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KS Bancorp, Inc. and Subsidiary

Consolidated Financial Statements

Years Ended December 31, 2021 and 2020

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KS Bancorp, Inc. and Subsidiary
Selected Financial Data

	December 31,				
	<u>2021</u>	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(Dollars In Thousands, Except Per Share Amounts)				
Financial Condition Data:					
Total assets	\$ 571,225	\$ 485,828	\$ 403,657	\$ 400,258	\$ 373,618
Investments ⁽¹⁾	206,625	98,385	78,330	89,020	71,416
Loans receivable, net	345,644	368,593	307,855	295,630	285,969
Deposits	487,437	402,523	326,919	330,423	296,574
FHLB advances/other borrowings	43,248	47,248	46,248	44,255	47,351
Stockholders' equity	36,645	32,021	26,827	22,125	26,303
Book value per common share	33.08	28.91	24.22	19.97	20.09
Operating Data					
Interest income	\$ 19,805	\$ 18,997	\$ 17,665	\$ 16,493	\$ 15,278
Interest expense	<u>2,144</u>	<u>3,588</u>	<u>4,726</u>	<u>3,886</u>	<u>3,031</u>
Net interest income	17,661	15,409	12,939	12,607	12,247
Provision (recovery) for loan losses	369	561	25	-	(227)
Noninterest income	2,876	2,617	2,825	2,874	2,789
Noninterest expense	<u>12,456</u>	<u>11,878</u>	<u>11,112</u>	<u>10,992</u>	<u>11,010</u>
Income before income taxes	7,712	5,587	4,627	4,489	4,253
Income tax expense	<u>1,618</u>	<u>1216</u>	<u>985</u>	<u>947</u>	<u>2,194</u>
Net income	<u>\$ 6,094</u>	<u>\$ 4,371</u>	<u>\$ 3,642</u>	<u>\$ 3,542</u>	<u>\$ 2,059</u>
Selected Other Data:					
Basic earnings per share	\$ 5.50	\$ 3.95	\$ 3.29	\$ 3.00	\$ 1.57
Diluted earnings per share	\$ 5.50	\$ 3.95	\$ 3.29	\$ 3.00	\$ 1.57
Dividends per common share	\$ 0.56	\$ 0.40	\$ 0.34	\$ 0.28	\$ 0.12
Return on average assets	1.15%	.94%	0.91%	0.92%	0.56%
Return on average equity	17.52%	14.49%	14.41%	16.12%	7.93%
Average equity to average assets	6.55%	6.49%	6.31%	5.68%	7.01%

⁽¹⁾ Includes interest-earning deposits, time deposits, investment securities, and Federal Home Loan Bank stock.



Independent Auditors' Report

Board of Directors
KS Bancorp, Inc.
Smithfield, North Carolina

Opinion

We have audited the consolidated financial statements of KS Bancorp, Inc. and subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and 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.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of KS Bancorp, Inc. and subsidiary as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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



In performing an audit in accordance with GAAS, we:

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

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

Dixon Hughes Goodman LLP

**Greenville, NC
March 24, 2022**

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Financial Condition
December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
ASSETS		
Cash and due from banks:		
Interest-earning	\$ 111,762,493	\$ 24,720,242
Noninterest-earning	2,625,789	3,127,631
Time deposits	5,100,000	100,000
Investment securities available for sale, at fair value	88,320,472	71,714,019
Federal Home Loan Bank stock, at cost	1,442,900	1,850,700
Loans	350,666,848	373,237,503
Less allowance for loan losses	<u>(5,022,525)</u>	<u>(4,644,311)</u>
Net loans	345,644,323	368,593,192
Accrued interest receivable	1,542,746	1,934,540
Foreclosed assets, net	620,650	620,650
Property and equipment, net	8,927,623	8,709,197
Other assets	<u>5,238,092</u>	<u>4,457,663</u>
Total assets	<u>\$ 571,225,088</u>	<u>\$ 485,827,834</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	\$ 487,436,823	\$ 402,522,651
Short-term borrowings	1,000,000	-
Long-term borrowings	42,248,000	47,248,000
Accrued interest payable	216,081	245,862
Accrued expenses and other liabilities	<u>3,679,418</u>	<u>3,790,351</u>
Total liabilities	<u>534,580,322</u>	<u>453,806,864</u>
Commitments and contingencies (Note 8)		
Stockholders' Equity:		
Common stock, no par value, authorized 20,000,000 shares; 1,107,776 shares issued and outstanding at December 31, 2021 and 2020, respectively	1,359,452	1,359,452
Retained earnings, substantially restricted	34,693,340	29,219,508
Accumulated other comprehensive income	<u>591,974</u>	<u>1,442,010</u>
Total stockholders' equity	<u>36,644,766</u>	<u>32,020,970</u>
Total liabilities and stockholders' equity	<u>\$ 571,225,088</u>	<u>\$ 485,827,834</u>

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Interest and dividend income:		
Loans, including fees	\$ 18,033,317	\$ 17,501,071
Investment securities:		
Taxable	1,083,622	1,170,410
Tax-exempt	549,152	216,036
Dividends	55,500	87,500
Interest-earning deposits	<u>83,643</u>	<u>22,315</u>
Total interest and dividend income	<u>19,805,234</u>	<u>18,997,332</u>
Interest expense:		
Deposits	1,023,164	2,232,955
Borrowings	<u>1,121,282</u>	<u>1,355,607</u>
Total interest expense	<u>2,144,446</u>	<u>3,588,562</u>
Net interest income	17,660,788	15,408,770
Provision for loan losses	<u>369,000</u>	<u>561,000</u>
Net interest income after provision for loan losses	<u>17,291,788</u>	<u>14,847,770</u>
Noninterest income:		
Service charges on deposit accounts	1,144,653	1,058,727
Fees from trust services	983,124	813,898
Fees from presold mortgages	56,259	168,815
Income from bank owned life insurance	214,500	232,500
Gain on sale of investment	-	3,653
Other	<u>477,609</u>	<u>339,577</u>
Total noninterest income	<u>2,876,145</u>	<u>2,617,170</u>
Noninterest expenses:		
Compensation and benefits	7,674,670	7,359,462
Occupancy and equipment	1,535,050	1,438,414
Data processing	960,471	936,046
Advertising	71,007	108,516
FDIC and other insurance	431,180	298,076
Professional services	574,181	608,057
Telephone and network services	323,180	290,156
Other	<u>886,007</u>	<u>839,009</u>
Total noninterest expenses	<u>12,455,746</u>	<u>11,877,736</u>
Income before income taxes	7,712,187	5,587,204
Income tax expense	<u>1,618,000</u>	<u>1,216,000</u>
Net income	<u>\$ 6,094,187</u>	<u>\$ 4,371,204</u>
Basic and diluted earnings per share	<u>\$ 5.50</u>	<u>\$ 3.95</u>

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Net income	\$ 6,094,187	\$ 4,371,204
Other comprehensive income (loss)		
Securities available for sale:		
Unrealized gain (loss) on available for sale securities	(1,103,655)	1,647,835
Tax effect	<u>253,619</u>	<u>(379,596)</u>
	<u>(850,036)</u>	<u>1,268,239</u>
Reclassification of gains on sales of available for sale securities	-	(3,653)
Tax effect	<u>-</u>	<u>839</u>
	<u>-</u>	<u>(2,814)</u>
Other comprehensive (loss) income, net of taxes	<u>(850,036)</u>	<u>1,265,425</u>
Comprehensive income	<u>\$ 5,244,151</u>	<u>\$ 5,636,629</u>

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2021 and 2020

	<u>Common Stock</u>		<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance, December 31, 2019	1,107,776	\$ 1,359,452	\$ 25,291,414	\$ 176,585	\$ 26,827,451
Net income	-	-	4,371,204		4,371,204
Redemption of common stock	-	-	-	1,265,425	1,265,425
Cash dividends paid on common stock	-	-	(443,110)	-	(443,110)
Balance, December 31, 2020	<u>1,107,776</u>	<u>1,359,452</u>	<u>\$29,219,508</u>	<u>1,442,010</u>	<u>32,020,970</u>
Net income	-	-	6,094,187	-	6,094,187
Other comprehensive loss, net of taxes	-	-	-	(850,036)	(850,036)
Cash dividends paid on common stock	-	-	(620,355)	-	(620,355)
Balance, December 31, 2021	<u>1,107,776</u>	<u>\$ 1,359,452</u>	<u>\$ 34,693,340</u>	<u>\$ 591,974</u>	<u>\$ 36,644,766</u>

