

1st Federal Savings Bank of SC, Inc.
A wholly owned subsidiary of First Carolina Bancshares, MHC

Report on Financial Statements

As of and for the years ended December 31, 2023 and 2022

1st Federal Savings Bank of SC, Inc.

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This statement has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.

Independent Auditor's Report

Board of Directors
1st Federal Savings Bank of SC, Inc.
Walterboro, South Carolina

Report on the Financial Statements

We have audited the financial statements of 1st Federal Savings Bank of SC, Inc. (the "Bank"), a wholly owned subsidiary of First Carolina Bancshares, MHC, which comprise the balance sheets as of December 31, 2023 and 2022, and the related statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended and the related notes to the financial statements (collectively, the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Bank 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.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Bank has changed its method of accounting for credit losses effective January 1, 2023 due to the adoption of Financial Accounting Standards Board Accounting Standards Codification No. 326, *Financial Instruments – Credit Losses (ASC 326)*. The Bank adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles. Our opinion is not modified with respect to this matter.

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 Bank's ability to continue as a going concern within one year after the date that the financial statements are 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.

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 Bank'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 Bank'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.



Charleston, South Carolina
April 30, 2024

1st Federal Savings Bank of SC, Inc.

Balance Sheets

As of December 31, 2023 and 2022

	<u>2023</u>	<u>2022</u>
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 2,021,904	\$ 2,060,444
Interest-bearing balances	3,805,254	7,717,443
Total cash and cash equivalents	<u>5,827,158</u>	<u>9,777,887</u>
Time deposits with other banks	2,500,000	5,250,000
Securities available-for-sale	14,636,343	18,639,452
Securities held-to-maturity, (fair value of \$12,100,902 as December 31, 2023 and 11,845,034 as of December 31, 2022)	13,134,358	13,045,184
Nonmarketable equity securities, at cost	955,400	149,600
Loans receivable	118,139,047	93,756,047
Less allowance for credit losses	<u>937,560</u>	<u>850,945</u>
Loans receivable, net	<u>117,201,487</u>	<u>92,905,102</u>
Premises, furniture and equipment, net	1,751,645	1,815,268
Accrued interest receivable	543,809	421,799
Deferred tax asset	588,894	701,184
Other assets	<u>774,077</u>	<u>1,233,983</u>
Total assets	<u>\$ 157,913,171</u>	<u>\$ 143,939,459</u>
Liabilities		
Deposits:		
Noninterest-bearing transaction accounts	\$ 24,885,287	\$ 23,541,883
Interest-bearing transaction accounts	38,484,451	43,521,820
Savings and money market	35,484,645	42,992,345
Time deposits	<u>25,667,368</u>	<u>20,618,689</u>
Total deposits	<u>124,521,751</u>	<u>130,674,737</u>
Advances from Federal Home Loan Bank	18,000,000	1,100,000
Other borrowings	4,002,000	2,000,000
Accrued interest payable	155,472	9,313
Other liabilities	<u>609,322</u>	<u>579,673</u>
Total liabilities	<u>147,288,545</u>	<u>134,363,723</u>
Commitments and contingencies - Note 9		
Stockholders' Equity		
Common stock, \$1.00 par value, 8,000,000 shares authorized, 1,012,755 issued and outstanding as of December 31, 2023 and 2022	1,012,755	1,012,755
Capital surplus	1,111,298	1,111,298
Retained earnings	10,196,529	9,570,062
Accumulated other comprehensive loss	<u>(1,695,956)</u>	<u>(2,118,379)</u>
Total stockholders' equity	<u>10,624,626</u>	<u>9,575,736</u>
Total liabilities and stockholders' equity	<u>\$ 157,913,171</u>	<u>\$ 143,939,459</u>

See Notes to Financial Statements

1st Federal Savings Bank of SC, Inc.

