</u>	<u>To</u>		
Fixed rate	12/24/2021	02/20/2024	2.47%	1.64%	3.25%	\$ 59,000	\$ 83,261
Convertible	10/19/2020	10/19/2020	2.01%	2.01%	2.01%	-	5,000
						<u>\$59,000</u>	<u>\$88,261</u>

Maturities of long-term advances as of September 30, 2021 are summarized as follows:

	<u>Amount</u>	<u>Weighted Average Rate</u>
	(In thousands)	
FHLB long-term debt:		
2022	\$ 12,000	2.20%
2023	36,000	2.44%
2024	<u>11,000</u>	<u>2.84%</u>
Total FHLB long-term debt	<u>59,000</u>	<u>2.47%</u>

## 8. INCOME TAXES

The Company computes its reserve for bad debts under the specific charge-off method. The bad debt deduction allowable under this method is available to large banks with assets greater than \$500 million. Generally, this method allows the Company to deduct an annual addition to the reserve for bad debts equal to its net charge-offs. Retained earnings at September 30, 2021 and 2020 includes approximately \$1,325,000 representing bad debt deductions for which no deferred income taxes have been provided.

The expense for income taxes differs from that computed at the statutory federal corporate tax rate as follows:

(In thousands)	Year Ended September 30,			
	2021	Percentage of Pretax Income	2020	Percentage of Pretax Income
	<u>Amount</u>		<u>Amount</u>	
At statutory rate	\$ 2,068	21.0%	\$ 1,968	21.0%
Adjustments resulting from:				
Tax-exempt income	(121)	(1.2)	(157)	(1.7)
State tax-net of federal tax benefit	558	5.7	459	4.9
Other	<u>61</u>	<u>0.6</u>	<u>(12)</u>	<u>(0.1)</u>
Expense per consolidated statements of income	<u>\$ 2,566</u>	<u>26.1%</u>	<u>\$ 2,258</u>	<u>24.1%</u>

Income tax expense is summarized as follows:

(In thousands)	Year Ended September 30,	
	2021	2020
Current	\$ 2,709	\$ 2,440
Deferred	<u>(143)</u>	<u>(182)</u>
Total Income Tax Expense	<u>\$ 2,566</u>	<u>\$ 2,258</u>

Items that gave rise to significant portions of the deferred tax accounts are as follows:

(In thousands)	September 30,	
	<u>2021</u>	<u>2020</u>
Deferred Tax Assets:		
Deferred Loan Fees	\$ 12	\$ 12
Allowance for Loan Losses	1,159	1,115
Lease Liability	620	641
Other	<u>399</u>	<u>360</u>
Sub-Total	<u>2,190</u>	<u>2,128</u>
Deferred Tax Liabilities:		
Unrealized gain on investment securities	(3)	(3)
Properties and equipment	(581)	(631)
Right-of-Use Assets	<u>(600)</u>	<u>(631)</u>
Sub-Total	<u>(1,184)</u>	<u>(1,265)</u>
Total	\$ <u>1,006</u>	\$ <u>863</u>

## 9. REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under U.S. GAAP, regulatory reporting requirements, and regulatory capital standards. The Bank'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 regulatory capital standards to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital to risk-weighted assets, common equity Tier 1 capital to total risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of September 30, 2021, that the Bank meets all capital adequacy requirements to which it is subject.

As of September 30, 2021, and September 30, 2020, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, common equity Tier 1 risk-based capital, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.



The Bank's actual capital amounts and ratios are also presented in the table.

(In thousands)	Actual		For Capital Adequacy Purposes		To Be Considered Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>At September 30, 2021</b>						
Tier 1 Capital (to assets)	\$80,739	8.91%	\$36,241	4.00%	\$45,302	5.00%
Common Equity Tier 1 Capital (to risk weighted assets)	80,739	15.95%	22,783	4.50%	32,908	6.50%
Tier 1 Capital (to risk weighted assets)	80,739	15.95%	30,377	6.00%	40,502	8.00%
Total Capital (to risk weighted assets)	86,344	17.05%	40,502	8.00%	50,628	10.00%
<b>At September 30, 2020</b>						
Tier 1 Capital (to assets)	\$78,583	9.19%	\$34,210	4.00%	\$42,762	5.00%
Common Equity Tier 1 Capital (to risk weighted assets)	78,583	14.49%	24,398	4.50%	35,241	6.50%
Tier 1 Capital (to risk weighted assets)	78,583	14.49%	32,530	6.00%	43,374	8.00%
Total Capital (to risk weighted assets)	83,976	15.49%	43,374	8.00%	54,217	10.00%

The Company's capital ratios are not significantly different than the Bank's disclosed above.