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
Cash Flows from Operating Activities:		
Net income	\$ 6,094,187	\$ 4,371,204
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	678,172	634,475
Net accretion and amortization	489,573	233,855
Deferred income taxes	(122,720)	(111,493)
Provision for loan losses	369,000	561,000
Gain on available-for-sale securities	-	(3,653)
Income from bank owned life insurance	(214,500)	(232,500)
Gain on sale of property and equipment	-	(11,186)
Changes in assets and liabilities:		
Decrease (increase) in:		
Other assets	(189,590)	497,386
Accrued interest receivable	391,794	(789,225)
Increase (decrease) in:		
Accrued interest payable	(29,781)	(149,877)
Accrued expenses and other liabilities	(110,933)	522,743
Net cash provided by operating activities	<u>7,355,202</u>	<u>5,522,729</u>
Cash Flows used by Investing Activities:		
Proceeds from maturities, prepayments, and calls of available-for-sale securities	16,197,515	19,615,579
Proceeds from sales of available-for-sale securities	-	1,756,020
Purchase of available for sale securities	(39,397,196)	(24,521,736)
Proceeds (purchase) of Federal Home Loan Bank stock	407,800	(87,900)
Net change in loans receivable	22,579,869	(61,920,015)
Proceeds from sale of property and equipment	-	37,100
Purchase of property and equipment	(896,598)	(1,337,145)
Net cash used by investing activities	<u>(1,108,610)</u>	<u>(66,458,097)</u>

KS Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2021 and 2020

(Continued)

	<u>2021</u>	<u>2020</u>
Cash Flows from Financing Activities:		
Net increase in deposits	\$ 84,914,172	\$ 75,604,051
Repayment of borrowings	(5,000,000)	(26,000,000)
Proceeds from borrowings	1,000,000	27,000,000
Cash dividends paid	<u>(620,355)</u>	<u>(443,110)</u>
Net cash provided by financing activities	<u>80,293,817</u>	<u>76,160,941</u>
Net increase in cash and cash equivalents	86,540,409	15,225,573
Cash and cash equivalents:		
Beginning	<u>27,847,873</u>	<u>12,622,300</u>
Ending	<u>\$ 114,388,282</u>	<u>\$ 27,847,873</u>
Supplemental Disclosure of Cash Flow Information:		
Cash payments for:		
Interest	<u>\$ 2,174,227</u>	<u>\$ 3,738,439</u>
Income taxes	<u>\$ 2,100,000</u>	<u>\$ 781,000</u>
Supplemental Disclosure of Noncash Investing and Financing Activities:		
Transfer from loans to real estate acquired in settlement of loans	<u>\$ -</u>	<u>\$ 620,650</u>
Change in unrealized gains (losses) on available for sale securities, net	<u>\$ (850,036)</u>	<u>\$ 1,265,425</u>

Notes to Consolidated Financial Statements

1. Nature of Business and Significant Accounting Policies

Organization and operations

In December 1993, pursuant to a Plan of Conversion approved by its members and regulators, Kenly Savings Bank, Inc., SSB amended and restated its charter to effect its conversion from a North Carolina-chartered mutual savings bank to a North Carolina-chartered stock savings bank and became a wholly owned subsidiary of KS Bancorp, Inc. ("KS Bancorp"), a holding company formed in connection with the conversion. On January 1, 1999, Kenly Savings Bank, Inc., SSB changed its name to KS Bank, Inc. (the "Bank"). On August 17, 2018, the Company changed its corporate charter from a North Carolina corporation to a Delaware corporation. The Bank conducts its operations through nine full-service branches in eastern North Carolina. In addition, the Company has a Trust Services department through which it offers a complete line of trust services, such as money management, IRAs, trust administration and estate administration.

The Bank's operations are primarily retail oriented and directed toward individuals and small to medium-sized businesses located in our banking market. The Bank provides traditional banking services which include taking of demand deposits and the making of consumer and commercial loans. The Bank's primary source of revenue is the interest income derived from its lending activities.

Basis of presentation

The consolidated financial statements include the accounts and transactions of KS Bancorp and its wholly owned subsidiary, KS Bank, Inc. KS Bancorp and the Bank are collectively referred to as the "Company". All significant intercompany transactions have been eliminated. In 2005, the Company formed KS Capital Trust I, a stand-alone trust, to facilitate the issuance of trust preferred securities totaling \$5.0 million. In 2006, the Company formed KS Statutory Trust II, a stand-alone trust, to facilitate the issuance of trust preferred securities totaling \$3.0 million (collectively, these are referred to as the "Trusts"). The Trusts are not consolidated in these financial statements under generally accepted accounting principles. The junior subordinated debentures issued by the Company to the Trusts are included in long-term obligations, and the Company's equity interests in the Trusts are included in other assets.

Use of estimates

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 the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, foreclosed real estate and repossessions, and income taxes.

Cash and cash equivalents

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

Time Deposits

Certificates of deposits with banks currently have original maturities ranging from January 2022 through October 2026 and bear interest at rates ranging from .02% to 2.80%. None of the certificates of deposits have maturities of three months or less at the time of origination.

Investment securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. Loans that are current or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt (as determined by the contractual terms of the note). Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms.

While a loan (including an impaired loan) is classified as nonaccrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to the principal outstanding. When the future collectability of the recorded loan balance is not in doubt, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged-off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

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 uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, regulatory examiners may require the Bank to recognize adjustments to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

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

and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Presold mortgages in process of settlement

As a part of normal business operations, the Bank originates residential mortgage loans that have been pre-approved by secondary investors. The terms of the loans are set by the secondary investors and are transferred to them at par within several weeks of the Bank initially funding the loan. The Bank receives origination fees from borrowers and servicing release premiums from the investors that are recognized on the income statement in the line item "fees from presold mortgages." Between the initial funding of the loans by the Bank and the subsequent reimbursement by the investors, the Bank carries the loans on its consolidated statements of financial condition at cost.

Foreclosed real estate and repossessions

Real estate acquired through, or in lieu of, loan foreclosure is initially recorded at fair value, less estimated selling costs, at the date of foreclosure establishing a new cost basis. After foreclosure, valuations of the property are periodically performed by management, and the real estate is carried at fair value minus estimated cost to sell the property. Revenue and expenses from operations and changes in the valuation allowance are included in foreclosed real estate expense.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. The estimated lives for buildings and improvements are 10 to 40 years, and the estimated lives for furniture and equipment range from 3 to 20 years. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred, and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts, and any gains or losses are reflected in current operations.

Bank owned life insurance

The Company has purchased life insurance policies on certain key executives. Company owned life insurance, included in other assets, is recorded at its cash surrender value or the amount that can be realized totaling \$2,471,660 and \$2,329,176 at December 31, 2021 and 2020, respectively.

Federal Home Loan Bank stock

As a requirement for membership, the Bank invests in stock of the Federal Home Loan Bank of Atlanta ("FHLB"). These securities can only be redeemed or sold at their par value and only to the respective member institution. The Bank records this investment at cost and periodically evaluates the investment for impairment. Accordingly, when evaluating the investment for impairment, management considers the ultimate recoverability of the par value rather than recognizing temporary declines in value. The Bank determined this investment was not impaired at December 31, 2021.

Revenue Recognition

The Company generally acts in a principal capacity, on its own behalf, in its contracts with customers. In these transactions, revenues are recognized with related costs to generate those revenues on a gross basis. Descriptions of noninterest revenue-generating activities are as follows.

Service Charges on Deposit Accounts - Service charges on personal and business demand deposit accounts consist of insufficient funds fees, monthly service fees, check orders, and other deposit account related fees. The Company's performance obligations include maintaining customer's deposit account(s), executing transactions, providing interest per the terms of the various account agreements, and making funds available upon maturity or at customer demand. For all revenue streams, transaction prices are disclosed with a single performance obligation

applicable to each transaction. The Company has determined the service fees are recognized at a point in time and monthly service fees are earned over the statement period.

Other Fees and Income - Other fees and income primarily consist of debit and credit card income, automated teller machines ("ATM") fees, merchant services income, and other service charges. Debit and credit card income primarily consists of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant service income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Other fees and income also include other recurring revenue streams such as safety deposit rental fees and other miscellaneous revenue streams. Safe deposit boxes rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur consistent over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Sale of Foreclosed Real Estate - Income derived from contractual sales of Foreclosed Real Estate primarily consist of revenues derived from the exchange of the foreclosed asset for consideration. The Company's performance obligation is to provide access and transfer control of the specified properties to the buyer. Transaction prices are agreed upon purchase prices as stated within contracts. The transaction price is allocated entirely to the performance obligation, which is satisfied at a point in time upon the date of sale.

Income taxes

Income tax expense is based on consolidated net income and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting. The Company uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company's assets and liabilities at enacted rates expected to be in effect when such amounts are recovered or settled.

The Company has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2021 and 2020. Interest and penalties related to income tax assessments, if any, are reflected in income taxes in the accompanying consolidated statements of income.

Earnings per share

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. There were no outstanding dilutive instruments during the years ended December 31, 2021 and 2020.

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet. These items, along with net income, are included as components of comprehensive income. Unrealized gains and losses on available for sale securities are the Company's only component of accumulated other comprehensive income.

Off-balance-sheet risk

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

Subsequent Events

In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through March 24, 2022, the date the consolidated financial statements were available to be issued.

