

Oak Ridge Financial Services, Inc.

Report on Consolidated Financial Statements

As of and for the years ended December 31, 2022 and 2021

Oak Ridge Financial Services, Inc.

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Independent Auditor's Report

Audit Committee of the Board of Directors
Oak Ridge Financial Services, Inc.

Opinion

We have audited the consolidated financial statements of Oak Ridge Financial Services, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "financial statements").

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

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

Auditor's Responsibilities for the Audit of the Financial Statements, Continued

In performing an audit in accordance with GAAS, we:

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

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

A handwritten signature in black ink that reads "Elliott Davis, PLLC". The signature is written in a cursive, flowing style.

Charlotte, North Carolina
April 27, 2023

Oak Ridge Financial Services, Inc.**Consolidated Balance Sheets****As of December 31, 2022 and 2021****(Dollars in thousands)**

	2022	2021
Assets		
Cash and due from banks	\$ 12,467	\$ 8,998
Interest-bearing deposits with banks	<u>37,889</u>	<u>79,086</u>
Total cash and cash equivalents	50,356	88,084
Securities available-for-sale	80,939	46,948
Securities held-to-maturity	11,161	387
Restricted stock, at cost	2,626	1,324
Loans, net of allowance for loan losses of \$4,851 and \$3,756 at December 31, 2022 and 2021, respectively	421,444	425,900
Property and equipment, net	9,192	9,907
Accrued interest receivable	1,996	1,842
Bank owned life insurance	6,095	6,014
Right-of-use assets – operating leases	1,183	1,594
Other assets	<u>4,289</u>	<u>4,921</u>
Total assets	<u><u>\$ 589,281</u></u>	<u><u>\$ 586,921</u></u>

Liabilities and Stockholders' Equity**Liabilities**

Deposits		
Noninterest-bearing	\$ 120,263	\$ 116,525
Interest-bearing	<u>360,722</u>	<u>392,754</u>
Total deposits	480,985	509,279
Short-term FHLB Advances	30,000	-
Long-term other borrowings	418	683
Junior subordinated notes – trust preferred securities	8,248	8,248
Subordinated debentures, net of discount	9,903	9,863
Lease liabilities – operating leases	1,183	1,594
Accrued interest payable	226	110
Other liabilities	<u>5,675</u>	<u>5,816</u>
Total liabilities	<u>536,638</u>	<u>535,593</u>

Commitments and contingencies (Note 11)**Stockholders' equity**

Common stock, no par value; 50,000,000 shares authorized; 2,702,020 and 2,672,620 issued and outstanding at December 31, 2022 and 2021, respectively	26,207	25,532
Retained earnings	28,642	22,815
Accumulated other comprehensive income (loss)	<u>(2,206)</u>	<u>2,981</u>
Total stockholders' equity	<u>52,643</u>	<u>51,328</u>
Total liabilities and stockholders' equity	<u><u>\$ 589,281</u></u>	<u><u>\$ 586,921</u></u>

See Notes to Consolidated Financial Statements

Oak Ridge Financial Services, Inc.
Consolidated Statements of Income
For the years ended December 31, 2022 and 2021
(Dollars in thousands)

	2022	2021
Interest and dividend income		
Loans and fees on loans	\$ 21,223	\$ 21,922
Interest on deposits in banks	514	35
Restricted stock dividends	66	78
Interest on investment securities	<u>2,234</u>	<u>1,340</u>
Total interest and dividend income	<u>24,037</u>	<u>23,375</u>
Interest expense		
Deposits	1,269	1,306
Short-term and long-term debt	<u>1,114</u>	<u>1,059</u>
Total interest expense	<u>2,383</u>	<u>2,365</u>
Net interest income	21,654	21,010
Provision for (recovery of) loan losses	<u>(41)</u>	<u>(682)</u>
Net interest income after provision for loan losses	<u>21,695</u>	<u>21,692</u>
Noninterest income		
Service charges on deposit accounts	591	534
Gain (loss) on sale of securities	(131)	182
Brokerage commissions on mortgage loans	200	290
Insurance commissions	463	413
Gain on sale of Small Business Administration loans	1,074	1,105
Debit and credit card interchange income	1,163	1,129
Income from Small Business Investment Company	179	102
Income earned on bank owned life insurance	81	84
Other service charges and fees	<u>450</u>	<u>251</u>
Total noninterest income	<u>4,070</u>	<u>4,090</u>
Noninterest expense		
Salaries	8,870	7,801
Employee benefits	1,118	1,119
Occupancy	1,111	1,086
Equipment	962	1,109
Data and item processing	1,728	1,925
Professional and advertising	1,104	831
Stationary and supplies	106	179
Impairment loss on securities	22	74
Telecommunications	438	369
FDIC assessment	291	171
Other expense	<u>1,647</u>	<u>1,326</u>
Total noninterest expense	<u>17,397</u>	<u>15,990</u>
Income before income taxes	8,368	9,792
Income tax expense	<u>1,706</u>	<u>2,029</u>
Net income and income available to common stockholders	<u>\$ 6,662</u>	<u>\$ 7,763</u>
Basic income per common share	<u>\$ 2.47</u>	<u>\$ 2.91</u>
Diluted income per common share	<u>\$ 2.47</u>	<u>\$ 2.91</u>
Basic weighted average shares outstanding	<u>2,697,538</u>	<u>2,668,720</u>
Diluted weighted average shares outstanding	<u>2,697,538</u>	<u>2,668,720</u>

See Notes to Consolidated Financial Statements

Oak Ridge Financial Services, Inc.
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2022 and 2021
(Dollars in thousands)

	<u>2022</u>	<u>2021</u>
Net income	\$ 6,662	\$ 7,763
Other comprehensive income:		
Unrealized holding losses on securities available-for-sale	(6,866)	(741)
Tax effect	<u>1,578</u>	<u>171</u>
Unrealized holding losses on securities available-for-sale, net of tax	(5,288)	(570)
Reclassification adjustment for realized (gains) losses	131	(182)
Tax effect	<u>(30)</u>	<u>42</u>
Reclassification adjustment for realized (gains) losses, net of tax	<u>101</u>	<u>(140)</u>
Other comprehensive loss, net of tax	<u>(5,187)</u>	<u>(710)</u>
Total comprehensive income	<u><u>\$ 1,475</u></u>	<u><u>\$ 7,053</u></u>

See Notes to Consolidated Financial Statements

Oak Ridge Financial Services, Inc.**Consolidated Statements of Changes in Stockholders' Equity****For the years ended December 31, 2022 and 2021****(In thousands except shares of common stock)**

	Common Stock		Retained	Accumulated	
	Number	Amount	Earnings	Other Comprehensive	Total
				Income (loss)	
Balance December 31, 2020	2,639,345	\$ 25,013	\$ 15,771	\$ 3,691	\$ 44,475
Net income	-	-	7,763	-	7,763
Other comprehensive loss	-	-	-	(710)	(710)
Common stock dividends	-	-	(719)	-	(719)
Common stock issued pursuant to restricted stock awards, net of forfeitures	33,275	519	-	-	519
Balance December 31, 2021	2,672,620	25,532	22,815	2,981	51,328
Net income	-	-	6,662	-	6,662
Other comprehensive loss	-	-	-	(5,187)	(5,187)
Common stock dividends	-	-	(835)	-	(835)
Common stock issued pursuant to restricted stock awards, net of forfeitures	29,400	675	-	-	675
Balance December 31, 2022	<u>2,702,020</u>	<u>\$ 26,207</u>	<u>\$ 28,642</u>	<u>\$ (2,206)</u>	<u>\$ 52,643</u>

See Notes to Consolidated Financial Statements

Oak Ridge Financial Services, Inc.
Consolidated Statements of Cash Flows
For the years ended December 31, 2022 and 2021
(In thousands)

	2022	2021
Operating activities		
Net income	\$ 6,662	\$ 7,763
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	1,166	1,094
Amortization of operating lease right-of-use assets	411	396
(Recovery of) provision for loan losses	(41)	(682)
Impairment loss on securities	23	74
Loss (gain) on sale of securities	131	(182)
Gain on sale of SBA loans	(1,074)	(1,105)
Stock compensation expense	675	519
Income earned on bank owned life insurance	(81)	(84)
Deferred income tax (benefit) expense	(6)	286
Originations of SBA loans	(12,472)	(9,222)
Proceeds from sale of SBA loans	13,545	10,327
Net amortization of discounts and premiums on securities	(189)	16
Net amortization of discounts and premiums on subordinated debentures	40	6
Changes in assets and liabilities:		
Accrued interest receivable	(154)	570
Other assets	2,186	(530)
Accrued interest payable	116	(30)
Lease liability	(411)	(396)
Other liabilities	(141)	212
Net cash provided by operating activities	<u>10,386</u>	<u>9,032</u>
Investing activities		
Activity in available-for-sale securities:		
Purchases	(64,120)	(6,594)
Sales	13,590	3,235
Maturities and repayments	9,838	1,954
Activity in held-to-maturity securities:		
Purchases	(10,850)	-
Maturities and repayments	78	160
Redemptions (purchases) of restricted stock, net	(1,302)	482
Net change in loans	4,497	19,909
Purchases of property and equipment	(451)	(369)
Net cash used in investing activities	<u>(48,720)</u>	<u>(18,777)</u>
Financing activities		
Net (decrease) increase in deposits	(28,294)	53,542
Proceeds from borrowings	30,000	-
Repayment of borrowings	(265)	(8,269)
Redemption of subordinated debentures	-	(5,627)
Common stock dividends	(835)	(719)
Net cash provided by financing activities	<u>606</u>	<u>38,927</u>
Net (decrease) increase in cash and cash equivalents	<u>(37,728)</u>	<u>66,736</u>
Cash and cash equivalents, beginning of year	<u>88,084</u>	<u>21,348</u>
Cash and cash equivalents, end of year	<u>\$ 50,356</u>	<u>\$ 88,084</u>

See Notes to Consolidated Financial Statements

Oak Ridge Financial Services, Inc.
Consolidated Statements of Cash Flows (continued)
For the years ended December 31, 2022 and 2021
(In thousands)

	<u>2022</u>	<u>2021</u>
Supplemental disclosure of cash flow information		
<i>Cash paid for:</i>		
Interest	\$ <u>2,267</u>	\$ <u>2,395</u>
Income taxes	\$ <u>1,449</u>	\$ <u>2,045</u>
<i>Non-cash investing and financing activities</i>		
Change in unrealized gain in securities available-for-sale, net of tax	\$ <u>(5,187)</u>	\$ <u>(710)</u>

See Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Consolidation:

The consolidated financial statements include the accounts of Oak Ridge Financial Services, Inc. ("Oak Ridge") and its wholly owned subsidiary, Bank of Oak Ridge (the "Bank") (collectively referred to hereafter as the "Company"). The Bank has one wholly-owned subsidiary, Oak Ridge Financial Corporation, which is currently inactive. All significant inter-company transactions and balances have been eliminated in consolidation.

Basis of financial statement presentation:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheets and the reported amounts of income and expenses for the periods presented. Actual results could differ significantly 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 and the valuation of the deferred tax asset.