## 10. RETIREMENT SAVINGS PLANS

The Company has a qualified 401 (k) retirement savings plan covering all full-time employees meeting certain eligibility requirements. Contributions for the plan are at the discretion of the Company's Board of Directors. Compensation expense related to the plan was \$560,000 and \$561,000 for the years ended September 30, 2021 and 2020, respectively.

## 11. STOCK BASED COMPENSATION AND EMPLOYEE STOCK PURCHASE PLAN

In January 2016, the stockholders approved the 2015 Stock Incentive Plan which provides 300,000 shares for the granting of incentive stock options, compensatory stock options, stock appreciation rights and share awards of restrictive stock. The number of shares available to be issued as share awards will not exceed 75,000 shares. There are 69,093 shares remaining for grant under this plan.

The life of the options under the above plan is ten years. The vesting period for the options is five years.

A summary of stock option transactions under these plans follows:

	2021		2020	
	Options	Weighted Average Price	Options	Weighted Average Price
Outstanding, beginning of year	286,236	\$ 20.40	327,257	\$ 19.35
Exercised	(25,465)	16.62	(72,984)	16.45
Forfeited	(3,900)	23.02	(6,800)	21.91
Expired	-	-	(300)	13.05
Granted	37,710	25.96	39,063	22.05
Outstanding, end of year	294,581	\$ 21.40	286,236	\$ 20.40
Options exercisable, end of year	116,190	\$ 19.16	115,449	\$ 18.66

A summary of the exercise price ranges at September 30, 2021 and 2020 is as follows:

<b>2021</b>			
<u>Number of Option Shares</u>	<u>Exercise Price Range</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price per Share</u>
20,336	\$ 14.84-16.95	2.68	\$ 16.65
73,863	16.96-18.79	3.47	18.31
<u>200,382</u>	<u>18.80-25.96</u>	<u>7.42</u>	<u>23.02</u>
<u>294,581</u>	<u>\$ 14.84-25.96</u>	<u>6.10</u>	<u>\$ 21.40</u>

  

<b>2020</b>			
<u>Number of Option Shares</u>	<u>Exercise Price Range</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price per Share</u>
37,394	\$ 13.05-16.95	2.93	\$ 16.12
76,870	16.96-18.79	4.43	18.31
<u>171,972</u>	<u>18.80-24.55</u>	<u>7.78</u>	<u>22.26</u>
<u>286,236</u>	<u>\$ 13.05-24.55</u>	<u>6.25</u>	<u>\$ 20.40</u>

At September 30, 2021 and 2020, the aggregate intrinsic value of options outstanding was \$1.3 million and \$590,000, respectively. At September 30, 2021 and 2020, the aggregate intrinsic value of options exercisable was \$760,000 and \$412,000, respectively. For the years ended September 30, 2021 and 2020, the aggregate intrinsic value of options exercised was \$201,000 and \$718,000, respectively.

The aggregate intrinsic value of a stock option represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holder had all option holders exercised their options on September 30, 2021. This amount changes based on changes in the market value of the Company's common stock.

The weighted average fair value of stock options granted in the years ended September 30, 2021 and 2020 was \$4.35 and \$2.87, respectively, and was estimated at the date of grant using a Binomial Option Pricing Model with the following weighted-average assumptions while the market price of the Company's common stock at the date of grant is used for restricted stock awards:

	<u>Year Ended September 30,</u>	
	<u>2021</u>	<u>2020</u>
Risk free interest rate of return	1.01%	0.47%
Expected option life	84 months	84 months
Expected volatility	25.00%	22.00%
Expected dividends	4.50%	4.90%

The expected volatility is based on historic volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

Stock based compensation expense related to stock options for the years ended September 30, 2021 and 2020 was \$29,000 or \$26,000 net of tax, and \$182,000 or \$166,000 net of tax, respectively. As of September 30,

2021, there was approximately \$230,000 of total unrecognized compensation cost related to non-vested stock options under the plans.