New accounting standards

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). This new guidance replaces the incurred loss impairment methodology in current standards with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. On October 16, 2019, the FASB voted to delay implementation of CECL until years beginning after December 15, 2022 for certain entities, including public business entities such as the Company. The Company will be running dual models beginning the second quarter of 2022 and is still assessing the impact that this new guidance will have on its consolidated financial statements.

ASU 2020-04, "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." ASU 2020-04 provides optional expedients and exceptions for accounting related to contracts, hedging relationships and other transactions affected by reference rate reform if certain criteria are met. ASU 2020-04 applies only to contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform and do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, that an entity has elected certain optional expedients for and that are retained through the end of the hedging relationship. ASU 2020-04 was effective upon issuance and generally can be applied through December 31, 2022. The adoption of ASU 2020-04 did not significantly impact our financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations and cash flows.

2. Investment Securities

The amortized cost and fair value of securities available for sale, with gross unrealized gains and losses, follows:

	2021			Estimated Market Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available for sale:				
Municipal securities	\$ 43,537,049	\$ 475,632	\$ (210,674)	\$ 43,802,007
Mortgage-backed securities - GSEs	30,922,320	531,259	(81,523)	31,372,056
Federal agency securities	2,592,505	49,929	-	2,642,434
Corporate securities	10,500,000	3,975	-	10,503,975
	<u>\$ 87,551,874</u>	<u>\$ 1,060,795</u>	<u>\$ (292,197)</u>	<u>\$ 88,320,472</u>
		2020		Estimated
		Gross	Gross	Estimated

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	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Market Value</u>
Available for sale:				
Municipal securities	\$ 23,575,995	\$ 429,726	\$ (15,680)	\$ 23,990,041
Mortgage-backed securities - GSEs	38,721,265	1,296,989	-	40,018,254
Federal agency securities	3,544,506	161,218	-	3,705,724
Corporate securities	<u>4,000,000</u>	<u>-</u>	<u>-</u>	<u>4,000,000</u>
	<u>\$ 69,841,766</u>	<u>\$ 1,887,933</u>	<u>\$ (15,680)</u>	<u>\$ 71,714,019</u>

The amortized cost and estimated market value of investment securities at December 31, 2021 by contractual maturity are as shown below. The amortized cost and estimated market value of mortgage-backed securities by contractual maturities are not reported because the actual maturities may be, and often are, significantly different from contractual maturities.

	<u>Amortized Cost</u>	<u>Estimated Market Value</u>
Available for sale:		
Due in next 12 months	\$ 230,000	\$ 230,532
Due after one year through five years	1,048,439	1,082,398
Due after five years through ten years	2,910,531	2,934,015
Due after excess of ten years	<u>52,440,584</u>	<u>52,701,471</u>
	<u>\$ 56,629,554</u>	<u>\$ 56,948,416</u>

There were no proceeds for securities sold for the year ended December 31, 2021. For the years ended December 31, 2020, proceeds from sales of securities available for sale amounted to \$1,756,020 and gross realized gains were \$9,671 and losses were \$6,018. There were no impairments recognized in 2021 or 2020.

Securities with a carrying value of approximately \$40,420,000 and \$28,752,000 at December 31, 2021 and 2020, respectively, were pledged to secure public monies on deposit, advances from the Federal Home Loan Bank and to secure the line of credit with the Federal Reserve and to secure a federal funds line of credit.

The following tables show investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2021 and 2020. The unrealized losses relate to debt securities that have incurred fair value reductions due to higher market interest rates since the securities were purchased. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, and considering that management has the intent and ability to hold these investments until recovery, none of the securities are deemed to be other than temporarily impaired. If management determines that it is not probable that the market value of these securities will recover to the Company's adjusted cost, the Company would record a charge to earnings to reflect the other-than-temporary impairment of the securities. At December 31, 2021, unrealized losses on investment securities relate to eleven municipal securities and eight mortgage-backed securities. At December 31, 2020, unrealized losses on investment securities relate to three municipal securities.

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	2021					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
Municipal securities	\$ 12,345,272	\$ (84,425)	\$ 3,036,100	\$ (126,249)	\$ 15,381,372	\$ (210,674)
Mortgage-backed securities	5,998,337	(66,066)	731,564	(15,457)	6,729,901	(81,523)
Total temporarily impaired securities	<u>\$ 18,343,609</u>	<u>\$ (150,491)</u>	<u>\$ 3,767,664</u>	<u>\$ (141,706)</u>	<u>\$ 22,111,273</u>	<u>\$ (292,197)</u>

	2020					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
Municipal securities	\$ 2,525,924	\$ (15,680)	\$ -	\$ -	\$ 2,525,924	\$ (15,680)
Mortgage-backed securities	-	-	-	-	-	-
Total temporarily impaired securities	<u>\$ 2,525,924</u>	<u>\$ (15,680)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,525,924</u>	<u>\$ (15,680)</u>

3. Loans

Loans consist of the following:

	2021	2020
Commercial real estate owner occupied	\$ 73,532,454	\$ 71,346,267
Commercial real estate non-owner occupied	62,152,260	61,089,960
Other construction, land development, and other land loans	41,731,209	45,536,985
Paycheck protection program loans	-	26,050,436
Commercial and industrial	12,495,465	15,729,499
Residential real estate construction	30,574,764	28,534,585
Residential 1-4 family first mortgage	101,120,513	89,631,266
Other loans	<u>29,060,183</u>	<u>35,318,505</u>
	350,666,848	373,237,503
Allowance for loan losses	<u>(5,022,525)</u>	<u>(4,644,311)</u>
	<u>\$ 345,644,323</u>	<u>\$ 368,593,192</u>

The loans presented above are net of unamortized loan fees of \$910,493 and \$1,320,436 at December 31, 2021 and 2020, respectively. Included within loans above are overdraft protection accounts of \$120,988 and \$145,715 at December 31, 2021 and 2020, respectively.

The following describe the risk characteristics relevant to each of the portfolio segments.

Commercial Real Estate

Commercial real estate loans are extensions of credit secured by both owner and non-owner-occupied collateral. In either case, underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies. Such repayment of owner-occupied loans is commonly derived from the successful ongoing operations of the business occupying the property. These may include small businesses, professional practices, and religious organizations. Non-owner-occupied loans include those credits financing commercial and multifamily rental

properties and, thus, typically present a higher risk than owner-occupied loans. All loans in the commercial real estate category are underwritten and assigned a risk grade at origination. Furthermore, nearly all of these loans carry call features whereby the note matures on regular intervals, prompting full underwriting and risk review based on the borrower's current financial condition.

Other Construction, Land Development and Other Land Loans

Construction and land development loans are short-term structures for the purpose of acquisition and development of land or lots to be improved through the construction of commercial or residential buildings. Such loans are usually paid off through the sale of the subject property upon completion or converted to permanent financing for the long-term benefit of the borrower's ongoing operations. Underwriting of these loans typically includes analysis of not only the borrower's financial condition and ability to meet the required debt obligations, but also the general market conditions associated with the area and type of project being funded. All loans in this category are underwritten at origination and assigned a risk grade which is generally commensurate with the elevated risks associated with speculative real estate in a fluctuating economic environment. The short-term nature of these loans ultimately results in the opportunity for the Bank to review those credits that are not paid off via disposition or converted to the appropriate permanent loan structure by the maturity of the original note.

Paycheck Protection Program

With the passage of the Paycheck Protection Program ("PPP"), administered by the Small Business Administration ("SBA"), the Company actively assisted its customers with loan applications through the program. PPP loans have a two- or five-year term and earn interest at 1%. Loans funded through the PPP program are guaranteed by the SBA and loans that meet certain regulatory criteria are subject to forgiveness. As of December 31, 2021, there were no PPP loans outstanding due to full forgiveness.

Commercial and Industrial

Commercial and industrial loans (C&I) receive similar underwriting treatment as commercial real estate loans in that the repayment source is analyzed to determine its ability to meet cash flow coverage requirements as set forth by Bank policies. C&I loans often require borrowers to produce finished products from raw materials and inventory that are then sold, thus converting the asset into cash for repayment. This asset-conversion cycle itself brings a certain level of risk to the portfolio. In some instances, these loans may carry a higher degree of risk due to a variety of reasons – illiquid collateral, specialized equipment, highly depreciable assets, uncollectable accounts receivable, revolving balances, or simply being unsecured. As a result of this risk, most commercial and industrial loans are extended as part of a larger relationship that may include substantial deposit accounts or additional lending facilities with a borrower or guarantor. These loans are risk graded at inception, and with a typically short-term maturity, re-evaluated at regular intervals for credit-worthiness and collateral evaluation.

Residential Real Estate

Residential real estate loans represent one of the Bank's core lending activities. This portfolio is largely made up of residential real estate construction loans and permanent mortgages to borrowers secured by first lien deeds of trust on 1 to 4 family residences. Residential construction loans are usually converted to permanent financing. Typically referred to as mortgage loans, the Bank underwrites these credits according to established Bank policies similar to those of the "secondary market". Evaluation criteria include but are not limited to the following: debt-to-income ratio, collateral loan-to-value, consumer credit score, consumer credit history, liquid assets, overall net worth, and repayment terms. While these loans are usually made to finance a borrower's primary residence, some credits in this category are extended as 1 to 4 family residential rental loans whereby repayment is derived from the rent or lease income of the subject property. In these instances, borrowers are further analyzed on secondary sources of repayment in addition to substantially more conservative loan terms to account for the non-owner-occupied nature of the collateral.