Substantially all of Oak Ridge's loan portfolio consists of loans in its market area. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate are susceptible to changes in local market conditions. The regional economy is diverse and is influenced by the manufacturing and retail segment of the economy.

While management uses available information to recognize loan and foreclosed real estate losses, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examination process, periodically review the Company's allowances for loan losses. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for loan losses may change materially in the near term.

Deferred income tax benefits and liabilities are valued using current federal and state income tax rates. Actual recognition of these deferred tax assets and liabilities will be affected by the actual future tax rates applicable to when the assets and liabilities become current tax items.

Business:

Oak Ridge is a bank holding company incorporated in North Carolina in April of 2007. The principal activity of Oak Ridge is ownership of the Bank. The Bank provides financial services through its branch network located in Guilford County, North Carolina. The Bank competes with other financial institutions and numerous other non-financial services commercial entities offering financial services products. The Bank is further subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. The Company has no foreign operations, and the Company's customers are principally located in Guilford County, North Carolina, and adjoining counties.

Note 1. Summary of Significant Accounting Policies, Continued

Cash and cash equivalents:

Cash and cash equivalents include demand and time deposits (with original maturities of 90 days or less) at other financial institutions and overnight investments. Overnight investments include federal funds sold which are generally outstanding for one day periods.

Securities:

Certain 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. Trading securities, including equity securities, are recorded at fair value with changes in fair value included in earnings. Debt securities not classified as held-to-maturity or trading are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in accumulated comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are generally amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Premiums on callable debt securities are amortized to their earliest call date. Discounts on callable debt securities are amortized to their maturity date. Gains and losses on sales are recorded on the trade date and determined using the specific identification method. 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. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Note 1. Summary of Significant Accounting Policies, Continued

Loans:

Loans are generally stated at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses and any deferred fees or costs. Loan origination fees net of certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual life of the related loans using the level-yield method.

Impaired loans are defined as those which management believes it is probable the Bank will not collect all amounts due according to the contractual terms of the loan agreement, as well as those loans whose terms have been modified in a troubled debt restructuring.

Interest on loans is recorded based on the principal amount outstanding. The Company ceases accruing interest on loans (including impaired loans) when, in management's judgment, the collection of interest appears doubtful or the loan is past due 90 days or more. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Management may return a loan classified as nonaccrual to accrual status when the obligation has been brought current, has performed in accordance with its contractual terms over an extended period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Allowance for loan losses:

The allowance for loan losses (ALL) is established through provisions for losses charged against income. Loan amounts deemed to be uncollectible are charged against the ALL, and subsequent recoveries, if any, are credited to the allowance. The ALL represents management's estimate of the amount necessary to absorb estimated probable losses in the loan portfolio. Management's periodic evaluation of the adequacy of the allowance is based on individual loan reviews, past loan loss experience, economic conditions in the Company's market areas, the fair value and adequacy of underlying collateral, and the growth and loss attributes of the loan portfolio. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Thus, future changes to the ALL may be necessary based on the impact of changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALL. Such agencies may require the Company to recognize adjustments to the ALL based on their judgments about information available to them at the time of their examination.

The ALL related to loans that are identified for evaluation and deemed impaired is based on discounted cash flows using the loan's initial effective interest rate, the loan's observable market price, or the fair value of the collateral for collateral dependent loans. Another component of the ALL covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is also maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Note 1. Summary of Significant Accounting Policies, Continued

Foreclosed assets:

Real estate acquired in settlement of loans consists of property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure. Real estate acquired in settlement of loans is recorded initially at estimated 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. Costs related to the improvement of the property are capitalized, whereas those related to holding the property are expensed. Such properties are held for sale and, accordingly, no depreciation or amortization expense is recognized. Repossessions are recorded at the fair value less cost to sell.

Restricted stock:

The Bank is a member of the Federal Home Loan Bank of Atlanta ("FHLB"). Membership, along with a signed blanket collateral agreement, provided the Bank with the ability to draw up to \$156.2 million and \$168.2 million of advances from the FHLB at December 31, 2022 and 2021, respectively. At December 31, 2022, the Bank had \$30.0 million in outstanding advances with the FHLB. The Bank had no outstanding advances with the FHLB on December 31, 2021.

As a requirement for membership, the Bank invests in stock of the FHLB in the amount of 1% of its outstanding residential loans or 4.25% of its outstanding advances from the FHLB, whichever is greater. Such stock is pledged as collateral for any FHLB advances drawn by the Bank. On December 31, 2022 and 2021, the Bank owned 15,664 and 2,722 shares, respectively, of the FHLB's \$100 par value capital stock. No ready market exists for such stock, which is carried at cost. Due to the redemption provisions of the FHLB, cost approximates market value.

As a requirement for membership, the Bank invests in stock of the Federal Reserve Bank ("FRB"). No ready market exists for the stock so carrying value approximates its fair value based on the redemption provisions of the FRB.

Property and equipment:

Land is carried at cost. Buildings and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method and is charged to operations over the estimated useful lives of the assets which range from 25 to 50 years for bank premises and 3 to 10 years for furniture and equipment. Construction in progress includes buildings and equipment carried at cost and depreciated once placed into service.

Maintenance, repairs, renewals and minor improvements are charged to expense as incurred. Major improvements are capitalized and depreciated.

Short-term debt:

Short-term debt consists of securities sold under agreements to repurchase, overnight sweep accounts, federal funds purchased and short-term FHLB advances.

Note 1. Summary of Significant Accounting Policies, Continued

Long-term debt and junior subordinated notes related to trust preferred:

Long-term debt consists of advances from FHLB and loans from other banks with maturities greater than one year. The Company formed Oak Ridge Statutory Trust I (the "Trust") during 2007 to facilitate the issuance of trust preferred securities. The Trust is a statutory business trust formed under the laws of the state of Connecticut, of which all common securities are owned by the Company. The Trust is not included in the Company's consolidated financial statements. The Company's equity interests for junior subordinated debentures issued by the Company to the Trust are included in other assets.

Income taxes:

The Company uses the liability method in accounting for income taxes. Deferred taxes and liabilities are recognized for operating loss and tax credit carry-forwards and for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities on their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. Current accounting standards prescribe a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return, as well as guidance on de-recognition, classification, interest and penalties, accounting in interim periods, and disclosures. The Company's policy is to classify any interest recognized as interest expense and to classify any penalties recognized as an expense other than income tax expense.

Advertising costs:

Advertising costs are expensed as incurred and totaled \$125 thousand and \$130 thousand for the years ended December 31, 2022 and 2021, respectively.

Note 1. Summary of Significant Accounting Policies, Continued

Stock option plan:

The Company recognizes compensation cost relating to share-based payment transactions in the financial statements in accordance with generally accepted accounting principles. The cost is measured based on the fair value of the equity or liability instruments issued. The expense measures the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and recognizes the cost over the period the employee is required to provide services for the award.

In 2007, the Company adopted the Long-Term Incentive Plan. Under this plan, up to 500,000 shares may be issued as either stock options, restricted stock, or performance units. The plan terminated on June 20, 2016, except with respect to awards then outstanding. The exercise price for awards under this plan shall be set by a committee of the Board of Directors at the date of grant, but shall not be less than 100 percent of fair market value at the date of the grant. Awards granted under this plan vest according to the terms of each particular grant. Restricted stock awards shall be in the form of restricted stock, subject to the terms and restrictions of the Long-Term Incentive Plan. The restricted stock awards are subject to forfeiture or cancellation under the plan and cannot be sold or transferred until the restrictions have lapsed.

The Company has adopted the *2016 Long-Term Incentive Plan*. Under this plan, up to 225,000 shares may be issued as either stock options, restricted stock, or performance units. The plan terminates on February 22, 2026, except with respect to awards then outstanding. The exercise price for awards under this plan shall be set by a committee of the Board of Directors at the date of grant, but shall not be less than 100 percent of fair market value at the date of the grant. Awards granted under this plan vest according to the terms of each particular grant. Restricted stock awards shall be in the form of restricted stock, subject to the terms and restrictions of the Long-Term Incentive Plan. The restricted stock awards are subject to forfeiture or cancellation under the plan and cannot be sold or transferred until the restrictions have lapsed.

Net income per share:

The computation of diluted earnings per common share is similar to the computation of basic earnings per common share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

In computing diluted net income per common share, it is assumed that all dilutive stock options are exercised during the reporting period at their respective exercise prices, with the proceeds from the exercises used by the Company to buy back stock in the open market at the average market price in effect during the reporting period. The difference between the number of shares assumed to be exercised and the number of shares bought back is added to the number of weighted-average common shares outstanding during the period. The sum is used as the denominator to calculate diluted net income per common share for the Company. At December 31, 2022 and 2021, there were no outstanding and exercisable stock options.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 1. Summary of Significant Accounting Policies, Continued

Net income per share, continued:

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net income per common share.

(Amounts in thousands, except share data)	Year ended December 31, 2022		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic income per common share	\$ 6,662	2,697,538	\$ 2.47
Effect of dilutive securities	-	-	-
Diluted income per common share	\$ 6,662	2,697,538	\$ 2.47

(Amounts in thousands, except share data)	Year ended December 31, 2021		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic income per common share	\$ 7,763	2,668,720	\$ 2.91
Effect of dilutive securities	-	-	-
Diluted income per common share	\$ 7,763	2,668,720	\$ 2.91

Revenue recognition:

Substantially all of the Company's revenue from contracts with customers that is within the scope of ASC 606, "Revenue from Contracts with Customers" is reported within noninterest income. A limited amount of other in-scope items such as gains and losses on other real estate owned are recorded in noninterest expense. The recognition of interest income and certain sources of noninterest income (e.g. gains on securities transactions, bank owned life insurance income, etc.) are governed by other areas of U.S. GAAP. Significant revenue streams that are within the scope of ASC 606 and included in noninterest income are discussed in the following paragraphs.

Service charges on deposit accounts – The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Brokerage commissions on mortgage loans – The Company is engaged in the business of originating and processing consumer residential mortgage loans as a mortgage broker. Loans brokered are originated in the name of the third-party lender. The fee the Company receives on mortgage loans originated by third-party lenders is recognized as income when the loans are funded.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 1. Summary of Significant Accounting Policies, Continued

Revenue recognition, continued:

Insurance commissions – The Company earns commissions on insurance product sales. The Company acts as an intermediary between the Company’s customer and the insurance carrier. The Company’s performance obligation is generally satisfied upon the issuance of the insurance policy. Shortly after the insurance policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue.

Debit and credit card interchange income – The Company earns interchange fees from debit and credit cardholder transactions conducted through the VISA payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are earned daily and recognized monthly, concurrently with the transaction processing services provided to the cardholder.

The following table presents the Company’s noninterest income by revenue stream (in thousands) for the years ended December 31, 2022 and 2021. Items outside the scope of Topic 606 are noted as such.