On August 15, 2018, 3,085 shares of restricted stock were awarded. The restricted shares awarded had a grant date fair value of \$24.55 per share. The restricted stock awarded vests 33% annually beginning August 15, 2019. On August 20, 2019, 3,334 shares of restricted stock were awarded. The restricted shares awarded had a grant date fair value of \$23.70 per share. The restricted stock awarded vests 33% annually beginning August 20, 2020. On August 19, 2020, 3,723 shares of restricted grant date fair value of \$22.00 vests beginning August 19, 2021. The restricted stock awarded vests 33% annually beginning August 19, 2021. On August 17, 2021, 3,298 shares of restricted grant date fair value of \$25.96 vests beginning August 17, 2022. During the years ended September 30, 2021 and 2020, \$21,000 and \$69,000, respectively in compensation expense was recognized in regard to these restricted stock awards. At September 30, 2021, there was \$112,000 of unrecognized compensation expense related to the restricted stock awards which is expected to be recognized over a period of three years.

Restricted stock award activity for the year ended September 30, 2021 was as follows:

	<b><u>Number of shares</u></b>	<b><u>Weighted Average Grant Date Fair Value</u></b>
Unvested restricted stock, beginning of year	8,466	\$ 22.76
Granted	3,298	25.96
Forfeited	-	-
Vested	<u>(4,868)</u>	<u>22.93</u>
Unvested restricted stock, end of year	<u>6,896</u>	<u>\$ 24.17</u>

Restricted stock award activity for the year ended September 30, 2020 was as follows:

	<b><u>Number of shares</u></b>	<b><u>Weighted Average Grant Date Fair Value</u></b>
Unvested restricted stock, beginning of year	9,975	\$ 22.56
Granted	3,723	22.00
Forfeited	-	-
Vested	<u>(5,232)</u>	<u>21.84</u>
Unvested restricted stock, end of year	<u>8,466</u>	<u>\$ 22.76</u>

The Company also has established an Employee Stock Purchase Plan (the “Purchase Plan”) whereby employees may elect to make contributions to the Purchase Plan in an aggregate amount not less than 2% or more than 10% of such employee’s total compensation. These contributions would then be used to purchase stock during an offering period determined by the Company’s Salary and Benefits Committee. The purchase price of the stock would be the lesser of 85% of the market price on the first day or the last day of the offering period. At September 30, 2021 and 2020, there were 53,583 shares available for future purchase. The Company suspended participation in the Purchase Plan in March 2005 and the plan is not currently active.

## 12. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income by component net of tax for the years ended September 30, 2021 and 2020.

	<b>Unrealized gains on available for sale securities (a)</b>	
	(In thousands)	
Balance as of September 30, 2020	\$	8
Other comprehensive loss before reclassification		(2)
Amount reclassified from accumulated other comprehensive income		-
Total other comprehensive loss		(2)
Balance as of September 30, 2021	<u>\$</u>	<u>6</u>

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

	<b>Unrealized gains on available for sale securities (a)</b>	
	(In thousands)	
Balance as of September 30, 2019	\$	7
Other comprehensive income before reclassification		1
Amount reclassified from accumulated other comprehensive income		-
Total other comprehensive income		1
Balance as of September 30, 2020	<u>\$</u>	<u>8</u>

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

There were no items that were reclassified from accumulated other comprehensive income for the years ended September 30, 2021 and 2020.

## 13. COMMITMENTS

At September 30, 2021, the Company had approximately \$10.5 million in outstanding commitments to originate mortgage loans, of which \$10.1 million were fixed rates ranging from 2.75% to 4.88% and \$375,000 was adjustable rate 2.75%. The unfunded home equity line of credit commitments at September 30, 2021 were \$62.9 million. The Company had \$7.0 million and \$1.3 million of committed commercial and consumer loans, respectively, at September 30, 2021. In addition, the Company had \$20.7 million of unused commercial lines of credit at September 30, 2021. The amounts of undisbursed portions of loans in process at September 30, 2021 were \$5.1 million. The Company had a total of \$758,000 in standby letters of credit. Also, at September 30, 2021, the Company had no outstanding futures or options positions.