Similar to loans in the commercial real estate category, all loans in this category are underwritten and assigned a risk grade at origination. In contrast to residential mortgages, the majority of 1 to 4 family rental loans receives periodic reviews and/or is subject to loan call dates whereby the note matures on regular intervals, prompting full underwriting and risk review based on the borrower's current financial condition.

Other Loans

Other loans consist of multifamily loans, home equity loans, 1-4 family junior liens plus consumer loans including overdraft protection and vehicle financing. These loans may fall in either the consumer or commercial portfolio, depending on the purpose of the funds. While multifamily loans are heavily dependent upon cash flows from rental activities, the remainders of these loans are underwritten using basic consumer loan standards – debt-to-income ratio, collateral loan-to-value, consumer credit score, consumer credit history, liquid assets, overall net worth, and repayment terms. Exclusive of the multifamily (commercial) loans, most loans in this category are assigned a risk rating at inception and placed on fully amortizing notes without a call date.

Loans outstanding to the Company's officers and directors (including their affiliates) are shown below. In the opinion of management, these loans were made at lending terms and rates available to the general public and do not involve more than the normal risks of collectability.

	<u>2021</u>	<u>2020</u>
Balance, beginning	\$ 971,523	\$ 1,502,807
Originations and transfers in	20,050	209,577
Repayments	<u>(190,131)</u>	<u>(740,861)</u>
Balance, ending	<u>\$ 801,442</u>	<u>\$ 971,523</u>

Loans are monitored for credit quality on a recurring basis, and the composition of the loans outstanding at December 31, 2021 and 2020 by credit quality indicator is provided below. The credit quality indicators used are dependent on the portfolio segment to which the loan relates.

The loan credit quality indicators for residential 1-4 family first mortgage loans are developed based on the past due status of the individual loans. Loan credit quality indicators for all other loans within the portfolio are developed through review of individual borrowers on an ongoing basis. The indicators represent the rating for loans as of the date presented based on the most recent assessment performed.

These credit quality indicators are defined as follows:

Pass (1 to 5) – Within the table below, Pass includes all loans risk graded higher than Special Mention. A pass rated loan is not adversely classified because it does not display any of the characteristics for adverse classification and has little identified risk of collection.

Special mention (6) – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention loans are not adversely classified and do not warrant adverse classification.

Substandard (7) – Within the table below, Substandard includes all loans risk graded lower than Special Mention. A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful (8) – These loans have all the weaknesses of substandard, nonaccruing loans plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values highly questionable and improbable.

Loss (9) – These loans are considered uncollectable and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off these loans even though partial recovery may be affected in the future.

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The loan credit quality indicators for each loan class are as follows:

**Credit Quality Indicators
As Of December 31, 2021**

Grade:	<u>Commercial Real Estate</u>		<u>Development, Commercial and Other Land Loans</u>	<u>Commercial and Industrial</u>	<u>Residential Real Estate Construction</u>	<u>Other Loans</u>	<u>Total</u>
	<u>Owner Occupied</u>	<u>Non-Owner Occupied</u>					
Pass	\$73,532,454	\$60,444,116	\$ 41,731,209	\$ 11,309,997	\$30,574,764	\$ 29,060,183	\$ 246,652,723
Special Mention	-	360,812	-	1,154,501	-	-	1,515,313
Substandard	-	1,347,332	-	30,967	-	-	1,378,299
Total	<u>\$73,532,454</u>	<u>\$62,152,260</u>	<u>\$ 41,731,209</u>	<u>\$ 12,495,465</u>	<u>\$30,574,764</u>	<u>\$ 29,060,183</u>	<u>\$ 249,546,335</u>

**Credit Quality Indicators
As Of December 31, 2020**

Grade:	<u>Commercial Real Estate</u>		<u>Development, Commercial and Other Land Loans</u>	<u>PPP</u>	<u>Commercial and Industrial</u>	<u>Residential Real Estate Construction</u>	<u>Other Loans</u>	<u>Total</u>
	<u>Owner Occupied</u>	<u>Non-Owner Occupied</u>						
Pass	\$70,238,262	\$61,089,960	\$ 45,453,171	\$ 26,050,436	\$14,442,017	\$ 28,534,585	\$ 35,017,258	\$ 280,825,689
Special Mention	561,861	-	-	-	1,255,004	-	216,805	2,033,670
Substandard	546,144	-	83,814	-	32,478	-	84,442	746,878
Total	<u>\$71,346,267</u>	<u>\$61,089,960</u>	<u>\$ 45,536,985</u>	<u>\$ 26,050,436</u>	<u>\$15,729,499</u>	<u>\$ 28,534,585</u>	<u>\$ 35,318,505</u>	<u>\$ 283,606,237</u>

The loan credit quality indicators for residential 1-4 family are as follows:

	Residential 1-4 Family First Mortgage	
	<u>2021</u>	<u>2020</u>
Current	\$ 100,723,887	\$ 89,146,889
1 - 29 Days Past Due	151,230	-
30 - 59 Days Past Due	208,908	332,418
60 - 89 Days Past Due	36,488	108,995
Greater Than 90 Days	-	42,964
	<u>\$ 101,120,513</u>	<u>\$ 89,631,266</u>

The aging of the outstanding loans by class at December 31, 2021 and 2020 is provided in the table below. The calculation of days past due begins on the day after payment is due and includes all days through which all required interest or principal have not been paid. Loans less than 30 days past due are considered current due to certain grace periods that allow borrowers to make payments within a stated period after the due date and still remain in compliance with the loan agreement.

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December 31, 2021

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater Than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Financing Receivables</u>	<u>Recorded Investment > 90 Days and Accruing</u>
Commercial Real Estate:							
Owner Occupied	\$ -	\$ -	\$ -	\$ -	\$ 73,532,454	\$ 73,532,454	\$ -
Nonowner Occupied	-	-	-	-	62,152,260	62,152,260	-
Other Construction, Land Development, and Other Land Loans	-	-	-	-	41,731,209	41,731,209	-
Paycheck Protection Program loans	-	-	-	-	-	-	-
Commercial and Industrial	-	-	-	-	12,495,465	12,495,465	-
Residential Real Estate Construction	-	-	-	-	30,574,764	30,574,764	-
Residential 1-4 Family First Mortgage	208,908	36,488	-	245,396	100,875,117	101,120,513	-
Other Loans	104,494	633	-	105,127	28,955,056	29,060,183	-
	<u>\$ 313,402</u>	<u>\$ 37,121</u>	<u>\$ -</u>	<u>\$ 350,523</u>	<u>\$350,316,325</u>	<u>\$350,666,848</u>	<u>\$ -</u>

December 31, 2020

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater Than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Financing Receivables</u>	<u>Recorded Investment > 90 Days and Accruing</u>
Commercial Real Estate:							
Owner Occupied	\$ -	\$ -	\$ -	\$ -	\$ 71,346,267	\$ 71,346,267	\$ -
Nonowner Occupied	-	-	-	-	61,089,960	61,089,960	-
Other Construction, Land Development, and Other Land Loans	33,000	-	-	33,000	45,503,985	45,536,985	-
Paycheck Protection Program loans	-	-	-	-	26,050,436	26,050,436	-
Commercial and Industrial	-	-	-	-	15,729,499	15,729,499	-
Residential Real Estate Construction	-	-	-	-	28,534,585	28,534,585	-
Residential 1-4 Family First Mortgage	332,418	108,995	42,963	484,376	89,146,890	89,631,266	-
Other Loans	56,102	12,313	1,726	70,141	35,248,364	35,318,505	-
	<u>\$ 421,520</u>	<u>\$ 121,308</u>	<u>\$ 44,689</u>	<u>\$ 587,517</u>	<u>\$372,649,986</u>	<u>\$373,237,503</u>	<u>\$ -</u>

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The following tables provide information on impaired loans at December 31, 2021 and 2020, including interest income recognized in the period during which the loans were considered impaired. The recorded investment balance does not include accrued interest receivable.