	<u>2022</u>	<u>2021</u>
Service charges on deposit accounts	\$ 591	\$ 534
Gain (loss) on sale of securities ⁽¹⁾	(131)	182
Brokerage commissions on mortgage loans	200	290
Insurance commissions	463	413
Gain on sale of Small Business Administration loans ⁽¹⁾	1,074	1,105
Debit and credit card interchange income	1,163	1,129
Income from Small Business Investment Company ⁽¹⁾	179	102
Income earned from bank owned life insurance ⁽¹⁾	81	84
Other service charges and fees ⁽¹⁾	450	251
Total noninterest income	<u>\$ 4,070</u>	<u>\$ 4,090</u>

⁽¹⁾Not within the scope of Topic 606

Lease accounting:

The Company has adopted Accounting Standards Update No. 2016-2, *Leases* (“Topic 842”) using the modified retrospective method. The Company has developed a methodology to estimate the right-of-use assets and lease liabilities, which is based on the present value of lease payments. See Note 5 for details of the Company’s right-of-use assets and lease liabilities related to its operating leases.

Note 1. Summary of Significant Accounting Policies, Continued

Risks and uncertainties:

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Reclassifications:

Certain prior year amounts have been reclassified in the consolidated financial statements to conform with the current year presentation. The reclassifications had no effect on previously reported net income or stockholders' equity.

New accounting pronouncements:

The following is a summary of recent authoritative pronouncements that may affect accounting, reporting, and disclosure of financial information by the Company:

In June 2016, the FASB issued ASU 2016-13, as amended, to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and similar instruments) and net investments in leases recognized by a lessor. For debt securities with other-than-temporary impairment (OTTI), the guidance will be applied prospectively. Existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The assets will be grossed up for the allowance of expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance. Adoption is effective for interim and annual reporting periods beginning after December 15, 2022. Early adoption was permitted. As a result of adopting this standard effective January 1, 2023, the Company's retained earnings increased \$24 thousand, the allowance for credit losses decreased \$247 thousand, and the reserves for unfunded commitments increased \$223 thousand. The adoption of ASU 2016-13 did not have significant impact on our regulatory capital reserves. At adoption, no allowance was recorded related to HTM or AFS debt securities.

Note 1. Summary of Significant Accounting Policies, Continued

New accounting pronouncements:

In March 2020, the FASB issued guidance to provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The guidance provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The ASU is intended to help stakeholders during the global market-wide reference rate transition period. The amendments are effective through December 31, 2022. The Company does not expect these amendments to have a material effect on its financial statements. In December 2022, the FASB issued amendments to extend the period of time preparers can use the reference rate reform relief guidance under Accounting Standards Codification (ASC) Topic 848 from December 31, 2022, to December 31, 2024, to address the fact that all London Interbank Offered Rate (LIBOR) tenors were not discontinued as of December 31, 2021, and some tenors will be published until June 2023. The amendments are effective immediately for all entities and applied prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2022, the FASB issued amendments which are intended to improve the decision usefulness of information provided to investors about certain loan refinancings, restructurings, and write-offs. The amendments are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The Company does not expect these amendments to have a material effect on its 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 or cash flows.

Oak Ridge Financial Services, Inc.
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December 31, 2022 and 2021

Note 2. Investment Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows (dollars in thousands):

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury securities	\$ 21,774	\$ -	\$ (757)	\$ 21,017
Federal agency mortgage-backed securities	13,875	-	(417)	13,458
Other residential mortgage-backed securities	26,897	1	(1,005)	25,893
Issued by U.S. Government agencies	2,951	17	(4)	2,964
Securities issued by states and political subdivisions in the U.S.	15,805	335	(862)	15,278
Corporate debt securities	<u>2,500</u>	<u>-</u>	<u>(171)</u>	<u>2,329</u>
Total securities available-for-sale	<u>\$ 83,802</u>	<u>\$ 353</u>	<u>\$ (3,216)</u>	<u>\$ 80,939</u>

Held-to-maturity:				
Other residential mortgage-backed securities	\$ 311	\$ 84	\$ (4)	\$ 391
Corporate debt securities	<u>10,850</u>	<u>-</u>	<u>(891)</u>	<u>9,959</u>
Total securities held-to-maturity	<u>\$ 11,161</u>	<u>\$ 84</u>	<u>\$ (895)</u>	<u>\$ 10,350</u>

	December 31, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
Federal agency mortgage-backed securities	\$ 6,229	\$ 191	\$ (50)	\$ 6,370
Other residential mortgage-backed securities	701	10	(5)	706
Issued by U.S. Government agencies	4,316	26	(8)	4,334
Securities issued by states and political subdivisions in the U.S.	29,332	3,554	(24)	32,862
Corporate debt securities	<u>2,500</u>	<u>176</u>	<u>-</u>	<u>2,676</u>
Total securities available-for-sale	<u>\$ 43,078</u>	<u>\$ 3,957</u>	<u>\$ (87)</u>	<u>\$ 46,948</u>

Held-to-maturity:				
Other residential mortgage-backed securities	\$ 387	\$ 166	\$ -	\$ 553
Total securities held-to-maturity	<u>\$ 387</u>	<u>\$ 166</u>	<u>\$ -</u>	<u>\$ 553</u>

Note 2. Investment Securities, Continued

Subinvestment grade available-for-sale and held-to-maturity other residential mortgage-backed securities are analyzed on a quarterly basis for impairment by utilizing an independent third party that performs an analysis of the estimated principal the Bank is expected to collect in a number of different economic scenarios. The result of this analysis determines whether the Bank records an impairment loss on these securities. During the years ended December 31, 2022 and 2021, the Bank recorded impairment charges of \$23 thousand and \$74 thousand, respectively, on private label securities.

The Company had approximately \$1.6 million and \$272 thousand at December 31, 2022 and 2021, respectively, of investments in stock of the FHLB, which is carried at cost. The following factors have been considered in determining the carrying amount of FHLB stock: 1) the recoverability of the par value; 2) the Company has sufficient liquidity to meet all operational needs in the foreseeable future and would not need to dispose of the stock below recorded amounts; 3) redemptions and purchases of the stock are at the discretion of the FHLB; 4) the Company feels the FHLB has the ability to absorb economic losses given the expectation that the various FHLBs have a high degree of government support; and 5) the unrealized losses related to securities owned by the FHLB are manageable given the capital levels of the organization. The Company estimated that the fair value equaled or exceeded the cost of this investment (that is, the investment was not impaired) on the basis of the redemption provisions of the issuing entity. Investment securities with amortized costs of \$537 thousand and \$2.8 million at December 31, 2022 and 2021, respectively, were pledged as collateral on public deposits or for other purposes as required or permitted by law.

As a member bank of the Federal Reserve, the Bank is required to maintain stock in the FRB. At December 31, 2022 and 2021, the Bank had \$1.1 million in FRB stock. For the years ended December 31, 2022 and 2021, the Bank received \$64 thousand and \$31 thousand, respectively, in dividends related to its investment in FRB stock.

Gross realized losses on sales of available-for-sale investment securities were \$131 thousand for the year ended December 31, 2022 with gross realized gains on sales of available-for-sale investment securities of \$182 thousand for the year ended December 31, 2021.

Oak Ridge Financial Services, Inc.
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Note 2. Investment Securities, Continued

The following tables detail unrealized losses and related fair values in the Company's held-to-maturity and available-for-sale investment securities portfolios at December 31, 2022 and 2021. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2022 and 2021 (dollars in thousands).

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2022						
Available-for-sale:						
U.S. Treasury Securities	\$ 15,571	\$ (297)	\$ 5,447	\$ (460)	\$ 21,018	\$ (757)
Federal agency mortgage-backed securities	10,959	(324)	2,499	(93)	13,458	(417)
Other residential mortgage-backed securities	24,041	(976)	298	(29)	24,399	(1,005)
Issued by U.S. Government agencies	-	-	746	(4)	746	(4)
Securities issued by states and political subdivisions in the U.S.	5,438	(223)	2,533	(639)	7,971	(862)
Corporate debt securities	<u>2,329</u>	<u>(171)</u>	<u>-</u>	<u>-</u>	<u>2,329</u>	<u>(171)</u>
Total available-for-sale temporarily impaired securities	<u>\$ 58,460</u>	<u>\$ (1,991)</u>	<u>\$ 11,523</u>	<u>\$ (1,225)</u>	<u>\$ 69,861</u>	<u>\$ (3,216)</u>
Held-to-Maturity:						
Other residential mortgage-backed securities	\$ 123	\$ (4)	\$ -	\$ -	\$ 123	\$ (4)
Corporate Debt	<u>9,959</u>	<u>(891)</u>	<u>-</u>	<u>-</u>	<u>9,959</u>	<u>(891)</u>
Total held-to-maturity temporarily impaired securities	<u>\$ 10,082</u>	<u>\$ (895)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,082</u>	<u>\$ (895)</u>
Total temporarily impaired securities	<u>\$ 68,420</u>	<u>\$ (2,886)</u>	<u>\$ 11,523</u>	<u>\$ (1,225)</u>	<u>\$ 79,943</u>	<u>\$ (4,111)</u>
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2021						
Available for sale:						
Federal agency mortgage-backed securities	\$ 3,216	\$ (50)	\$ -	\$ -	\$ 3,216	\$ (50)
Other residential mortgage-backed securities	253	(1)	110	(4)	363	(5)
Issued by U.S. Government agencies	508	(2)	1,477	(6)	1,985	(8)
Securities issued by states and political subdivisions in the U.S.	<u>1,742</u>	<u>(24)</u>	<u>-</u>	<u>-</u>	<u>1,742</u>	<u>(24)</u>
Total available-for-sale temporarily impaired securities	<u>\$ 5,719</u>	<u>\$ (77)</u>	<u>\$ 1,587</u>	<u>\$ (10)</u>	<u>\$ 7,306</u>	<u>\$ (87)</u>
Total temporarily impaired securities	<u>\$ 5,719</u>	<u>\$ (77)</u>	<u>\$ 1,587</u>	<u>\$ (10)</u>	<u>\$ 7,306</u>	<u>\$ (87)</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
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Note 2. Investment Securities, Continued

There were 53 securities in an unrealized loss position at December 31, 2022, 17 of which was in a continuous unrealized loss position for 12 months or more. There were 12 securities in an unrealized loss position at December 31, 2021, 3 of which was in a continuous unrealized loss position for 12 months or more. Management has considered industry analyst reports, whether downgrades by bond rating agencies have occurred, sector credit reports, the corporation's ability and intent to hold securities to maturity, and volatility in the bond market, in concluding that the unrealized losses as of December 31, 2022 were primarily the result of fluctuations in the bond market related primarily to changes in market interest rates. As a result, all security impairments as of December 31, 2022 are considered to be temporary with the exception of 4 held-to-maturity securities for which impairment charges were recorded in the fourth quarter of 2022.