Statements of Operations

For the years ended December 31, 2023 and 2022

	<u>2023</u>	<u>2022</u>
Interest income		
Loans, including fees	\$ 4,889,733	\$ 3,389,155
Investment securities, available-for-sale and held-to-maturity	615,672	494,141
Nonmarketable equity securities	20,631	6,200
Interest-bearing deposits	<u>365,665</u>	<u>265,156</u>
Total interest income	<u>5,891,701</u>	<u>4,154,652</u>
Interest expense		
Time deposits	466,107	73,077
Other deposits	181,960	180,161
Advances from Federal Home Loan Bank	<u>378,383</u>	<u>5,139</u>
Total interest expense	<u>1,026,450</u>	<u>258,377</u>
Net interest income	4,865,251	3,896,275
Provision (recovery) for credit losses	<u>102,500</u>	<u>(12,500)</u>
Net interest income after provision (recovery) of credit losses	<u>4,762,751</u>	<u>3,908,775</u>
Noninterest income		
Service charges on deposit accounts	402,737	394,559
Gain on sale of loans, net	-	62,431
Gain on sale of equity Investments	-	33,590
Loss on sale of securities available-for-sale	(39,651)	-
Other service fees and commissions	550,562	478,741
Other income	<u>10,486</u>	<u>8,700</u>
Total noninterest income	<u>924,134</u>	<u>978,021</u>
Noninterest expenses		
Salaries and employee benefits	2,800,265	2,494,398
Net occupancy	221,268	208,151
Furniture and equipment	313,290	289,580
Data processing	415,187	426,166
FDIC assessments	118,307	86,340
Other operating	743,152	671,339
Professional consulting	<u>253,949</u>	<u>225,229</u>
Total noninterest expense	<u>4,865,418</u>	<u>4,401,203</u>
Income before income tax expense	821,467	485,593
Income tax expense	<u>195,000</u>	<u>105,000</u>
Net income	<u>\$ 626,467</u>	<u>\$ 380,593</u>
Earnings per share		
Basic	<u>\$ 0.62</u>	<u>\$ 0.38</u>
Average shares outstanding	<u>1,012,755</u>	<u>1,012,755</u>

See Notes to Financial Statements

1st Federal Savings Bank of SC, Inc.
Statements of Comprehensive Income (Loss)
For the years ended December 31, 2023 and 2022

	<u>2023</u>	<u>2022</u>
Net income	\$ 626,467	\$ 380,593
Other comprehensive income (loss)		
Unrealized holding gains (losses) on securities arising during the year on securities available-for-sale	336,903	(1,096,339)
Reclassification adjustment for net losses realized in net income	(39,651)	-
Unrealized holding losses on securities arising during the year on securities available-for-sale transferred to held-to-maturity	-	(1,460,930)
Reclassification adjustment for amortization of unrealized losses on securities available-for-sale transferred to held-to-maturity	<u>197,810</u>	<u>89,913</u>
Net unrealized gains (losses) on securities	495,062	(2,467,356)
Tax effect	<u>(72,639)</u>	<u>518,146</u>
Other comprehensive income (loss)	<u>422,423</u>	<u>(1,949,210)</u>
Comprehensive income (loss)	<u>\$ 1,048,890</u>	<u>\$ (1,568,617)</u>

See Notes to Financial Statements

1st Federal Savings Bank of SC, Inc.
Statements of Changes in Stockholders' Equity
For the years ended December 31, 2023 and 2022

	<u>Number of Shares</u>	<u>Common Stock</u>	<u>Capital Surplus</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
Balance at December 31, 2021	1,012,755	\$ 1,012,755	\$ 1,111,298	\$ 9,189,469	\$ (169,169)	\$ 11,144,353
Net income	-	-	-	380,593	-	380,593
Other comprehensive loss	-	-	-	-	(1,949,210)	(1,949,210)
Balance at December 31, 2022	1,012,755	\$ 1,012,755	\$ 1,111,298	\$ 9,570,062	\$ (2,118,379)	\$ 9,575,736
Net income	-	-	-	626,467	-	626,467
Other comprehensive income	-	-	-	-	422,423	422,423
Balance at December 31, 2023	<u>1,012,755</u>	<u>\$ 1,012,755</u>	<u>\$ 1,111,298</u>	<u>\$ 10,196,529</u>	<u>\$ (1,695,956)</u>	<u>\$ 10,624,626</u>