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment (1)</u>	<u>Interest Income Recognized</u>
2021					
With no related allowance recorded:					
Commercial Real Estate:					
Owner Occupied	\$ 1,721,344	\$ 1,727,586	\$ -	\$ 1,756,763	\$ 86,852
Nonowner Occupied	1,024,207	1,024,207	-	1,039,148	41,642
Other Construction, Land Development and Other					
Land Loans	120,496	161,235	-	132,680	12,761
Commercial and Industrial	180,031	180,031	-	193,123	17,254
Residential Real Estate					
Construction	-	-	-	-	-
Residential 1-4 Family					
First Mortgage	1,126,062	1,159,171	-	1,173,343	57,202
Other Loans	249,200	281,933	-	273,284	15,755
Total	<u>\$ 4,421,340</u>	<u>\$ 4,534,163</u>	<u>\$ -</u>	<u>\$ 4,568,341</u>	<u>\$ 231,466</u>
With an allowance recorded:					
Commercial Real Estate:					
Owner Occupied	\$ -	\$ -	\$ -	\$ -	\$ -
Nonowner Occupied	-	-	-	-	-
Real Estate Construction	-	-	-	-	-
Other Construction, Land Development and Other					
Land Loans	-	-	-	-	-
Commercial and Industrial	-	-	-	-	-
Residential 1-4 Family					
First Mortgage	-	-	-	-	-
Other Loans	-	-	-	-	-
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Total:					
Commercial	\$ 3,046,078	\$ 3,093,059	\$ -	\$ 3,121,714	\$ 158,509
Consumer	249,200	281,933	-	273,284	15,755
Residential	<u>1,126,062</u>	<u>1,159,171</u>	<u>-</u>	<u>1,173,343</u>	<u>57,202</u>
Total	<u>\$ 4,421,340</u>	<u>\$ 4,534,163</u>	<u>\$ -</u>	<u>\$ 4,568,341</u>	<u>\$ 231,466</u>

(1) The average recorded investments represent the average of the recorded investments of impaired loans at December 31, 2021.

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment (1)</u>	<u>Interest Income Recognized</u>
2020					
With no related allowance recorded:					
Commercial Real Estate:					
Owner Occupied	\$ 943,768	\$ 950,010	\$ -	\$ 958,930	\$ 48,008
Nonowner Occupied	1,056,718	1,056,718	-	1,071,094	43,036
Other Construction, Land Development and Other					
Land Loans	147,177	187,916	-	158,438	14,817
Commercial and Industrial	262,367	262,367	-	272,258	25,834
Residential Real Estate					
Construction	-	-	-	-	-
Residential 1-4 Family					
First Mortgage	1,283,726	1,326,588	-	1,318,123	64,876
Other Loans	412,071	447,130	-	440,108	27,575
Total	<u>\$ 4,105,827</u>	<u>\$ 4,230,729</u>	<u>\$ -</u>	<u>\$ 4,218,951</u>	<u>\$ 224,146</u>

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With an allowance recorded:

Commercial Real Estate:					
Owner Occupied	\$ -	\$ -	\$ -	\$ -	\$ -
Nonowner Occupied	-	-	-	-	-
Real Estate Construction	-	-	-	-	-
Other Construction, Land Development and Other Land Loans	-	-	-	-	-
Commercial and Industrial	-	-	-	-	-
Residential 1-4 Family First Mortgage	-	-	-	-	-
Other Loans	-	-	-	-	-
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Total:					
Commercial	\$ 2,410,030	\$ 2,457,011	\$ -	\$ 2,460,720	\$ 131,695
Consumer	412,071	447,130	-	440,108	27,575
Residential	<u>1,283,726</u>	<u>1,326,588</u>	<u>-</u>	<u>1,318,123</u>	<u>64,876</u>
Total	<u>\$ 4,105,827</u>	<u>\$ 4,230,729</u>	<u>\$ -</u>	<u>\$ 4,218,951</u>	<u>\$ 224,146</u>

(1) The average recorded investments represent the average of the recorded investments of impaired loans at December 31, 2021.

As of the year ended December 31, 2021, there was one loan modified as a troubled debt restructure. The carry amount for this loan at December 31, 2021 was \$809,663. There were no loans modified as troubled debt restructurings during the year ended December 31, 2020. There were no properties in the process of foreclosure at December 31, 2021 and December 31, 2020.

The recorded investment, by class, in loans on nonaccrual status at December 31, 2021 and 2020 is as follows:

	<u>2021</u>	<u>2020</u>
Commercial Real Estate:		
Owner Occupied	\$ 809,663	\$ -
Nonowner Occupied	-	-
Other Construction, Land Development and Other Land Loans	-	7,741
Commercial and Industrial	-	-
Residential 1-4 family first mortgage	92,568	291,021
Other loans	<u>-</u>	<u>629</u>
Total	<u>\$ 902,231</u>	<u>\$ 299,391</u>

Interest income that has not been recorded due to these loans being in nonaccrual status for 2021 and 2020 was approximately \$4 and \$734, respectively.

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The ending balances of loans and the related allowance presented by portfolio segment and allowance methodology as of December 31, 2021 and 2020 are as follows:

	Commercial Real Estate		Other Construction, Land Development, and Other Land Loans	Commercial and Industrial	Residential Real Estate Construction	Residential 1-4 Family First Mortgage	Other Loans	Total
	Owner Occupied	Non-Owner Occupied						
2021								
Allowance for credit losses:								
Beginning balance	\$ 922,802	\$ 676,362	\$ 1,237,894	\$ 406,282	\$ 286,084	\$ 761,651	\$ 353,236	\$ 4,644,311
Charge-offs	-	-	-	-	-	-	(4,233)	(4,233)
Recoveries	754	-	-	-	9,753	-	2,940	13,447
Provision	100,000	100,000	-	39,000	50,000	50,000	30,000	369,000
Ending balance	<u>\$ 1,023,556</u>	<u>\$ 776,362</u>	<u>\$ 1,237,894</u>	<u>\$ 445,282</u>	<u>\$ 345,837</u>	<u>\$ 811,651</u>	<u>\$ 381,943</u>	<u>\$ 5,022,525</u>
Ending balance, individually evaluated for impairment	-	-	-	-	-	-	-	-
Ending balance, collectively evaluated for impairment	<u>1,023,556</u>	<u>776,362</u>	<u>1,237,894</u>	<u>445,282</u>	<u>345,837</u>	<u>811,651</u>	<u>381,943</u>	<u>5,022,525</u>
Financing Receivables:								
Ending balance	\$ 73,532,454	\$ 62,152,260	\$ 41,731,209	\$ 12,495,465	\$ 30,574,764	\$ 101,120,513	\$ 29,060,183	\$ 350,666,848
Ending balance, individually evaluated for impairment	<u>1,721,344</u>	<u>1,024,207</u>	<u>120,496</u>	<u>180,031</u>	-	<u>1,126,062</u>	<u>249,200</u>	<u>4,421,340</u>
Ending balance, collectively evaluated for impairment	<u>\$ 71,811,110</u>	<u>\$ 61,128,053</u>	<u>\$ 41,610,713</u>	<u>\$ 12,315,434</u>	<u>\$ 30,574,764</u>	<u>\$ 99,994,451</u>	<u>\$ 28,810,983</u>	<u>\$ 346,245,508</u>

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	Commercial Real Estate		Other Construction, Land Development, and Other Land Loans	Commercial and Industrial	PPP	Residential Real Estate Construction	Residential 1-4 Family First Mortgage	Other Loans	Total
	Owner Occupied	Non-Owner Occupied							
2020									
Allowance for credit losses:									
Beginning balance	\$ 772,802	\$ 526,362	\$ 1,166,748	\$ 336,448	\$ -	\$ 236,084	\$ 711,651	\$ 306,451	\$ 4,056,546
Charge-offs	-	-	-	-	-	-	-	(8,921)	(8,921)
Recoveries	-	-	21,146	9,834	-	-	-	4,706	35,686
Provision	150,000	150,000	50,000	60,000	-	50,000	50,000	51,000	561,000
Ending balance	<u>\$ 922,802</u>	<u>\$ 676,362</u>	<u>\$ 1,237,894</u>	<u>\$ 406,282</u>	<u>\$ -</u>	<u>\$ 286,084</u>	<u>\$ 761,651</u>	<u>\$ 353,236</u>	<u>\$ 4,644,311</u>
Ending balance, individually evaluated for impairment	-	-	-	-	-	-	-	-	-
Ending balance, collectively evaluated for impairment	<u>922,802</u>	<u>676,362</u>	<u>1,237,894</u>	<u>406,282</u>	<u>-</u>	<u>286,084</u>	<u>761,651</u>	<u>353,236</u>	<u>4,644,311</u>
Financing Receivables:									
Ending balance	\$ 71,346,267	\$ 61,089,960	\$ 45,536,985	\$ 15,729,499	\$ 26,050,436	\$ 28,534,585	\$ 89,631,266	\$ 35,318,505	\$ 373,237,503
Ending balance, individually evaluated for impairment	943,768	1,056,718	147,177	262,367	-	-	1,283,726	412,071	4,105,827
Ending balance, collectively evaluated for impairment	<u>\$ 70,402,499</u>	<u>\$ 60,033,242</u>	<u>\$ 45,389,808</u>	<u>\$ 15,467,132</u>	<u>\$ 26,050,436</u>	<u>\$ 28,534,585</u>	<u>\$ 88,347,540</u>	<u>\$ 34,906,434</u>	<u>\$ 369,131,676</u>

4. Property and Equipment

Following is a summary of property and equipment at December 31, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Land	\$ 2,491,479	\$ 2,409,885
Buildings and improvements	8,952,478	8,448,015
Leasehold improvements	62,466	77,373
Furniture and equipment	<u>4,075,088</u>	<u>3,882,970</u>
	15,581,511	14,818,243
Accumulated depreciation	<u>(6,653,888)</u>	<u>(6,109,046)</u>
Total	<u>\$ 8,927,623</u>	<u>\$ 8,709,197</u>

Depreciation and amortization amounting to \$678,172 and \$634,475 for the years ended December 31, 2021 and 2020, respectively, is included in occupancy and equipment expense.