At September 30, 2020, the Company had approximately \$13.8 million in outstanding commitments to originate mortgage loans, of which \$13.8 million were fixed rates ranging from 2.75% to 4.86% and no adjustable rate mortgages. The unfunded home equity line of credit commitments at September 30, 2020 were \$64.4 million. The Company had \$30.2 million and \$2.6 million of committed commercial and consumer loans, respectively, at September 30, 2020. In addition, the Company had \$20.2 million of unused commercial lines of credit at September 30, 2020. The amounts of undisbursed portions of loans in process at September 30, 2020 were \$3.4 million. The Company had a total of \$230,000 in standby letters of credit. Also, at September 30, 2020, the Company had no outstanding futures or options positions.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as

deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of September 30, 2021 for guarantees under standby letters of credit issued is not material.

As announced on March 15, 2020, the Federal Reserve Board reduced reserve requirement ratios to zero percent effective March 26, 2020. This action eliminated reserve requirements for all depository institutions.

#### **14. LEGAL CONTINGENCIES**

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

#### **15. RESTRICTED RETAINED EARNINGS**

At the time of conversion to a stock savings bank, in 1987, the Bank established a liquidation account in an amount equal to the Bank's net worth as reflected in the latest Consolidated Statements of Financial Condition of the Bank contained in the offering circular utilized in the conversion. The function of the liquidation account is to establish a priority on liquidation and, except with respect to the payment of cash dividends on, or the re-purchase of, any of the common stock by the Bank, the existence of the liquidation account will not operate to restrict the use or application of any of the net worth accounts of the Bank. In the event of a complete liquidation of the Bank (and only in such event), each eligible account holder will be entitled to receive a pro rata distribution from the liquidation account, based on such holder's proportionate amount of the total current adjusted balances from deposit accounts then held by all eligible holders, before any liquidation distribution may be made with respect to stockholders. The liquidation account was approximately \$2,300,000 at September 30, 2021. Furthermore, the Company may not repurchase any of its stock if the effect thereof would cause the Company's net worth to be reduced below (i) the amount required for the liquidation account or (ii) the regulatory capital requirements.

#### **16. FAIR VALUE MEASUREMENTS AND DISCLOSURES**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with accounting guidance, the fair value of a financial instrument is 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. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumption used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is determined at a reasonable point within the range that is most representative of fair value under current market conditions.

The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2021 and 2020 are as follows (in thousands):

Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
September 30, 2021				
Available for sale securities:				
Collateralized mortgage obligations	\$ 544	\$ -	\$ 544	\$ -
U.S. Government money market funds	<u>596</u>	<u>596</u>	<u>-</u>	<u>-</u>
Totals	<u>\$ 1,140</u>	<u>\$ 596</u>	<u>\$ 544</u>	<u>\$ -</u>

Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
September 30, 2020				
Available for sale securities:				
Collateralized mortgage obligations	\$ 686	\$ -	\$ 686	\$ -
U.S. Government money market funds	<u>4,922</u>	<u>4,922</u>	<u>-</u>	<u>-</u>
Totals	<u>\$ 5,608</u>	<u>\$ 4,922</u>	<u>\$ 686</u>	<u>\$ -</u>

There were no transfers in and out of Level 1 and Level 2 fair value measurements for the year ended September 30, 2021.

For assets measured at fair value on a non recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2021 and 2020 are as follows (in thousands):

Description	September 30, 2021	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Impaired Loans	\$ 8,344	\$ -	\$ -	\$ 8,344
Totals	<u>\$ 8,344</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,344</u>

Description	September 30, 2020	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Impaired Loans	\$ 8,118	\$ -	\$ -	\$ 8,118
Totals	<u>\$ 8,118</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,118</u>

#### Quantitative Information about Level 3 Fair Value Measurements

September 30, 2021

Description	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average) (3)
Impaired loans	\$ 8,344	Fair Value of Collateral (1)	Appraised Value (2)	17% - 27% (18%)

#### Quantitative Information about Level 3 Fair Value Measurements

September 30, 2020

Description	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average) (3)
Impaired loans	\$ 8,118	Fair Value of Collateral (1)	Appraised Value (2)	17% - 27% (18%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which include Level 3 inputs that are not identifiable.
- (2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

The significant unobservable inputs for impaired loans are the appraised value or an agreed upon sales price. These values are adjusted for estimated costs to sell which are incremental direct costs to transact a sale such as broker commission, legal fees, closing costs and title transfer fees. The costs must be considered essential to the sale and would not have been incurred if the decision to sell had not been made. The costs to sell are based on costs associated with the Company's actual sales of other real estate owned which are assessed annually.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2021 and 2020.

### **Cash and Cash Equivalents (Carried at Cost)**

The carrying amounts reported in the Consolidated Statements of Financial Condition for cash and short-term instruments approximate those assets' fair values.