Maturities of mortgage-backed securities are presented based on contractual amounts. Actual maturities will vary as the underlying loans prepay. The scheduled maturities of securities at December 31, 2022 were as follows (dollars in thousands):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Costs	Fair Value
Due in less than one year	\$ 9,544	\$ 9,448	\$ -	\$ -
Due after one year through five years	36,861	35,900	-	-
Due after five years through ten years	31,609	30,491	7,850	7,199
Due after ten years	<u>5,788</u>	<u>5,100</u>	<u>3,311</u>	<u>3,151</u>
	<u>\$ 83,802</u>	<u>\$ 80,939</u>	<u>\$ 11,161</u>	<u>\$ 10,350</u>

Note 3. Loans

The major components of loans on the balance sheet at December 31, 2022 and 2021, are as follows (dollars in thousands):

	December 31,	
	2022	2021
Commercial	\$ 55,563	\$ 71,101
Loans to nondepository financial institutions	1,171	-
Real estate:		
Real estate construction and development	24,480	22,397
Residential, one-to-four families	78,152	86,835
Residential, 5 or more families	20,453	20,793
Other commercial real estate	241,870	222,389
Agricultural	<u>1,058</u>	<u>2,852</u>
Total real estate	366,013	355,266
Consumer	<u>4,001</u>	<u>3,924</u>
Total loans	426,748	430,891
Deferred loan origination fees, net of costs	(453)	(1,235)
Allowance for loan losses	<u>(4,851)</u>	<u>(3,756)</u>
Total loans, net	<u>\$ 421,444</u>	<u>\$ 425,900</u>

Note 3. Loans, Continued

Commercial loans totaled \$55.6 million and \$71.1 million at December 31, 2022 and 2021, respectively. Commercial loans include both secured and unsecured loans for working capital, expansion, and other business purposes.

Short-term working capital loans are secured by accounts receivable, inventory and/or equipment. The Company also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, cash flow, management and credit history of the borrower, and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment. Commercial loans generally provide greater yields and reprice more frequently than other types of loans, such as real estate loans.

Also within the “commercial” loan category are loans originated under the Paycheck Protection Program (PPP). On March 27, 2021, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law, which established the PPP. Under the PPP, the Small Business Administration (SBA) will forgive loans, in whole or in part, made by approved lenders to eligible borrowers for paycheck and other permitted purposes in accordance with the requirements of the program. These loans carry a fixed rate of 1.00% and a term of two years if originated prior to June 5, 2021, or a term of five years if originated after June 5, 2021, if not forgiven, in whole or in part. The loans are 100% guaranteed by the SBA and as long as the borrower submits its loan forgiveness application within ten months of completion of the covered period, the borrower is not required to make any payments until the forgiveness amount is remitted to the lender by the SBA. The Company received a processing fee ranging from 1% to 5% based on the size of the loan from the SBA. The fees are deferred and amortized over the life of the loans in accordance with ASC 310-20. The Company received approximately \$2.1 million of processing fees and has recognized approximately \$39 thousand and \$560 thousand in fee income during the years ended December 31, 2022, and 2021, respectively. The Company originated 455 PPP loans and 612 PPP loans during the years ended December 31, 2021, and 2020, respectively. These loans totaled approximately \$30.8 million and \$50.1 million during the years ended December 31, 2021, and December 31, 2020, respectively. No PPP loans were originated in 2022. Because these loans are 100% guaranteed by the SBA and did not undergo the Company’s typical underwriting process, they are not graded and do not have an associated reserve. The SBA began accepting PPP Forgiveness Applications on August 10, 2021. Borrowers must submit the application within ten months of the completion of the covered period. Once the borrower has submitted the application, the Company has 60 days to review, issue a lender decision, and submit to the SBA. Once the application is submitted, the SBA has 90 days to review and remit the appropriate forgiveness amount to the Company plus any interest accrued through the date of payment. Outstanding PPP loan balances totaled approximately \$228 thousand and \$19.1 million on December 31, 2022, and 2021, respectively.

Loans to nondepository financial institutions totaled \$1.2 million at December 31, 2022. These represent investments in Small Business Investment Companies that provide debt and equity financing to small businesses.

Real estate loans include construction and land development loans, one-to-four and 5 or more family loans, other commercial real estate loans and agricultural loans.

Note 3. Loans, Continued

Construction and development loans totaled \$24.5 million and \$22.4 million at December 31, 2022 and 2021, respectively. The Bank originates one-to-four family residential construction loans for the construction of custom homes (where the home buyer is the borrower) and provides financing to builders and consumers for the construction of pre-sold homes. The Bank generally receives a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. The Bank also makes commercial real estate construction loans, primarily for owner-occupied properties.

Other commercial real estate loans totaled \$241.9 million and \$222.4 million at December 31, 2022 and 2021, respectively. This lending has involved loans secured by owner-occupied commercial buildings for office, storage and warehouse space, as well as non-owner-occupied commercial buildings. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Residential one-to-four family loans amounted to \$78.2 million and \$86.8 million at December 31, 2022 and 2021, respectively. The Bank's residential mortgage loans are typically either construction loans that convert into permanent financing and are secured by properties located within the Bank's market areas, or refinances of existing one-to-four properties or financing of newly purchased one-to-four family properties.

Residential, 5 or more families' loans totaled \$20.5 million and \$20.8 million at December 31, 2022 and 2021, respectively. This lending has involved loans secured by residential properties with 5 or more properties. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by these types of properties may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Agricultural loans totaled \$1.1 million and \$2.9 million at December 31, 2022 and 2021, respectively. This lending has involved loans secured by agricultural properties. The Bank generally requires the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by these types of properties may be larger in size and may involve a greater degree of risk than one-to-four family residential mortgage loans. Payments on such loans are often dependent on successful operation or management of the properties.

Loans to individuals (consumer loans) include automobile loans, boat and recreational vehicle financing, and miscellaneous secured and unsecured personal loans and totaled \$4.0 million and \$3.9 million at December 31, 2022 and 2021, respectively. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. Consumer loan collections are sensitive to job loss, illness and other personal factors. The Bank manages the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

Note 3. Loans, Continued

Loans of approximately \$291.6 million at December 31, 2022 are pledged as eligible collateral for FHLB advances.

Loan approvals:

The Bank's loan policies and procedures establish the basic guidelines governing its lending operations. The guidelines address the type of loans that the Bank seeks, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to the Bank, including any indebtedness as a guarantor. The policies are reviewed and approved at least annually by the Board of Directors of the Bank. The Bank supplements its own supervision of the loan underwriting and approval process with periodic loan reviews by independent, outside professionals experienced in loan review. Responsibility for loan review and loan underwriting resides with the Chief Credit Officer position. This position is responsible for loan underwriting and approval. On a periodic basis, the Board of Directors of the Bank determines officers lending authority. Authorities may include loans, letters of credit, overdrafts, uncollected funds and such other authorities as determined by the Board of Directors.

The Company, through its normal lending activity, originates and maintains loans receivable that are substantially concentrated in Guilford, Rockingham, Forsyth and Alamance counties in North Carolina.

Credit review and evaluation:

The Bank has a credit administration department that reports to the Bank's Chief Credit Officer. In addition to underwriting and approval of larger credits, the focus of the department is on policy compliance and the proper grading of higher credit risk loans as well as new and existing loans on a sample basis. Additional reporting for problem/criticized assets has been developed along with an after-the-fact loan review.

The Bank uses a risk grading program to facilitate the evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses for real estate, commercial and consumer loans. In this program, risk grades are initially assigned by loan officers, reviewed by credit officers, and reviewed by internal credit review analysts on a test basis. The Bank strives to maintain the loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of the Bank's market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies.

All loans are risk graded on a scale from 1 (highest quality) to 8 (loss). Acceptable loans at inception are grades 1 through 4, and these grades have underwriting requirements that at least meet the minimum requirements of a secondary market source. If borrowers do not meet credit history requirements, other mitigating criteria such as substantial liquidity, low loan-to-value ratios or satisfactory experience with the Bank could be considered and would generally have to be met in order to make the loan. The Bank's loan policy states that a guarantor may be necessary if reasonable doubt exists as to the borrower's ability to repay.

The risk grades, normally assigned by the loan officers when the loan is originated and reviewed by the credit officers, are based on several factors including historical data, current economic factors, composition of the portfolio, and evaluations of the total loan portfolio and assessments of credit quality within specific loan types.

Note 3. Loans, Continued

Credit review and evaluation, continued:

In some cases the risk grades can be assigned by credit executives, depending upon dollar exposure. Because these factors are dynamic, the provision for loan losses can fluctuate. Credit quality reviews are based primarily on an analysis of the borrowers' cash flows, with asset values considered only as a second source of payment. Credit officers work with lenders in underwriting, structuring and risk grading the Bank's credits. The credit administration department focuses on lending policy compliance, credit risk grading, and credit risk reviews on larger dollar exposures. Management uses the information developed from the procedures above in evaluating and grading the loan portfolio. This continual grading process is used to monitor the credit quality of the loan portfolio and to assist management in determining the appropriate levels of the allowance for loan losses.

The following is a summary of the credit risk grade definitions for all loan types.

1. Highest Quality – These loans represent a credit extension of the highest quality. The borrower's historic (at least five years) cash flows manifest extremely large and stable margins of coverage. Balance sheets are conservative, well capitalized, and liquid. After considering debt service for proposed and existing debt, projected cash flows continue to be strong and provide ample coverage. The borrower typically reflects broad geographic and product diversification and has access to alternative financial markets.
2. Good Quality – These loans have a sound primary and secondary source of repayment. The borrower may have access to alternative sources of financing, but sources are not as widely available as they are to a higher graded borrower. This loan carries a normal level of risk, with minimal loss exposure. The borrower has the ability to perform according to the terms of the credit facility. The margins of cash flow coverage are satisfactory but vulnerable to more rapid deterioration than the highest quality loans.
3. Satisfactory – The borrowers are a reasonable credit risk and demonstrate the ability to repay the debt from normal business operations. Risk factors may include reliability of margins and cash flows, liquidity, dependence on a single product or industry, cyclical trends, depth of management, or limited access to alternative financing sources. Historic financial information may indicate erratic performance, but current trends are positive. Quality of financial information is adequate, but is not as detailed and sophisticated as information found on higher graded loans. If adverse circumstances arise, the impact on the borrower may be significant.
4. Satisfactory – Merits Attention – These credit facilities have potential developing weaknesses that deserve extra attention from the account manager and other management personnel. If the developing weakness is not corrected or mitigated, there may be deterioration in the ability of the borrower to repay the bank's debt in the future.
5. Watch or Special Mention – These loans are typically existing loans, made using the passing grades outlined above, that have deteriorated to the point that cash flow is not consistently adequate to meet debt service or current debt service coverage is based on projections. Secondary sources of repayment may include specialized collateral or real estate that is not readily marketable or undeveloped, making timely collection in doubt.

Oak Ridge Financial Services, Inc.
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Note 3. Loans, Continued

Credit review and evaluation, continued:

6. Substandard – Loans and other credit extensions bearing this grade are considered inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These obligations, even if apparently protected by collateral value, have well-defined weaknesses related to adverse financial, managerial, economic, market, or political conditions jeopardizing repayment of principal and interest as originally intended. Clear loss potential, however, does not have to exist in any individual assets classified as substandard.
7. Substandard Impaired (also includes any loans over 90 days past due, excluding sold mortgages) – Loans and other credit extensions graded “7” have all the weaknesses inherent in those graded “6,” with the added characteristic that the severity of the weaknesses makes collection or liquidation in full highly questionable or improbable based upon currently existing facts, conditions, and values. The probability of some loss is extremely high.
8. Loss – Loans in this classification are considered uncollectible and cannot be justified as a viable asset of the bank. Such loans are to be charged-off or charged-down. This classification does not mean the loan has absolutely no recovery value, but that it is neither practical nor desirable to defer writing off this loan even though partial recovery may be obtained in the future.