The Company leases a branch facility located in Wendell, NC under a 2-year lease term that will mature in February 2023. The Company also leases an additional property: an operation facility located in Smithfield, NC under a 3-year lease term that will mature in June 2023. Lease expense amounted to \$80,940 and \$83,390 for the years ended December 31, 2021 and 2020, respectively. Future lease expense related to these arrangements totals \$80,940 in 2022 and \$34,715 in 2023. The Company leases other equipment under immaterial lease arrangements that mature over the next 5 years.

Amounts recognized as right-of-use assets related to operating leases are included in other assets while lease liabilities are included in accrued expenses and other liabilities. As of December 31, 2021, right-of-use assets and lease liabilities related to operating leases was \$221,000.

5. Deposits

Deposits consist of the following:

	<u>2021</u>	<u>2020</u>
Regular savings accounts	\$ 28,737,480	\$ 21,893,245
NOW accounts	66,280,236	55,055,675
Money market deposit accounts	153,120,975	104,503,736
Noninterest-bearing accounts	140,708,213	116,911,414
Time deposits	<u>98,589,919</u>	<u>104,158,581</u>
	<u>\$ 487,436,823</u>	<u>\$ 402,522,651</u>

Time deposit accounts are summarized by maturity at December 31, 2021 as follows:

	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026 and Thereafter</u>	<u>Total</u>
Less than \$250,000	\$57,552,832	\$11,366,786	\$ 2,154,109	\$ 281,372	\$ 906,977	\$ 72,262,076
\$250,000 or more	<u>18,798,008</u>	<u>3,436,835</u>	<u>4,093,000</u>	-	-	<u>26,327,843</u>
	<u>\$76,350,840</u>	<u>\$14,803,621</u>	<u>\$ 6,247,109</u>	<u>\$ 281,372</u>	<u>\$ 906,977</u>	<u>\$ 98,589,919</u>

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The aggregate amount of time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2021 and 2020 was \$26,327,843 and \$27,592,868, respectively.

6. Borrowings

A summary of the balances of borrowings follows:

	<u>December 31,</u>	
	<u>2021</u>	<u>2020</u>
Short Term:		
Line of Credit	\$ 1,000,000	\$ -
Total short term borrowings	<u>1,000,000</u>	<u>-</u>
	<u>2021</u>	<u>2020</u>
Long term:		
Federal Home Loan Bank advances	\$ 32,000,000	\$ 35,000,000
Junior subordinated debentures	8,248,000	8,248,000
Subordinated debentures	<u>2,000,000</u>	<u>4,000,000</u>
Total long term borrowings	<u>42,248,000</u>	<u>47,248,000</u>
Total borrowings	<u>\$ 43,248,000</u>	<u>\$ 47,248,000</u>

The Company may purchase federal funds through a secured and unsecured federal funds line of credit agreement totaling \$17.0 million. These lines of credit are payable on demand and bear interest based upon the daily federal funds rate. The Company had no federal funds borrowings outstanding as of December 31, 2021 and at December 31, 2020. Additionally, the Company may borrow funds through a secured line of credit totaling \$5.8 million from the Federal Reserve discount window and a \$3.0 million loan commitment agreement from Community Bankers' Bank. These lines are intended for short term borrowings and are subject to restrictions limiting the frequency and term of advances. For year ended December 31, 2021, there was \$ 1.0 million with the maturity date of June 9, 2022 at the rate of 3.25% outstanding with the Community Banker's Bank.

The Company had no short-term advances from the FHLB at December 31, 2021 and 2020. Long-term advances from the FHLB consist of the following:

<u>Type</u>	<u>Maturing in Year Ending</u>	<u>Interest Rate</u>	<u>December 31,</u>	
			<u>2021</u>	<u>2020</u>
Fixed-Hybrid	2021	1.94%	\$ -	\$ 3,000,000
Fixed-Hybrid	2023	1.76%	4,000,000	4,000,000
Fixed-Hybrid	2024	2.84%	8,000,000	8,000,000
Fixed-Hybrid	2024	1.92%*	5,000,000	5,000,000
Fixed-Hybrid	2024	1.92%*	5,000,000	5,000,000
Fixed-Hybrid	2025	2.41%*	5,000,000	5,000,000
Fixed-Hybrid	2025	2.41%*	<u>5,000,000</u>	<u>5,000,000</u>
			<u>\$ 32,000,000</u>	<u>\$ 35,000,000</u>

*Periodically, the Bank may restructure fixed rate advances into fixed-hybrid rate advances with lower interest rates. Where applicable, interest rates presented for the new fixed-hybrid rate advances represent blended rates that incorporate the coupon rates, as well as a built-in spread to amortize the prepayment penalty over the life of the new advances. The actual coupon rate on the fixed-hybrid rate advances maturing in 2024 is .75%, and the coupon rate on the fixed-hybrid rate advances maturing in 2025 is .89%.

Pursuant to collateral agreements with the Federal Home Loan Bank (FHLB), advances are collateralized by all of the Company's FHLB stock, qualifying first mortgage loans, commercial real estate loans pledged in the form of a blanket-floating lien, and investment securities available for sale. The balance of qualifying first mortgage loans and commercial real estate loans as of December 31, 2021 was approximately \$135.0 million. This agreement with the FHLB provides for a line of credit up to 25% of the Bank's assets. The maximum amount outstanding under the line of credit at any month-end during 2021 was \$35.0 million. Additionally, the Bank has a \$13.0 million standby letter of credit which is used to secure public deposits.

In June of 2005 and September 2006, \$5.0 million and \$3.0 million, respectively, of trust preferred securities were placed through KS Capital Trust I (the "Trust I") and KS Statutory Trust II ("Trust II"). Trust I and Trust II (collectively, the "Trusts") were formed for the sole purpose of issuing trust preferred securities and investing the proceeds from the sale of such trust preferred securities in junior subordinated debentures. The debentures held by the Trusts are their sole assets. The Company owns 100% of the Trusts outstanding common securities and unconditionally guarantees the Trusts financial obligations. The debentures and the trust preferred securities of Trust I and Trust II bear an interest rate of LIBOR (London Inter-Bank Offered Rate) plus 1.66% and 1.70%, respectively. The trust preferred securities generally rank equal to the trust common securities in priority of payment, but will rank prior to trust common securities if, and so long as, the Company fails to make principal or interest payment on the debentures. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities of Trust I are redeemable on or after September 15, 2010, in whole or in part, and redemption is mandatory at June 27, 2035. The trust preferred securities of Trust II are redeemable on or after December 15, 2011, in whole or in part, and redemption is mandatory at December 15, 2036. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company.

The trust preferred securities issued by both Trust I and Trust II presently qualify as Tier 1 regulatory capital.

Subordinated debt in the amount of \$2.0 million was issued December 19, 2014, the proceeds from which were used to repay Cumulative Perpetual Preferred Stock then outstanding. The subordinated debt was scheduled to mature on December 19, 2019; however, it was refinanced on July 31, 2019. The subordinated debt pays interest quarterly, at the annual rate of 5.75% through July 31, 2022, and thereafter at the rate of 6.50% per annum. Interest is payable on March 15, June 15, September 15, and December 15 of each year commencing September 15, 2019, until the principal hereof is paid. The subordinated debt matures on July 31, 2024 and can be prepaid any time after August 1, 2021.

Subordinated debt in the amount of \$4.0 million was issued May 1, 2018, the proceeds from which were used to repurchase common stock. The subordinated debt pays interest quarterly, at the annual rate of 6.25% through April 30, 2023, and thereafter at the rate of LIBOR (to be defined at that time) plus 4%. Interest is payable on March 15, June 15, September 15, and December 15 of each year. The subordinated debt matures on May 16, 2028 and can be prepaid any time. In both September 2020 and July 2019, \$1.0 million of this subordinated debt was repaid. The remaining balance of \$2.0 million was paid in full in 2021.

7. Income Taxes

At December 31, 2021, retained earnings contain certain historical additions to bad debt reserves for income tax purposes in the amount of \$1,221,000 for which no deferred taxes have been provided because the Bank does not intend to use these reserves for purposes other than to absorb losses. If amounts which qualified as bad debt deductions are used for purposes other than to absorb bad debt losses or adjustments arising from the carryback of net operating losses, income taxes may be imposed at the then existing rates. In the future, if the Bank does not meet the income tax requirements necessary to permit the deduction of an allowance for bad debts, the Bank's effective tax rate would be increased to the maximum percent under existing law. Unrecorded deferred income taxes on Pre-1988 tax bad debt reserves amounted to approximately \$281,000 at December 31, 2021.