### **Securities**

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. The Company currently holds U.S. Government money market funds which are classified as Level 1, because quoted prices are available for these securities in an active market.

The Bank's investment portfolio is maintained by a third-party which utilizes Interactive Data Corporation (IDC) as its primary source for security valuations. IDC is not affiliated with or owned by a securities broker, dealer or underwriter, nor is it actively involved in the business of investment management or securities trading. Some of the major asset classes that IDC provides pricing and market inputs are as follows: U.S. Agency/Government Sponsored Enterprise (GSE) issues, U.S. high grade municipal issues, and U.S. Structured Securities Agency/GSE Collateralized Mortgage Obligation issues. The methodology used to price the above asset classes include: broker quotes, proprietary models, vast descriptive terms and conditions databases, as well as extensive quality control programs. Market inputs used to help determine the fair value hierarchy include but not limited to: security characteristics, ratings updates, prepayment schedules; cash flows and yield to maturity. Based on these methodologies employed by IDC; the Company considers these evaluations Level 2 in reference to ASC 820 with the exception of inactive markets. There are no securities in an inactive environment.

### **Loans Receivable (Carried at Cost)**

The fair values of loans, excluding impaired loans are estimated using discounted cash flow analyses, using market rates at the Consolidated Statements of Financial Condition date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired loans are those loans which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3



values, based upon the lowest level of input that is significant to the fair value measurements.

#### **Federal Home Loan Bank Stock (Carried at Cost)**

The carrying amount of this restricted investment in bank stock approximates fair value, and considers the limited marketability of this security.

#### **Bank Owned Life Insurance**

Fair value is equal to the cash surrender value of the life insurance policies.

#### **Accrued Interest Receivable and Payable (Carried at Cost)**

The carrying amount of accrued interest receivable and accrued interest payable approximates their fair value.

#### **Deposit Liabilities (Carried at Cost)**

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of an aggregated expected monthly maturities on time deposits.

#### **Borrowings (Carried at Cost)**

The fair value of short-term borrowings approximates the current book value. Fair values of long-term borrowings are estimated using discounted cash flow analysis, based on quoted prices for new advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

#### **Off-Balance Sheet financial Instruments (Disclosed at Cost)**

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remain terms of the agreements and the counterparties' credit standing. The fair value of these off-balance sheet financial instruments are not considered material as of September 30, 2021 and 2020.

The fair value amounts have been determined by the Company using available market information appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret the data to develop the estimates.

The carrying amounts and fair values of all the Company's financial instruments that are not required to be measured or reported at fair value on the Company's Consolidated Statements of Financial Condition as of September 30, 2021 and 2020 are as follows:

Fair Value Measurements at September 30, 2021					
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Cash and cash equivalents	\$ 205,793	\$ 205,793	\$ 205,793	\$ -	\$ -
Securities held to maturity	104,336	106,258	-	106,258	-
Loans receivable - net	544,706	544,505	-	-	544,505
Federal Home Loan Bank stock	3,583	3,583	3,583	-	-
Bank-owned life insurance	17,654	17,654	17,654	-	-
Accrued interest receivable	1,606	1,606	1,606	-	-
Liabilities:					
Checking, club and NOW deposit accounts	273,274	273,274	273,274	-	-
Money Market and passbook deposit accounts	299,306	299,306	299,306	-	-
Certificate of deposit accounts	153,356	154,352	-	-	154,352
Short-term borrowings	18,558	18,558	18,558	-	-
Long-term borrowings	59,000	61,122	-	-	61,122
Accrued interest payable	138	138	138	-	-
Off-balance sheet financial instruments	-	-	-	-	-

Fair Value Measurements at September 30, 2020					
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:					
Cash and cash equivalents	\$ 115,263	\$ 115,263	\$ 115,263	\$ -	\$ -
Securities held to maturity	88,931	92,306	-	92,306	-
Loans receivable - net	606,862	622,514	-	-	622,514
Federal Home Loan Bank stock	4,463	4,463	4,463	-	-
Bank-owned life insurance	17,260	17,260	17,260	-	-
Accrued interest receivable	2,354	2,354	2,354	-	-
Liabilities:					
Checking, club and NOW deposit accounts	231,068	231,068	231,068	-	-
Money Market and passbook deposit accounts	252,117	252,117	252,117	-	-
Certificate of deposit accounts	174,545	177,630	-	-	177,630
Short-term borrowings	21,423	21,423	21,423	-	-
Long-term borrowings	88,261	91,736	-	-	91,736
Accrued interest payable	209	209	209	-	-
Off-balance sheet financial instruments	-	-	-	-	-