The following is a summary of credit quality indicators by class as of December 31, 2022 and 2021 (dollars in thousands):

<u>December 31, 2022</u>	<u>Pass (Grades 1-4)</u>	<u>Special Mention (Grade 5)</u>	<u>Substandard and Lower (Grades 6-8)</u>	<u>Total</u>
Commercial	\$ 54,834	\$ 583	\$ 146	\$ 55,563
Loans to nondepository financial institutions	1,171	-	-	1,171
Real estate construction and development	21,737	1,540	1,203	24,480
Residential, one-to-four families	75,496	636	2,020	78,152
Residential, 5 or more families	19,629	278	546	20,453
Other commercial real estate	235,337	5,607	926	241,870
Agricultural	1,058	-	-	1,058
Consumer	3,992	5	4	4,001
	<u>\$ 413,254</u>	<u>\$ 8,649</u>	<u>\$ 4,845</u>	<u>\$ 426,748</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 3. Loans, Continued

Credit review and evaluation, continued:

<u>December 31, 2021</u>	<u>Pass (Grades 1-4)</u>	<u>Special Mention (Grade 5)</u>	<u>Substandard and Lower (Grades 6-8)</u>	<u>Total</u>
Commercial	\$ 69,375	\$ 1,978	\$ 348	\$ 71,701
Real estate construction and development	19,366	2,851	180	22,397
Residential, one-to-four families	83,297	1,481	2,057	86,835
Residential, 5 or more families	20,505	288	-	20,793
Other commercial real estate	214,719	6,061	1,609	222,389
Agricultural	1,118	-	1,734	2,852
Consumer	3,916	-	8	3,924
	<u>\$ 412,296</u>	<u>\$ 12,659</u>	<u>\$ 5,936</u>	<u>\$ 430,891</u>

The following tables present the Bank's aged analysis of past due loans and nonaccrual loans as of December 31, 2022 and 2021 (dollars in thousands):

<u>December 31, 2022</u>	<u>30-89 Days Past Due</u>	<u>Greater than 90 Days Past Due (Nonaccrual)</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Past Due 90 Days or More and Still Accruing</u>
Commercial	\$ 41	\$ 21	\$ 62	\$ 55,501	\$ 55,563	\$ -
Loans to nondepository financial institutions	-	-	-	1,171	1,171	-
Real estate construction and development	-	-	-	24,480	24,480	-
Residential, one-to-four families	29	202	231	77,921	78,152	-
Residential, 5 or more families	-	-	-	20,453	20,453	-
Other commercial real estate	-	151	151	241,719	241,870	-
Agricultural	-	-	-	1,058	1,058	-
Consumer	33	-	33	3,968	4,001	-
	<u>\$ 103</u>	<u>\$ 374</u>	<u>\$ 477</u>	<u>\$ 426,271</u>	<u>\$ 426,748</u>	

<u>December 31, 2021</u>	<u>30-89 Days Past Due</u>	<u>Greater than 90 Days Past Due (Nonaccrual)</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Past Due 90 Days or More and Still Accruing</u>
Commercial	\$ -	\$ 270	\$ 270	\$ 71,431	\$ 71,701	\$ -
Real estate construction and development	-	180	180	22,217	22,397	-
Residential, one-to-four families	178	705	883	85,952	86,835	-
Residential, 5 or more families	-	-	-	20,793	20,793	-
Other commercial real estate	-	-	-	222,389	222,389	-
Agricultural	-	1,734	1,734	1,118	2,852	-
Consumer	10	8	18	3,906	3,924	-
	<u>\$ 188</u>	<u>\$ 2,897</u>	<u>\$ 3,085</u>	<u>\$ 427,806</u>	<u>\$ 430,891</u>	<u>\$ -</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 3. Loans, Continued

Credit review and evaluation, continued:

Past due loans reported in the preceding tables do not include loans granted forbearance terms since payment terms have been modified or extended, although the loans are past due based on original contract terms. All loans with forbearance terms are included and reported as impaired loans.

Loans are considered past due if the required principal and interest income have not been received as of the date such payments were due.

Troubled debt restructurings:

The total amount of TDR loans outstanding as of December 31, 2022 was \$1.3 million with \$103 thousand in related reserves. Approximately \$1.0 million of TDR loans were accruing interest as of December 31, 2022, as these loans had sufficient evidence of paying according to the new restructured terms to warrant a return to accrual status. The total amount of TDR loans outstanding as of December 31, 2021 was \$2.4 million with no related reserves. Approximately \$816 thousand of TDR loans were accruing interest as of December 31, 2021, as these loans had sufficient evidence of paying according to the new restructured terms to warrant a return to accrual status.

The Company reports the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. Reductions in the recorded investment are primarily due to the partial charge-off of the principal balance prior to modification. There are no commitments to lend additional funds to debtors owing receivables whose terms have been modified. There were no TDRs as of December 31, 2022 that subsequently defaulted. The following table includes the recorded investment and number of modifications for TDR restructured loans for the years ended December 31, 2022 and 2021 (dollars in thousands):

December 31, 2022				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Adjustment to the Reserves as a Result of the Restructuring
Extended payment terms:				
Commercial real estate	1	\$ 864	\$ 864	\$ -
	1	\$ 864	\$ 864	\$ -
December 31, 2021				
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Adjustment to the Reserves as a Result of the Restructuring
Extended payment terms:				
Commercial	1	\$ 15	\$ 15	\$ -
Residential,				
one-to-four families	1	93	93	-
Consumer	1	8	8	-
	3	\$ 116	\$ 116	\$ -

Note 3. Loans, Continued

Impaired loans:

Management considers certain loans graded “substandard” (loans graded 6), “substandard impaired” (loans graded 7), or “loss” (loans graded 8) to be individually impaired. The Bank measures impairment based upon probable cash flows or the value of the collateral. Collateral value is assessed based on collateral value trends, liquidation value trends, and other liquidation expenses to determine logical and credible discounts that may be needed. Updated appraisals are required for all impaired loans and typically at renewal or modification of larger loans if the appraisal is more than 12 months old.

Impaired loans for all classes of loans typically include nonaccrual loans, loans over 90 days past due and still accruing, troubled debt restructured loans and other potential problem loans considered impaired based on other underlying factors. TDR loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal have been granted due to the borrower’s weakened financial condition. Interest on TDR loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur and a sustained payment performance period is obtained. Due to the borrowers’ inability to make the payments required under the original loan terms, the Bank modifies the terms by granting a longer amortized repayment structure or reduced interest rates. Potential problem loans are loans which are currently performing and are not included in nonaccrual or restructured loans above, but about which we have concerns as to the borrower’s ability to comply with present repayment terms. These loans are likely to be included later in nonaccrual, past due or troubled debt restructured loans, so they are considered by management in assessing the adequacy of the allowance for loan losses.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 3. Loans, Continued

Impaired loans, continued:

The following tables present the Bank's investment in loans considered to be impaired and related information on those impaired loans as of December 31, 2022 and 2021 (dollars in thousands):

December 31, 2022	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 90	\$ 92	\$ -	\$ 179	\$ -
Real estate construction and development	-	-	-	22	-
Residential, one-to-four families	633	668	-	914	1
Other commercial real estate	846	846	-	499	4
Agricultural	-	-	-	700	-
Consumer	8	8	-	8	-
Total impaired loans with no related allowance recorded	1,577	1,614	-	2,322	5
With allowance recorded:					
Commercial	227	227	227	121	3
Real estate construction and development	1,204	1,204	555	669	11
Other commercial real estate	151	152	152	76	-
Residential, one-to-four families	-	-	-	50	-
Agricultural	-	-	-	60	-
Consumer	1	1	1	-	-
Total impaired loans with related allowance recorded	1,583	1,584	935	976	14
Total impaired loans	<u>\$ 3,160</u>	<u>\$ 3,198</u>	<u>\$ 935</u>	<u>\$ 3,298</u>	<u>\$ 19</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 3. Loans, Continued

Impaired loans, continued:

<u>December 31, 2021</u>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With no related allowance recorded:					
Commercial	\$ 268	\$ 268	\$ -	\$ 281	\$ 8
Real estate construction and development	44	44	-	510	-
Residential, one-to-four families	1,194	1,222	-	1,057	33
Other commercial real estate	151	151	-	189	-
Agricultural	1,400	1,400	-	1,474	-
Consumer	<u>8</u>	<u>8</u>	<u>-</u>	<u>9</u>	<u>1</u>
Total impaired loans with no related allowance recorded	3,065	3,093	-	3,520	42
With allowance recorded:					
Commercial	16	16	16	16	1
Real estate construction and development	135	135	36	135	-
Residential, one-to-four families	101	101	39	101	5
Agricultural	<u>120</u>	<u>273</u>	<u>54</u>	<u>120</u>	<u>-</u>
Total impaired loans with related related allowance recorded	<u>372</u>	<u>525</u>	<u>145</u>	<u>372</u>	<u>6</u>
Total impaired loans	<u>\$ 3,437</u>	<u>\$ 3,618</u>	<u>\$ 145</u>	<u>\$ 3,892</u>	<u>\$ 48</u>

Note 4. Allowance for Loan Losses

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate for probable losses that have been incurred within the existing portfolio of loans. The primary risks inherent in the Bank's loan portfolio, including the adequacy of the allowance or reserve for loan losses, are based on management's assumptions regarding, among other factors, general and local economic conditions, which are difficult to predict and are beyond the Bank's control. In estimating these risks, and the related loss reserve levels, management also considers the financial conditions of specific borrowers and credit concentrations with specific borrowers, groups of borrowers, and industries.

The allowance for loan losses is adjusted by direct charges to provision expense. Losses on loans are charged against the allowance for loan losses in the accounting period in which they are determined by management to be uncollectible. Recoveries during the period are credited to the allowance for loan losses. The Company recorded a recovery of loan losses of approximately \$41 thousand and \$682 thousand for the years ended December 31, 2022 and 2021, respectively. The provision expense is determined by the Bank's allowance for loan losses model. The components of the model are specific reserves for impaired loans and a general allocation for unimpaired loans. The general allocation has two components, an estimate based on historical loss experience and an additional estimate based on internal and external environmental factors due to the uncertainty of historical loss experience in predicting current embedded losses in the portfolio that will be realized in the future.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 4. Allowance for Loan Losses, continued

The portion of the general allocation on environmental factors includes estimates of losses related to interest rate trends, unemployment trends, past due and nonaccrual trends, watch list trends, charge-off trends, and monitoring assessments. The market served by the Bank continues to experience softening from the general economy and some declines in real estate values.