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Deferred tax assets and liabilities for the years ended December 31, 2021 and 2020 have been established utilizing a 21% effective federal tax rate as enacted under the Tax Cuts and Jobs Act ("Act"). Significant components of deferred taxes at December 31, 2021 and 2020 are as follows:

	December 31,	
	2021	2020
Deferred tax assets:		
Allowance for loan losses	\$ 993,403	\$ 888,673
Deferred compensation and directors' deferred compensation	618,261	602,662
Impairment on foreclosed real estate and repossessions	2,304	2,304
AMT credit carry forward	-	25,927
Other	-	521
Total deferred tax assets	<u>1,613,968</u>	<u>1,520,087</u>
Deferred tax liabilities:		
Accumulated depreciation	307,951	337,613
Unrealized gains on securities available for sale	176,624	430,129
Federal Home Loan Bank stock	250	320
Other	854	521
Total deferred tax liabilities	<u>485,679</u>	<u>768,062</u>
Net deferred tax assets	<u>\$ 1,128,289</u>	<u>\$ 752,025</u>

It is management's opinion that recognition of net deferred tax assets is more likely than not based on the Company's history of taxable income and estimates of future taxable income.

The significant components of the provision for income taxes for the years ended December 31, 2021 and 2020 are as follows:

	Years Ended December 31,	
	2021	2020
Current tax provision (benefit):		
Federal	\$ 1,533,419	\$ 1,165,015
State	207,301	162,478
	<u>1,740,720</u>	<u>1,327,493</u>
Deferred tax provision (benefit):		
Federal	(110,583)	(94,975)
State	(12,137)	(16,518)
	<u>(122,720)</u>	<u>(111,493)</u>
Net income tax provision	<u>\$ 1,618,000</u>	<u>\$ 1,216,000</u>

The difference between the provision for income taxes and the amounts calculated by applying the statutory federal income tax rate of 21% for the years ended 2021 and 2020 to income before income taxes is summarized below:

	2021	2020
Expense computed at statutory rate of 21%	\$ 1,619,559	\$ 1,173,313
Effect of state income taxes	154,180	115,309
Tax exempt income	(171,046)	(102,626)
Expiration of tax attribute carryforward	-	42,729
Other, net	15,307	(12,725)
	<u>\$ 1,618,000</u>	<u>\$ 1,216,000</u>

8. Concentration of Credit Risk, Off-Balance-Sheet Risk and Commitments

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and equity lines of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial condition. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk is as follows:

	<u>December 31,</u>	
	<u>2021</u>	<u>2020</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 6,101,600	\$ 6,443,139
Undisbursed lines of credit	76,686,313	68,286,283
Standby letters of credit	203,269	153,084

The Bank evaluates each customer's credit worthiness on a case-by-case basis. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The collateral obtained by the Bank upon extension of credit is based on management's credit evaluation of the customer. The collateral held is the underlying real estate.

9. Employee Benefits

The Bank has a 401(k)-retirement plan which contains provisions for specified matching contributions. The Bank funds contributions as they accrue, and 401(k) expense totaled \$215,000 and \$211,000 for the years ended December 31, 2021 and 2020, respectively. During 2018, the plan was amended to allow common stock of the Company available as an investment option.

During 2001, the Company adopted a Supplemental Executive Retirement Plan (SERP) for its senior executives. The Company has purchased life insurance policies in order to provide future funding of benefit payments. Plan benefits will accrue and vest during the period of employment and will be paid in fixed monthly benefit payments over ten years commencing with the officer's retirement at any time after attainment of age sixty-five. Benefits will accrue based upon the performance of the underlying life insurance policies both during employment and after retirement. The total liability under this plan was approximately \$2,603,000 and \$2,539,000 at December 31, 2021 and 2020, respectively, and is included in accrued expenses and other liabilities in the accompanying consolidated statements of financial condition.

In 2004, the Company also enacted additional retirement and life insurance benefits for selected middle management employees. This plan calls for additional contributions to 401(k) accounts for these selected employees. During 2021 and 2020, expenses attributable to these plans amounted to \$35,600 and \$33,500 respectively.

The Company has entered into employment agreements with several of its senior executive officers in order to attract and retain a competent management team. The employment agreements generally provide for severance payments to be paid to the executive upon termination without cause, termination for good reason, and in the event of a change of control and separation from service. The agreements may also restrict the executive from competing against the Company, or soliciting its customers or employees, for a period of time following a termination of employment.

10. Deferred Compensation for Directors

The Bank has a director's deferred compensation plan, and the retirement benefits vest to each director in amounts ranging from \$4,000 to \$20,000 depending upon years of service. As of December 31, 2021, and 2020, the Bank had accrued \$88,000 and \$84,000, respectively, which represents the present value of the respective deferred compensation.

11. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal and state 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 regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Bank is subject to the capital requirements of the Federal Deposit Insurance Corporation (the "FDIC") and the Administrator of the North Carolina Savings Institutions Division.

The FDIC requires the Bank to have a minimum leverage ratio of Tier I Capital (principally consisting of retained earnings and common stockholders' equity, less any intangible assets) to total assets of 4%. The FDIC also requires the Bank to have a ratio of total capital to risk-weighted assets of 8%, of which at least 6% must be in the form of Tier I capital. Effective January 1, 2015 the FDIC requires the Bank to have a minimum common equity Tier 1 to risk-weighted assets of 4.5%. The North Carolina Administrator requires a net worth equal to at least 5% of total assets.

At December 31, 2021 and 2020, the Bank complied with all the capital requirements as shown below:

	<u>Actual</u>		<u>Minimum for capital adequacy purposes</u>		<u>Minimum to be well capitalized under prompt corrective action provision</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Dollars in thousands)						
<u>December 31, 2021</u>						
Total Capital (to Risk-Weighted Assets)	\$ 51,301	14.09%	\$ 38,242	10.500%	\$ 36,421	10.0%
Tier I Capital (to Risk-Weighted Assets)	46,743	12.83%	30,958	8.500%	29,137	8.0%
Common Equity (to Risk-Weighted Assets)	46,743	12.83%	25,495	7.000%	23,674	6.5%
Tier I Capital (to Average Assets)	46,743	8.29%	22,546	4.000%	28,182	5.0%
<u>December 31, 2020</u>						
Total Capital (to Risk-Weighted Assets)	\$ 46,418	13.81%	\$ 35,319	10.5%	\$ 33,637	10.0%
Tier I Capital (to Risk-Weighted Assets)	42,251	12.56%	28,591	8.5%	26,909	8.0%
Common Equity (to Risk-Weighted Assets)	42,251	12.56%	23,546	7.0%	21,864	6.5%
Tier I Capital (to Average Assets)	42,251	8.77%	19,267	4.0%	24,083	5.0%

Under the FDIC prompt corrective action regulations, a savings institution is considered to be well capitalized if its ratio of total capital to risk-weighted assets is at least 10.0%, its ratio of Tier I capital to risk-weighted assets is at least 8.0%, and its ratio of Tier I capital to total average assets is at least 5.0%.

At the time of its conversion from a mutual to a stock charter, the Bank established a liquidation account in an amount equal to its net worth as of September 30, 1993 for the benefit of all holders of deposit accounts with an aggregate balance in excess of \$50 on March 31, 1993. In the unlikely event of a complete liquidation of the Bank (and only in such event), each eligible account holder will be entitled to his or her interest in the liquidation account prior to any payments to holders of common stock. An eligible account holder's interest in the liquidation account will be computed on December 31 each year and is reduced, or will cease to exist, if the funds in the related deposit account are withdrawn. The interest of an eligible account holder in the liquidation account will never be increased, even if there is an increase in the related deposit account after March 31, 1993.

During 2021 and 2020, the Bank paid dividends of \$1,982,000 and \$1,952,000 to KS Bancorp, respectively. Subject to regulations promulgated by the North Carolina Administrator, the Bank will not be permitted to pay dividends on its common stock if its stockholders' equity would be reduced below the amount required for the liquidation account or its capital requirement.

12. Fair Value of Financial Instruments

Fair value estimates are made at a specific moment in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The fair value estimates are based on pertinent information available to management as of December 31, 2021 and 20. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates, and therefore, current estimates of fair value may differ significantly from the amounts presented herein. The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments.

Cash and due from banks, time deposits, and accrued interest receivable

The carrying amounts reported in the consolidated statement of financial condition for these instruments approximate their fair values due to their short-term nature.

Certificates of Deposit with Banks

The fair value of certificates of deposits with other banks is estimated based on discounting cash flows using the rates currently offered for instruments of similar remaining maturities.

Investment securities available for sale

Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, level 2 fair value is estimated using quoted market prices for similar securities, or other inputs that are observable or can be corroborated by observable market data. Level 3 securities are valued utilizing various assumptions such as valuation multiples, discounts for lack of marketability or liquidity, and default rates.