## 17. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

Condensed financial statements of Harleyville Financial Corporation are as follows:

(In thousands)	September 30,	
<b>Condensed Statements of Financial Condition</b>	<b>2021</b>	<b>2020</b>
<b>Assets</b>		
Cash	\$ 30	\$ 115
Investment in subsidiary	<u>80,748</u>	<u>78,594</u>
<b>Total Assets</b>	<u>\$ 80,778</u>	<u>\$ 78,709</u>
<b>Liabilities and Stockholders' Equity</b>		
Other liabilities	\$ 76	\$ 78
Stockholders' equity	<u>80,702</u>	<u>78,631</u>
<b>Total Liabilities and Stockholders' Equity</b>	<u>\$ 80,778</u>	<u>\$ 78,709</u>
	<b>For the Year Ended September 30,</b>	
<b>Condensed Statements of Income:</b>	<b>2021</b>	<b>2020</b>
Equity in income of subsidiary	\$ 2,154	\$ 2,330
Distributed earnings of subsidiary	5,640	5,500
Other expense	<u>510</u>	<u>719</u>
<b>Net income</b>	<u>\$ 7,284</u>	<u>\$ 7,111</u>
	<b>For the Year Ended September 30,</b>	
<b>Condensed Statements of Cash Flows</b>	<b>2021</b>	<b>2020</b>
Net income	\$ 7,284	\$ 7,111
Decrease in other liabilities	(2)	(5)
Stock based compensation	50	251
Equity in undistributed earnings of subsidiary	<u>(2,154)</u>	<u>(2,330)</u>
Net cash provided by operating activities	<u>5,178</u>	<u>5,027</u>
<b>Financing activities:</b>		
Acquisition of treasury stock	(1,281)	(1,268)
Sale of treasury stock delivered under employee stock plans	185	283
Dividends paid	<u>(4,165)</u>	<u>(3,994)</u>
Net cash used in financing activities	<u>(5,261)</u>	<u>(4,979)</u>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(83)</b>	<b>48</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<u><b>115</b></u>	<u><b>67</b></u>
<b>Cash and cash equivalents at the end of the period</b>	<u><b>\$ 32</b></u>	<u><b>\$ 115</b></u>

## 18. REVENUE RECOGNITION

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as income from bank owned life insurance, sales of investment securities, and certain items within other income are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees and interchange fees. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606.

The following table presents noninterest income for the year ended September 30, 2021 and 2020:

(Dollars in thousands)	Year Ended	
	September 30,	
	2021	2020
<b>Non-Interest Income</b>		
<b>In-scope of Topic 606:</b>		
Fee income	\$ 168	\$ 142
Insufficient fund fees	375	393
Interchange fee income	972	838
Other income	432	296
<b>Total Non-Interest Income (in-scope of Topic 606)</b>	<u>1,947</u>	<u>1,669</u>
<b>Out-of-scope of Topic 606:</b>		
Increase in cash surrender value of bank-owned life insurance	393	398
Gains on sales of loans, net	252	-
Other	584	465
<b>Total Non-Interest Income (out-scope of Topic 606)</b>	<u>1,229</u>	<u>863</u>
<b>Total Non-Interest Income (in-scope of Topic 606)</b>	<u>1,947</u>	<u>1,669</u>
<b>Total Non-Interest Income</b>	<u>\$ 3,176</u>	<u>\$ 2,532</u>

The following is a discussion of key revenues of fees for customer services that are within the scope of the new revenue guidance:

- *Fee income* – Fees include service charges on deposits and consist of transaction-based fees, debit card replacement fees, Automated Clearing House (ACH) fees and account maintenance fees for various retail and business checking customers. These fees are charged as earned on the day of the transaction or within the month of the service.
- *Insufficient funds fees and other income*– Revenue from service charges on deposit accounts is earned through cash management, wire transfer, ATM fees and other deposit-related services; as well as overdraft, non-sufficient funds and account management fees. Revenue is recognized for these services either over time, corresponding with deposit accounts’ monthly cycle, or at a point in time for transactional related services and fees. These revenues are included in insufficient funds fees and other income in the table above.
- *Interchange fee income* – Fees generated when Company cardholders conduct transactions on their debit cards with merchants for goods or services. The Company then collects a portion of the fees generated from those transactions. Revenue is recognized for these transactions within the month they transpire.