The following table summarizes the balances by loan category of the allowance for loan losses with changes arising from charge-offs, recoveries and provision expense for the years ended December 31, 2022 and 2021 (dollars in thousands):

December 31, 2022:

Allowance for Loan Losses	Commercial	Loans to nondepository financial institutions	Real estate Construction and Development	Residential, one-to-four families	Residential, 5 or more families	Other commercial real estate	Agricultural	Consumer	Total
Allowance for credit losses:									
Beginning balance	\$ 533	\$ -	\$ 618	\$ 632	\$ 49	\$ 1,092	\$ 812	\$ 20	\$ 3,756
Charge-offs	-	-	-	(141)	-	-	-	(15)	(156)
Recoveries	1,043	-	-	240	-	-	-	9	1,292
Provision	(339)	-	605	(707)	(49)	1,249	(812)	12	(41)
Ending balance	\$ 1,237	\$ -	\$ 1,223	\$ 24	\$ -	\$ 2,341	\$ -	\$ 26	\$ 4,851

December 31, 2021:

	Commercial	Real estate construction and development	Residential one-to-four families	Residential 5 or more families	Other commercial real estate	Agricultural	Consumer	Total
Allowance for loan losses:								
Beginning balance	\$ 2,057	\$ 403	\$ 436	\$ 129	\$ 2,248	\$ 95	\$ 90	\$ 5,458
Charge-offs	(403)	(592)	(35)	-	-	-	(11)	(1,041)
Recoveries	17	-	1	-	-	-	3	21
Provision	(1,138)	807	230	(80)	(1,156)	717	(62)	(682)
Ending balance	\$ 533	\$ 618	\$ 632	\$ 49	\$ 1,092	\$ 812	\$ 20	\$ 3,756

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 4. Allowance for Loan Losses, Continued

The following tables summarize the allowance for loan losses and recorded investment in loans as of December 31, 2022 and 2021 (dollars in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
December 31, 2022						
Commercial	\$ 227	\$ 1,010	\$ 1,237	\$ 317	\$ 55,246	\$ 55,563
Loans to nondepository financial institutions	-	-	-	-	1,171	1,171
Real estate construction and development	555	668	1,223	1,204	23,276	24,480
Residential, one-to-four families	-	24	24	633	77,519	78,152
Residential, 5 or more families	-	-	-	-	20,453	20,453
Other commercial real estate	152	2,189	2,341	997	240,873	241,870
Agricultural	-	-	-	-	1,058	1,058
Consumer	1	25	26	9	3,992	4,001
	<u>\$ 935</u>	<u>\$ 3,916</u>	<u>\$ 4,851</u>	<u>\$ 3,160</u>	<u>\$ 423,588</u>	<u>\$ 426,748</u>

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
December 31, 2021						
Commercial	\$ 16	\$ 517	\$ 533	\$ 284	\$ 71,417	\$ 71,701
Real estate construction and development	36	582	618	179	22,218	22,937
Residential, one-to-four families	39	593	632	1,295	85,540	86,835
Residential, 5 or more families	-	49	49	-	20,793	20,793
Other commercial real estate	-	1,092	1,092	151	222,238	222,389
Agricultural	54	758	812	1,520	1,332	2,852
Consumer	-	20	20	8	3,916	3,924
	<u>\$ 145</u>	<u>\$ 3,611</u>	<u>\$ 3,756</u>	<u>\$ 3,437</u>	<u>\$ 427,454</u>	<u>\$ 430,891</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 5. Property and Equipment

Components of property and equipment and total accumulated depreciation are as follows (dollars in thousands):

	<u>December 31,</u>	
	<u>2022</u>	<u>2021</u>
Land, buildings, and improvements	\$ 10,298	\$ 10,265
Furniture and equipment	<u>11,366</u>	<u>10,948</u>
Property and equipment, total	21,664	21,213
Less accumulated depreciation	<u>(12,472)</u>	<u>(11,306)</u>
Property and equipment, net of depreciation	<u>\$ 9,192</u>	<u>\$ 9,907</u>

Depreciation expense for the years ended December 31, 2022 and 2021, was \$1.2 and \$1.1 million, respectively.

Leases:

The Company has applied the requirements of ASU 2016-02, *Leases (Topic 842)* and all subsequent ASUs that modified Topic 842. The Company's lease agreements in which Topic 842 has been applied are primarily for retail branch real estate properties. The Company has non-cancelable operating leases for four branch locations, and these lease agreements have terms ranging from 5 to 20 years and will expire between 2023 and 2035. Most of them have options to terminate the lease without penalty at specific intervals ranging from 3 to 5 years. For operating leases, the lease liability is recorded at the present value of the unpaid lease payments discounted at the discount rate for the lease established at the commencement date. Regarding the discount rate, Topic 842 requires that the implicit rate within the lease agreement be used if readily determinable. If not readily determinable, the Company should use its incremental borrowing rate at the commencement date over a similar term. The Company utilized Federal Home Loan Bank (FHLB) Atlanta's Fixed Rate Credit rates for terms consistent with the Company's lease terms. Right-of-use ("ROU") assets represent the Company's right to use an underlying asset for the lease term. ROU assets are measured at the commencement date as the amount of the initial lease liability, adjusted for lease payments made to the lessor at or before commencement date, minus incentives; and for any initial direct costs incurred by the lease.

The following table summarizes the activity of the Company's operating ROU assets during the years ended December 31, 2022 and 2021 (dollars in thousands):

	<u>December 31,</u>	
	<u>2022</u>	<u>2021</u>
Beginning balance	\$ 1,594	\$ 1,990
Operating ROU assets recognized during the year	-	-
Amortization of operating ROU assets	<u>(411)</u>	<u>(396)</u>
Ending balance	<u>\$ 1,183</u>	<u>\$ 1,594</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 5. Property and Equipment, Continued

Leases, continued:

Total rent expense related to these leases was \$438 thousand and \$436 thousand for the years ended December 31, 2022 and 2021, respectively.

The following table summarizes other information related to the Company's operating leases (dollars in thousands):

	<u>December 31,</u>	
	<u>2022</u>	<u>2021</u>
Total operating lease costs	\$ 410	\$ 396
Cash paid for amounts related to operating leases	\$ 438	\$ 436
Weighted-average remaining lease term – operating leases, in years	10.25	8.87
Weighted-average discount rate – operating leases	1.95%	1.98%

The following table summarizes the maturity of remaining operating lease liabilities as of December 31, 2022 (dollars in thousands):

2023	\$ 297
2024	244
2025	214
2026	184
2027	194
Thereafter	597
Total lease payments	1,730
Less: imputed interest	(547)
Operating lease liability	<u>\$ 1,183</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 6. Income Taxes

Current and deferred income tax components:

The components of income tax expense (benefit) for the years ended December 31, 2022 and 2021, are as follows (dollars in thousands):

	<u>2022</u>	<u>2021</u>
Current		
Federal	\$ 1,471	\$ 1,506
State	215	237
	<u>1,686</u>	<u>1,743</u>
Deferred		
Federal	13	265
State	(7)	1
Deferred tax asset valuation change	14	20
Deferred taxes	20	286
Net income tax expense	<u>\$ 1,706</u>	<u>\$ 2,029</u>

Rate reconciliation:

A reconciliation of income tax expense (benefit) computed at the statutory federal income tax rate included in the statement of operations for the years ended December 31, 2022 and 2021, is as follows (dollars in thousands):

	<u>2022</u>	<u>2021</u>
Tax at statutory federal rate	\$ 1,757	\$ 2,057
Income from bank owned life insurance	(17)	(18)
Tax-exempt income	(175)	(191)
State taxes, net of federal benefit	165	188
Deferred tax asset valuation allowance change	14	20
Other	(38)	(27)
	<u>\$ 1,706</u>	<u>\$ 2,029</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 6. Income Taxes, Continued

Deferred income tax analysis:

The significant components of the net deferred tax asset (liability) at December 31, 2022 and 2021, are reported in other assets and are summarized as follows (dollars in thousands):

	<u>2022</u>	<u>2021</u>
Deferred tax assets		
Allowance for loan losses	\$ 729	\$ 820
Accrued compensation	468	480
Other accrued liabilities	268	199
State carryforwards	128	114
Deferred loan fees	104	284
Unrealized loss on investment securities	94	89
Post-retirement benefit obligation	87	86
Investment in partnership	162	121
Unrealized loss on available-for-sale securities	658	-
Total deferred tax assets	<u>2,698</u>	<u>2,193</u>
Valuation allowance	<u>(128)</u>	<u>(114)</u>
Deferred tax asset	<u>2,570</u>	<u>2,079</u>
Deferred tax liabilities		
Stock compensation	(38)	(66)
Depreciation	(757)	(876)
Unrealized appreciation on available-for-sale securities	-	(889)
Total deferred tax liabilities	<u>(795)</u>	<u>(1,831)</u>
Net deferred tax (liability) asset	<u>\$ 1,775</u>	<u>\$ 248</u>

At December 31, 2022 and 2021, the Company had net loss carryforwards for state income tax purposes of approximately \$6.4 million and \$5.7 million, respectively. The state net loss carryforwards begin to expire in 2022. Utilization of state net loss carryforwards to reduce future income taxes will depend on the Company's ability to generate sufficient taxable income of the appropriate type and character prior to expiration. Accordingly, the Company has established a deferred tax valuation allowance to offset state net loss carryforwards. For the years ended December 31, 2022 and 2021, the valuation allowance increased \$14 thousand and \$20,000, respectively.

Unrecognized tax benefits:

Current accounting standards prescribe a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, as well as guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosure.

There have been no gross amounts of unrecognized tax benefits, interest or penalties related to uncertain tax positions since adoption. There are no unrecognized tax benefits that would, if recognized, affect the effective tax rate. There are no positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 6. Income Taxes, Continued

Unrecognized tax benefits, continued:

With few exceptions, years prior to December 31, 2019 are closed under the statute of limitations for federal, state and local income tax matters.

Note 7. Deposits

At December 31, 2022 and 2021, time deposits that met or exceeded the FDIC insurance limit of \$250,000 amount to approximately \$6.0 million and \$8.7 million, respectively. At December 31, 2022, the scheduled maturities of time deposits are as follows: (dollars in thousands)

2023	\$	53,790
2024		18,364
2025		4,449
2026		5,863
2027		7
Thereafter		-
Total time deposits	\$	<u>82,473</u>

Brokered deposits were \$34.9 million as of December 31, 2022 and 2021, respectively.

Note 8. Borrowed Funds

Short-term FHLB Advances:

The Company's short-term borrowings consist of borrowings from the Federal Home Loan Bank (the "FHLB"). The following table summarizes short-term borrowings at December 31, 2022 and 2021 (dollars in thousands):

	<u>2022</u>		<u>2021</u>	
	<u>Total Principal</u>	<u>Weighted Average Rate</u>	<u>Total Principal</u>	<u>Weighted Average Rate</u>
Federal Home Loan Bank Advances	\$ 30,000	4.57%	\$ -	-%

The Federal Home Loan Bank Advances as of December 31, 2022 mature on November 29, 2023.

Information concerning short-term Federal Home Loan Bank borrowings for 2022 and 2021, is summarized below (dollars in thousands):

	<u>2022</u>	<u>2021</u>
Average daily balance during the year	\$ 5,041	\$ 2,751
Maximum month-end balance during the year	\$ 30,000	\$ 8,000
Amount outstanding at end of year	\$ 30,000	\$ -

Note 8. Borrowed Funds, Continued

Short-term borrowings, continued:

All short-term FHLB advances are floating-rate instruments. Pursuant to a collateral agreement with the FHLB, advances are collateralized by all of the Bank's FHLB stock and qualifying residential one-to-four family first mortgage loans, home equity lines of credit, and commercial real estate loans. The eligible residential one-to-four family first mortgage, home equity lines of credit, and commercial real estate loans as of December 31, 2022, were \$11.2 million, \$5.0 million and \$170.0 million, respectively. This agreement with the FHLB provides for a line of credit of up to 30% of the Bank's assets, subject to the Bank providing adequate collateral to secure the borrowings. In addition, the Bank had investments with a market value of \$869 thousand held in safekeeping that the Bank can provide as collateral for borrowings.