Federal Home Loan Bank stock

The carrying value of FHLB stock approximates fair value based on the redemption provisions of the FHLB.

Loans

The fair value is estimated based on discounted future cash flows, incorporating liquidity and secondary market comparable pricing, in order to estimate an exit price notion.

Federal Home Loan Bank Stock

The carrying amount is a reasonable estimate of fair value.

Deposits

The fair value of deposits with no stated maturities, including transaction accounts and savings accounts, is estimated to be equal to the amount payable on demand as of December 31, 2021 and 2020. The fair value of certificates of deposit is based upon the discounted value of future contractual cash flows. The discount rate is estimated using the rates offered on December 31, 2021 and 2020 for deposits of similar remaining maturities.

Borrowings

The carrying amounts of short-term borrowings approximate their fair value. The fair value of the long term borrowings are estimated based on observable market prices and discounted cash flow analyses using current rates at which borrowings of similar maturity and characteristics could be obtained.

Accrued interest payable

The carrying amount of accrued interest payable approximates its fair value.

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2021 and 2020.

	Fair Value Hierarchy Level	2021		2020	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
Cash and cash equivalents	1	\$ 114,388,282	\$ 114,388,282	\$ 27,847,873	\$ 27,847,873
Time deposits	1	5,100,000	5,100,000	100,000	100,000
Investment securities available for sale	2 & 3	88,320,472	88,320,472	71,714,019	71,714,019
Federal Home Loan Bank stock	2	1,442,900	1,442,900	1,850,700	1,850,700
Loans, net	3	345,644,323	338,278,642	368,593,192	369,385,667
Accrued interest receivable	2	1,542,746	1,542,746	1,934,540	1,934,540
Financial liabilities:					
Deposits	2	487,436,823	473,962,000	402,522,651	401,378,000
Borrowings	1	43,248,000	43,253,977	46,248,000	47,824,931
Accrued interest payable	2	216,081	216,081	245,862	245,862

13. Fair Value Measurement

The FASB has issued authoritative guidance regarding fair value measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value as defined under generally accepted accounting principles is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Bank utilizes market data or assumptions that market participants would use in pricing the asset or liability. Generally accepted accounting principles establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Recurring Basis Measurements

The following tables set forth by level within the fair value hierarchy the Company's assets and liabilities accounted for at fair value on a recurring basis as of December 31, 2021 and 2020. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Fair values of assets measured on a recurring basis at December 31, 2021 and 2020 are as follows:

<u>Description</u>	<u>Fair Value</u>	<u>Fair Value Measurements at December 31,</u>		
		<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
2021				
Available for sale:				
Federal agency securities	\$ 2,642,434	\$ -	\$ 2,642,434	\$ -
Municipal securities	43,802,007	-	43,802,007	-
Mortgage-backed securities-GSEs	31,372,056	-	31,372,056	-
Corporate securities	<u>10,503,975</u>	<u>-</u>	<u>2,503,975</u>	<u>8,000,000</u>
	<u>\$ 88,320,472</u>	<u>\$ -</u>	<u>\$ 80,320,472</u>	<u>\$ 8,000,000</u>

<u>Description</u>	<u>Fair Value</u>	<u>Fair Value Measurements at December 31,</u>		
		<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
2020				
Available for sale:				
Federal agency securities	\$ 3,705,724	\$ -	\$ 3,705,724	\$ -
Municipal securities	23,990,041	-	23,990,041	-
Mortgage-backed securities-GSEs	40,018,254	-	40,018,254	-
Corporate securities	<u>4,000,000</u>	<u>-</u>	<u>-</u>	<u>4,000,000</u>
	<u>\$ 71,714,019</u>	<u>\$ -</u>	<u>\$ 67,714,019</u>	<u>\$ 4,000,000</u>

The valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis are as follows:

Investment Securities Available for Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets market funds. Level 2 securities include federal agency securities and mortgage-backed securities issued by government sponsored entities, as well as municipal bonds. There were no changes during the years ended December 31, 2021 and 2020 to the Company's valuation techniques used to measure asset fair values on a recurring basis.

Non-Recurring Basis Measurements

Certain other financial assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). There were no liabilities measured on a nonrecurring basis at December 31, 2021 and December 31, 2020.

The valuation methodologies used for assets recorded at fair value on a nonrecurring basis are as follows:

Foreclosed Real Estate

Real estate owned balances are adjusted to fair value upon transfer of the loans to the real estate owned. Real estate acquired in settlement of loans is recorded initially at fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charged to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the company records the foreclosed assets as nonrecurring level 2. When an appraised value is not available, or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed real estate asset as nonrecurring level 3.

For Level 3 assets and liabilities measured at fair value on a non-recurring basis as of December 31, 2021 and 2020, the significant unobservable inputs used in the fair value adjustments were as follows (dollars in thousands):

<u>Level 3 Assets with Significant Unobservable Inputs</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Significant Unobservable Input Value</u>
2021 and 2020				
Foreclosed real estate and repossessions, net	\$ 621	Discounted appraisals ⁽¹⁾	Appraisal adjustments ⁽²⁾	5% to 10% ⁽³⁾

(1) Fair value is generally based on appraisals of the underlying collateral.

(2) Appraisals may be adjusted by management for customized discounting criteria, estimated sales costs, and proprietary qualitative adjustments.

(3) Weighted average of the significant unobservable input value is 7% in 2021.

Real estate and repossessions acquired in settlement of loans classified as Level 3 are based on management's judgment and estimation.

14. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income included the following at December 31, 2021 and 2020:

	<u>December 31,</u>	
	<u>2021</u>	<u>2020</u>
Unrealized gains on investment securities available for sale:		
Accumulated other comprehensive income	\$ 768,598	\$ 1,872,253
Deferred tax effect	(176,624)	(430,243)
Accumulated other comprehensive income, net of tax	<u>\$ 591,974</u>	<u>\$ 1,442,010</u>

The following table highlights changes in accumulated other comprehensive income (loss) by component for the years ended December 31, 2021 and 2020:

	<u>December 31,</u>	
	<u>2021</u>	<u>2020</u>
Accumulated other comprehensive income (loss), beginning	\$ 1,442,010	\$ 176,585
Unrealized gains on investment securities available for sale:		
Other comprehensive (loss) income before reclassifications, net of tax	(850,036)	1,268,239
Amount reclassified from accumulated other comprehensive (gain), net of tax	-	(2,814)
Accumulated other comprehensive income, ending	<u>\$ 591,974</u>	<u>\$ 1,442,010</u>

15. Parent Company Financial Data

The following is a summary of the condensed financial statements of KS Bancorp, Inc. as of and for the years ended December 31, 2021 and 2020:

Condensed Balance Sheets
December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 331	\$ 304
Investment in subsidiaries	47,335	43,736
Other assets	<u>252</u>	<u>252</u>
	<u>\$ 47,918</u>	<u>\$ 44,292</u>
Liabilities and Stockholders' Equity		
Liabilities:		
Short term borrowings	\$ 1,000	\$ -
Junior subordinated debentures	8,248	8,248
Subordinated debt	2,000	4,000
Other liabilities	<u>25</u>	<u>23</u>
Stockholders' equity:		
Common stock	1,360	1,360
Accumulated other comprehensive income	592	1,442
Retained earnings, substantially restricted	<u>34,693</u>	<u>29,219</u>
	<u>\$ 47,918</u>	<u>\$ 44,292</u>

Condensed Statements of Income
Years Ended December 31, 2021 and 2020

	<u>2021</u>	<u>2020</u>
	(Dollars in thousands)	
Equity in earnings of subsidiaries	\$ 6,431	\$ 4,829
Other expense	(427)	(580)
Income tax benefit	<u>90</u>	<u>122</u>
Net income	<u>\$ 6,094</u>	<u>\$ 4,371</u>

Condensed Statements of Cash Flows
Years Ended December 31, 2021 and 2020

	2021	2020
	(Dollars in thousands)	
Cash Flows from Operating Activities:		
Net income	\$ 6,094	\$ 4,371
Noncash items included in net income:		
Equity in earnings of subsidiaries	(6,431)	(4,829)
Change in assets and liabilities:		
Decrease (Increase) in other liabilities	<u>2</u>	<u>(1)</u>
Net cash used by operating activities	<u>(335)</u>	<u>(459)</u>
Cash Flows from Investing Activities:		
Upstream dividends received from subsidiary	<u>1,982</u>	<u>1,952</u>
Net cash provided by investing activities	<u>1,982</u>	<u>1,952</u>
Cash Flows from Financing Activities:		
Proceeds from short term borrowings	1,000	-
Repayment of subordinated debt	(2,000)	(1,000)
Cash dividends paid	<u>(620)</u>	<u>(443)</u>
Net cash used by financing activities	<u>(1,620)</u>	<u>(1,443)</u>
Net increase in cash:	27	50
Beginning	<u>304</u>	<u>254</u>
Ending	<u>\$ 331</u>	<u>\$ 304</u>