## 19. LEASES

A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On October 1, 2019, the Company adopted ASU No. 2016-02 “Leases” (Topic 842) and all subsequent ASUs that modified Topic 842. For the Company, Topic 842 primarily affected the accounting treatment for operating lease agreements in which the Company is the lessee.

### Lessee Accounting

Substantially all of the leases in which the Company is the lessee are comprised of real estate property for branches and office space with terms extending through 2043. All of our leases are classified as operating leases, and therefore, were previously not recognized on the Company’s Consolidated Statement of Financial Condition. With the adoption of Topic 842, operating lease agreements are required to be recognized on the Consolidated Statement of Financial Condition as a right-of-use (“ROU”) asset and a corresponding lease liability.

The following table presents the Consolidated Statement of Financial Condition classification of the Company’s ROU assets and lease liabilities. The Company elected not to include short-term leases (i.e., leases with initial terms of twelve months or less), or equipment leases (deemed immaterial) on the Consolidated Statement of Financial Condition as of September 30, 2021 and 2020.

(in thousands)		<u>September 30, 2021</u>	<u>September 30, 2020</u>
<b>Lease Right-of-Use Assets</b>	<b>Classification</b>		
Operating lease right-of-use assets	Other assets	\$2,861	\$3,005
<b>Total Lease Right-Of-Use Assets</b>		<u>\$2,861</u>	<u>\$3,005</u>
(in thousands)		<u>September 30, 2021</u>	<u>September 30, 2020</u>
<b>Lease Liabilities</b>	<b>Classification</b>		
Operating lease liabilities	Other liabilities	\$2,954	\$3,054
<b>Total Lease Liabilities</b>		<u>\$2,954</u>	<u>\$3,054</u>

The calculated amount of the ROU assets and lease liabilities in the table above are impacted by the length of the lease term and the discount rate used to present value the minimum lease payments. The Company’s lease agreements often include one or more options to renew at the Company’s discretion. If at lease inception, the Company considers the exercising of a renewal option to be reasonably certain, the Company will include the extended term in the calculation of the ROU asset and lease liability. Regarding the discount rate, Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, the Company utilizes its incremental borrowing rate at lease inception, on a collateralized basis, over a similar term.

A summary of weighted average remaining lease term, as of September 30, 2021 and 2020.

	<u>September 30, 2021</u>	<u>September 30, 2020</u>
<b>Weighted average remaining lease term</b>		
Operating leases	14.9 years	14.7 years
<b>Weighted average discount rate</b>		
Operating leases	2.68%	2.67%

The following table represents lease costs and other lease information. As the Company elected, for all classes of underlying assets, not to separate lease and non-lease components and instead to account for them as a single lease component, the variable lease cost primarily represents variable payments such as common area maintenance and utilities, as of September 30, 2021 and 2020.

<u>Lease Costs (in thousands)</u>	<u>Twelve Months Ended</u>	
	<u>September 30, 2021</u>	<u>September 30, 2020</u>
Operating lease cost	\$153	\$151
Variable lease cost	<u>46</u>	<u>47</u>
<b>Net lease cost</b>	<b>\$199</b>	<b>\$198</b>

Future minimum payments for operating leases with initial or remaining terms of one year or more as of September 30, 2021 as follows:

(in thousands)	<u>Operating leases</u>
	<u>September 30, 2021</u>
<b>Twelve months Ended:</b>	
<b>Within one year</b>	<b>\$153</b>
<b>After one but within two years</b>	<b>159</b>
<b>After two but within three years</b>	<b>168</b>
<b>After three but within four years</b>	<b>169</b>
<b>After four but within five years</b>	<b>175</b>
<u><b>After five years</b></u>	<u><b>3089</b></u>
<b>Total future minimum lease payments</b>	<b>\$3,913</b>
<u>Amounts representing interest</u>	<u>(959)</u>
<b>Present Value of Net Future Minimum Lease Payments</b>	<b>\$2,954</b>

## 20. SUBSEQUENT EVENTS

Management has reviewed events occurring through December 7, 2021, the date the financial statements were issued, and no subsequent events occurred requiring accrual or disclosures.