The Company has established various credit facilities to provide additional liquidity if and as needed. These include unsecured lines of credit with correspondent banks totaling \$47.0 million and are subject to cancellation without notice.

Other borrowings:

The Company had long-term borrowings of \$418 and \$683 thousand outstanding at December 31, 2022 and 2021, respectively.

The long-term borrowings outstanding as of December 31, 2022 and 2021, are secured by a pledge and assignment of a money market deposit account by the Company to the lender. If requested by the Company to the lender, the amount of the pledge and assignment of the money market account may be reduced to an amount not less than the current principal balance of the loan plus an amount equal to six months interest. The loan agreement calls for nineteen quarterly principal payments of \$33,125 beginning on October 17, 2018 with one final principal payment of \$714,779 due on July 17, 2023. The loan carries a variable interest rate, with the index being the lender's rate on the money market deposit account plus 1.50%. As of December 31, 2022, the rate on the index was 4.42%.

Junior subordinated debentures:

In 2007, the Company issued \$8.2 million of junior subordinated debentures to the Trust in exchange for the proceeds of trust preferred securities issued by the Trust. The junior subordinated debentures are included in long-term debt and the Company's equity interest in the Trust is included in other assets.

The Trust was created by Oak Ridge on June 28, 2007, at which time the Trust issued \$8.0 million in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature on June 28, 2037. Distributions are payable on the securities at the floating rate equal to the three-month London Interbank Offered Rate ("LIBOR") plus 1.60%, and the securities may be prepaid at par by the Trust at any time after June 28, 2017. The principal assets of the Trust are \$8.3 million of Oak Ridge's junior subordinated debentures which mature on June 28, 2037, and bear interest at the floating rate equal to the three-month LIBOR plus 1.60%, and which are callable by Oak Ridge after June 28, 2017. All \$248,000 in the aggregate liquidation amount of the Trust's common securities are held by Oak Ridge.

Note 8. Borrowed Funds, Continued

Subordinated debentures:

On June 29, 2016, \$5.5 million of subordinated debentures were issued by the Company. Interest is payable every three months on the securities at a fixed rate of 7%, and the debentures may be prepaid at par by the Company at any time, without penalty, after June 29, 2021. The company prepaid the entire balance at par on June 30, 2021. The maturity date of the debentures was June 29, 2026.

On June 4, 2020, \$10.0 million of subordinated debentures were issued by the Company. Interest is payable semi-annually on the securities at a fixed rate of 6.25%, and the debentures may be prepaid at par by the Company at any time, without penalty, after June 4, 2025. Thereafter, interest is payable every three months on the securities at the floating rate equal to 3-month LIBOR plus 587 basis points. The subordinated debenture agreement provides for an index other than 3-month LIBOR if that index is no longer published. The possible alternative rate indexes plus 587 basis points include either (1) Term Secured Overnight Financing Rate (SOFR); (2) Compounded SOFR; (3) the alternate rate of interest that has been selected or recommended by the Relevant Governmental Body as the replacement for the then current Benchmark for the applicable Corresponding Tenor; (4) the International Swaps and Derivatives Association, Inc. Fallback Rate; or (5) the alternate rate of interest that has been selected by the Issuer as the replacement for the then-current Benchmark for the applicable Corresponding Tenor giving due consideration to any industry-accepted rate of interest as a replacement for the then current Benchmark for U.S. dollar denominated floating rate notes at such time.

Note 9. Retirement Plans and Other Postretirement Benefits

Defined contribution plan:

The Company maintains a profit-sharing plan pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). The plan covers substantially all employees. Participants may contribute a percentage of compensation, subject to the maximum allowed under the Code. In addition, the Company may make additional contributions at the discretion of the Board of Directors. The Company paid \$195 thousand and \$163 thousand during the years ended December 31, 2022 and 2021, respectively.

Employee Stock Ownership Plan:

In 2010, the Company established an Employee Stock Ownership Plan ("ESOP") for the employees of the Bank. The ESOP is a qualifying plan under Internal Revenue Service guidelines. It covers all employees who work at least 1,000 hours per year, are at least 21 years of age, and have completed one year of service. In the years ended December 31, 2022 and 2021, the Company expensed \$314 thousand and \$360 thousand, respectively, to be contributed to the Plan. On June 25, 2016, the Company issued and sold 124,842 shares of its common stock to the ESOP for a total purchase price of \$900 thousand. On July 17, 2018, the ESOP purchased 54,098 shares of the Company's common stock for a total purchase price of \$750 thousand.

Note 9. Retirement Plans and Other Postretirement Benefits, Continued

Flexible Benefits Plan:

The Company maintains a Flexible Benefits Plan, which covers substantially all employees. Participants may set aside pre-tax dollars to provide for the future expenses such as insurance, dependent care or health care. Expenses of the plan were \$429 thousand and \$435 thousand for the years ended December 31, 2022 and 2021, respectively.

Cash value of life insurance:

The Company is the owner and beneficiary of life insurance policies on certain current and former executive officers. Policy cash values on the balance sheet totaled \$6.1 million and \$6.0 million at December 31, 2022 and 2021, respectively.

Supplemental executive retirement plan:

In January of 2006, the Company adopted a supplemental executive retirement plan to provide benefits for certain members of management. Under plan provisions, aggregate fixed annual payments of \$153 thousand are payable for these members of management for their lifetime, beginning with their normal retirement ages of 65. In 2016, the Company adopted another supplemental executive retirement plan to provide a benefit to a member of the Company's management. Under this plan's provisions, aggregate fixed annual payments of \$29 thousand begin at the time the member of management attains the age of 70 and cease at the time they are 80. In September of 2021, the Company adopted a supplemental executive retirement plan to provide benefits for certain members of management. Under plan provisions, aggregate fixed annual payments of \$130 thousand are payable for these members of management for fifteen years, beginning with their normal retirement ages of 65. The liability for all of the agreements is calculated by discounting the anticipated future cash flows at 4.75%. The liability accrued for this obligation was \$1.5 million and \$1.4 million at December 31, 2022 and 2021, respectively. Charges to income and expense are based on changes in the cash value of insurance as well as any additional charges required to fund the liability, and in both of the years ended December 31, 2022 and 2021, the Company paid \$75 thousand to members of management covered by the supplemental retirement plan. The Company funded the supplemental executive retirement plan through the purchase of bank-owned life insurance ("BOLI") during 2003 and 2004 with initial investments of \$1.9 million and \$1.8 million, respectively. The corresponding cash surrender values of the BOLI policies as of December 31, 2022 and 2021, were \$6.1 million and \$6.0 million, respectively.

Stock plans:

During 2007, the Company adopted the Stock Ownership and Long-Term Stock Incentive Plan (the "Omnibus Plan"). The Omnibus Plan provides for the issuance of up to an aggregate of 500,000 shares of common stock in the form of stock options, restricted stock awards and performance unit awards. The Omnibus Plan expired in June of 2016. An award that is outstanding when the Omnibus Plan expired will remain valid for the stated term of the award, but no additional awards may be made after plan expiration.

Note 9. Retirement Plans and Other Postretirement Benefits, Continued

During 2016, the Company adopted the 2016 Long-Term Stock Incentive Plan (the “Stock Incentive Plan”). The Stock Incentive Plan provides for the issuance of up to an aggregate of 225,000 shares of common stock in the form of stock options, restricted stock awards and performance unit awards. The Stock Incentive Plan expires on February 22, 2026. An award that is outstanding when the Stock Incentive Plan expires will remain valid for the stated term of the award, but no additional awards may be made after plan expiration.

Compensation cost charged to income for the Employee Stock Option Plan, the Director Stock Option Plan, and the Long-Term Incentive Plan for the years ended December 31, 2022 and 2021, was approximately \$676 thousand and \$516 thousand, respectively.

Stock options:

No options were granted in the years ended December 31, 2022 and 2021. All stock options were fully vested at December 31, 2019.

Stock options may be issued as incentive stock options or as nonqualified stock options. The term of the option will be established at the time it is granted but shall not exceed ten years. Vesting will also be established at the time the option is granted. The exercise price may not be less than the fair market value of a share of common stock on the date the option is granted. It is the Company’s policy to issue new shares of stock to satisfy option exercises.

Restricted stock awards:

Restricted stock awards are subject to restrictions and the risk of forfeiture if conditions stated in the award agreement are not satisfied at the end of a restriction period. During the restriction period, restricted stock covered by the award will be held by the Company. If the conditions stated in the award agreement are satisfied at the end of the restriction period, the restricted stock will become unrestricted and the certificate evidencing the stock will be delivered to the employee.

Anticipated total unrecognized compensation costs related restricted stock grants will be recognized over the following periods (dollars in thousands):

2023	\$	404
2024		285
2025		202
2026		110
2027 and thereafter		17
	\$	<u>1,018</u>

Restricted stock share grants of 29,750 and 36,275 shares were made during the years ended December 31, 2022 and 2021, respectively. The shares granted in both years have vesting periods of five years. There were forfeitures of restricted stock share grants of 350 and 3,000 shares during the years ended December 31, 2022 and 2021, respectively. Nonvested restricted stock was \$1.0 million and \$1.1 million at December 31, 2022 and 2021, respectively.

Note 10. Reserve Requirements

To comply with banking regulations, the Company is required to maintain certain cash reserve balances. On December 3, 2021, the Federal Reserve kept the reserve requirement at zero percent for all of 2022.

Note 11. Commitments and Contingencies

The Company has various financial instruments (outstanding commitments) with off-balance sheet risk that are issued in the normal course of business to meet the financing needs of its customers.

These financial instruments included commitments to extend credit of \$61.2 million and standby letters of credit of \$1.1 million at December 31, 2022.

The Company's exposure to credit loss for commitments to extend credit and standby letters of credit is the contractual amount of those financial instruments. The Company uses the same credit policies for making commitments and issuing standby letters of credit as it does for on-balance sheet financial instruments. Each customer's creditworthiness is evaluated on an individual case-by-case basis. The amount and type of collateral, if deemed necessary by management, is based upon this evaluation of creditworthiness. Collateral obtained varies, but may include marketable securities, deposits, property, plant and equipment, investment assets, real estate, inventories and accounts receivable. Management does not anticipate any significant losses as a result of these financial instruments and anticipates funding them from normal operations. The Company is not involved in any legal proceedings which, in management's opinion, could have a material effect on the consolidated financial position or results of operations of the Company.

Note 12. Fair Value of Financial Instruments

Fair value estimates are made by management at a specific point in time, based on relevant information about the financial instrument and the market. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument nor are potential taxes and other expenses that would be incurred in an actual sale considered. 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 and/or the methodology used could significantly affect the estimates disclosed. Similarly, the fair values disclosed could vary significantly from amounts realized in actual transactions.

Note 12. Fair Value of Financial Instruments, continued

Fair value hierarchy:

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

There were no changes to the techniques used to measure fair value during the period ended December 31, 2022.

Following is a description of valuation methodologies used for assets recorded at fair value.

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, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets. The sensitivity of fair value to unobservable inputs may result in a significantly higher or lower value.

Note 12. Fair Value of Financial Instruments, Continued

Loans:

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of several methods, including collateral value, market price and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2022, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan 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 impaired loan as nonrecurring Level 3.

Foreclosed assets:

Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated 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 asset 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 asset as nonrecurring Level 3. The bank had no foreclosed assets as of December 31.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 12. Fair Value of Financial Instruments, Continued

Assets recorded at fair value on a recurring basis were as follows (dollars in thousands):

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2022</u>				
Investment securities available for sale:				
U.S. Treasury securities	\$ 21,017	\$ 21,017	\$ -	\$ -
Federal agency mortgage-backed securities	9,896	-	9,896	-
Other residential mortgage-backed securities	18,678	-	18,678	-
Issued by U.S. Government agencies	13,741	-	13,741	-
Securities issued by states and political subdivisions in the U.S.	15,278	-	15,278	-
Corporate debt securities	2,329	-	2,329	-
Total assets at fair value	<u>\$ 80,939</u>	<u>\$ 21,017</u>	<u>\$ 59,922</u>	<u>\$ -</u>

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2021</u>				
Investment securities available for sale:				
Federal agency mortgage-backed securities	\$ 6,370	\$ -	\$ 6,370	\$ -
Other residential mortgage-backed securities	706	-	706	-
Issued by U.S. Government agencies	4,334	-	4,334	-
Securities issued by states and political subdivisions in the U.S.	32,862	-	32,862	-
Corporate debt securities	2,676	-	2,676	-
Total assets at fair value	<u>\$ 46,948</u>	<u>\$ -</u>	<u>\$ 46,948</u>	<u>\$ -</u>

Assets recorded at fair value on a nonrecurring basis were as follows (dollars in thousands):

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>December 31, 2022</u>				
Impaired loans receivable	\$ 2,225	\$ -	\$ -	\$ 2,225
Total assets at fair value	<u>\$ 2,225</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,225</u>
<u>December 31, 2021</u>				
Impaired loans receivable	\$ 3,292	\$ -	\$ -	\$ 3,292
Total assets at fair value	<u>\$ 3,292</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,292</u>

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 12. Fair Value of Financial Instruments, Continued

There were no liabilities recorded at fair value on a recurring or nonrecurring basis at December 31, 2022 or 2021.

There were no assets or liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2022 and 2021.

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2022, the significant unobservable inputs used in the fair value measurements were as follows:

<u>(Dollars in thousands)</u>	<u>Fair Value at December 31, 2022</u>	<u>Fair Value at December 31, 2021</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>General Range of Significant Unobservable Input Values</u>
Impaired loans	\$ 2,225	\$ 3,292	Appraised Value/Discounted Cash Flows/Market Value of Note	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0 – 18%

Note 13. Regulatory Matters

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

Oak Ridge's dividends will be made from dividends received from the Bank. As a North Carolina corporation, our payment of cash dividends is also subject to restrictions under North Carolina law on the declaration of cash dividends. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure the financial soundness of such bank.

Quantitative measures established by regulation to ensure capital adequacy require Oak Ridge and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations), and of Tier I capital to average assets (as defined in the regulations). Management believes, as of December 31, 2022, that the Bank and Oak Ridge meet all capital adequacy requirements to which they are subject.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Note 13. Regulatory Matters, Continued

On September 17, 2019, the federal banking agencies finalized a rule that introduces a simplified measure of capital adequacy for qualifying banking organizations, as directed by the Economic Growth, Regulatory Relief and Consumer Protection Act ("EGRRCPA"). The community bank leverage ratio ("CBLR") framework removes the requirement to measure capital adequacy based on risk-based capital ratios for those qualifying banking organizations that opt into the CBLR framework. Qualifying banking organizations will have met the well-capitalized ratio requirement for purposes of section 38 of the Federal Deposit Insurance Act if the banking organization (1) has less than \$10 billion in total consolidated assets and (2) maintains a tier 1 leverage ratio greater than 9.0%. The Bank opted into the CBLR framework, effective January 1, 2020.

On March 27, 2020, the CARES Act was passed into law. Section 4012 of the CARES Act provided direction to the federal banking agencies to issue an interim rule that modified the requirements under section 201 of the EGRRCPA. Under the interim rule, the required minimum CBLR ratio is 8.0%. For qualifying banking organizations whose CBLR ratios fall below the minimum requirement, but not below 7.0%, the interim rule allows for a two-quarter grace period to meet the minimum requirement of 8.0% as of December 31, 2020. Under the interim rule, the minimum requirement is 8.5% for calendar year 2021 and 9.0% for calendar years 2022 and beyond. The two-quarter grace period requirement for calendar year 2021 is 7.5% and 8% for calendar years 2022 and beyond.

Under the final rule, a qualifying banking organization may opt out of the CBLR framework at any time and revert back to measuring capital adequacy in accordance with the requirements set forth in the BASEL III regulatory capital framework.

Based on the most recent notification from the FDIC, the Bank is well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total common Tier 1, risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's Tier 1 Capital (dollars in thousands) and Community Bank Leverage Ratio as of December 31, 2022 and 2021 is as follows:

	Actual		Minimum CBLR To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio
<u>December 31, 2022</u>				
Tier I Capital (to average total assets)	\$ 64,363	11.27%	\$ 51,400	9.0%
<u>December 31, 2021</u>				
Tier I Capital (to average total assets)	\$ 58,052	10.28%	\$ 47,992	8.5%

Note 14. Related Party Transactions

Oak Ridge and the Bank have had, and expect to have in the future, banking transactions in the ordinary course of business with directors, officers and their affiliates ("Related Parties") on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Those transactions neither involve more than normal risk of collectability nor present any unfavorable features.

Loans at December 31, 2022 and 2021, include loans to officers and directors and their affiliates totaling approximately \$2.1 million and \$964 thousand, respectively. During 2022, \$1.7 million in new loans were disbursed to officers, directors and their associates and principal repayments of approximately \$518 thousand were received on such loans. During 2021, \$205 thousand in new loans were disbursed to officers, directors and their associates and principal repayments of approximately \$52 thousand were received on such loans. Deposits at December 31, 2022 and 2021, include deposits to officers and directors and their affiliates totaling approximately \$518 thousand and \$633 thousand, respectively.

Note 14. Privacy, Data Protection and Cyber Security

Various federal and state laws and regulations contain extensive data privacy and cybersecurity provisions, and the regulatory framework for data privacy and cybersecurity is in considerable flux and rapidly evolving. Current federal law requires financial institutions to periodically disclose their privacy policies and practices relating to sharing such information and enables retail customers to opt out of our ability to share information with unaffiliated third parties under certain circumstances. Other federal and state laws and regulations impact our ability to share certain information with affiliates and non-affiliates for marketing and/or non-marketing purposes, or to contact customers with marketing offers. Current federal law also requires financial institutions to implement a comprehensive information security program that includes administrative, technical and physical safeguards to ensure the security and confidentiality of customer records and information. These security and privacy policies and procedures for the protection of personal and confidential information are in effect across all businesses and geographic locations. Federal law also makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

In November 2022, the Federal Reserve, OCC, and FDIC adopted a new regulation that, among other things, requires a banking organization to notify its primary federal regulators within 36 hours after identifying a "computer-security incident" that the banking organization believes in good faith could materially disrupt or degrade its business or operations in a manner that would, among other things, jeopardize the viability of its operations, result in customers being unable to access their deposit and other accounts, result in a material loss of revenue, profit or franchise value, or pose a threat to the financial stability of the U.S.

Note 14. Privacy, Data Protection and Cyber Security, Continued

Data privacy and data protection are also areas of increasing state legislative focus. For example, the California Consumer Privacy act of 2018 (“CCPA”) gives consumers the right to request disclosure of information collected about them, and whether that information has been sold or shared with others, the right to request deletion of personal information (subject to certain exceptions), the right to opt out of the sale of the consumer’s personal information, and the right not to be discriminated against for exercising these rights. the CCPA contains several exemptions, including that many, but not all, requirements of the CCPA are inapplicable to information that is collected, processed, sold, or disclosed pursuant to federal law. because our correspondent division has an office in California, we have complied with the CCPA. similar laws have been or may be adopted by other states where we do business, such as the Consumer Data Protection act, a privacy law adopted in Virginia in 2022 that grants consumers rights over their personal data. the federal government may also pass data privacy or data protection legislation.

Like other lenders, the Bank uses credit bureau data in their underwriting activities. Use of such data is regulated under the Fair Credit Reporting Act, which also regulates reporting information to credit bureaus, prescreening individuals for credit offers, sharing of information between affiliates, and using affiliate data for marketing purposes. similar state laws may impose additional requirements on us and our subsidiaries. the Bank is also subject to rules and regulations issued by the Federal Trade Commission, which regulates unfair or deceptive acts or practices, including with respect to data privacy and cybersecurity.

We, our customers, regulators and other third parties have been subject to, and are likely to continue to be the target of, cyberattacks. Cyberattacks include computer viruses, malicious or destructive code, phishing attacks, denial of service or information or other security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of confidential, proprietary and other information of ours, our employees, our customers or of third parties, or otherwise materially disrupt our or our customers’ or other third parties’ network access or business operations. The Bank experienced an intentional cyberattack from an external source in 2021 and was able to resume operations with minimal disruption to our customers. Substantially all expenses related to the cyberattack were reimbursed under insurance policies the Bank had in place prior to the cyberattack. The Bank was able to renew these insurance policies after the cyberattack.

Note 15. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date, but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through April 27, 2023, the date the financial statements were available to be issued, and no subsequent events occurred that would require recognition or disclosure in the financial statements.

Oak Ridge Financial Services, Inc.
Notes to Consolidated Financial Statements
December 31, 2022 and 2021

Stockholder Information

Annual Meeting

The Annual Meeting of Shareholders will be held on June 21, 2023 at 11:30 am at the World Headquarters for Oak Ridge Financial Services, Inc. located at 8050 Fogleman Road, Oak Ridge, NC 27310. In the event it is not possible or advisable to hold the annual meeting in person, we will announce alternative arrangements for the meeting at the Company's website at <https://www.bankofoakridge.com/investor-relations/> under the heading "About Us—Investor Relations". As always, we encourage you to vote your shares prior to the annual meeting.

Requests for Information

Requests for information should be directed to Mr. Thomas W. Wayne, Chief Executive Officer and Chief Financial Officer, at Oak Ridge Financial Services Inc., P.O. Box 2, Oak Ridge, North Carolina, 27310; telephone (336) 644-9944.

Independent Auditors

Elliott Davis, PLLC
Certified Public Accountants
500 East Morehead Street, Suite 700
Charlotte, North Carolina 28202

Stock Transfer Agent

Computershare
480 Washington Boulevard
Jersey City, New Jersey 07310

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4423 Highway 220 North
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1597 New Garden Road
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