See Notes to Financial Statements

1st Federal Savings Bank of SC, Inc.
Statements of Cash Flows
For the years ended December 31, 2023 and 2022

	<u>2023</u>	<u>2022</u>
Operating activities		
Net income	\$ 626,467	\$ 380,593
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	101,471	110,755
Provision (recovery) of credit losses	102,500	(12,500)
Deferred income taxes	39,651	1
Discount accretion and premium amortization	50,328	18,353
Gain on sale of equity investments	-	(33,590)
Loss on sale of securities available-for-sale	(39,651)	-
Proceeds from sale of loans held for sale	-	7,116,331
Origination of loans held for sale	-	(7,053,900)
Gain on sale of loans, net	-	(62,431)
Increase in accrued interest receivable	(122,010)	(159,375)
Increase in accrued interest payable	146,159	3,708
Decrease in other assets	459,906	6,413
Increase (decrease) in other liabilities	<u>22,149</u>	<u>(191,091)</u>
Net cash provided by operating activities	<u>1,386,790</u>	<u>123,267</u>
Investing activities		
Purchase of securities available-for-sale	(300,000)	(11,302,520)
Proceeds from sales and calls of securities available-for-sale	3,960,608	-
Proceeds from sale of equity securities	-	572,570
Principal paydowns on securities available-for-sale	629,076	864,957
Principal paydowns on securities held-to-maturity	108,636	-
Purchase of nonmarketable equity securities	(805,800)	(6,200)
Decrease (increase) in time deposits held with other banks	2,750,000	(2,500,000)
Net increase in loans	(24,391,385)	(16,728,838)
Purchase of premises, furniture and equipment, net	<u>(37,848)</u>	<u>(23,228)</u>
Net cash used in investing activities	<u>(18,086,713)</u>	<u>(29,123,259)</u>
Financing activities		
Net (decrease) increase in deposit accounts	(6,152,986)	13,064,493
Paydowns of advances	(16,355,022)	-
Proceeds from advances and other borrowings	<u>35,257,022</u>	<u>3,100,000</u>
Net cash provided by financing activities	<u>12,749,014</u>	<u>16,164,493</u>
Net decrease in cash and cash equivalents	(3,950,729)	(12,835,499)
Cash and cash equivalents, beginning of year	<u>9,777,887</u>	<u>22,613,386</u>
Cash and cash equivalents, end of year	<u>\$ 5,827,158</u>	<u>\$ 9,777,887</u>
Cash paid during the year for:		
Interest	<u>\$ 880,291</u>	<u>\$ 254,669</u>
Income taxes	<u>\$ 181,000</u>	<u>\$ 167,000</u>
Supplemental disclosures of non-cash transactions:		
Change in unrealized gain (loss) on securities available-for-sale, net realized loss	<u>\$ 297,252</u>	<u>\$ (1,096,339)</u>
Amortization of unrealized gain (loss) on securities held-to-maturity	<u>\$ 197,810</u>	<u>\$ (1,371,017)</u>
Transfer of investment securities available-for-sale to held-to-maturity	<u>\$ -</u>	<u>\$ (14,416,201)</u>

See Notes to Financial Statements

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies

On November 14, 1994, 1st Federal Savings Bank of SC, Inc. (the "Bank") converted from a mutual association to a federally chartered stock savings and loan. The accounting principles of the Bank conform to generally accepted accounting principles. The significant financial reporting policies are summarized below.

Management's estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, including valuation allowances for impaired loans, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises, furniture and equipment.

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

Concentrations of credit risk:

Financial instruments, which potentially subject the Bank to concentrations of credit risk, consist principally of loans receivable, investment securities, interest-bearing balances and amounts due from banks. The Bank makes loans to individuals and small businesses for various personal and commercial purposes. The Bank's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by changing economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.) and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices outside of the geographic regions the Bank lends. See Note 5 for discussion of the geographic regions where the Bank originates loans. Additionally, there are industry practices that could subject the Bank to increased credit risk should economic conditions change over the course of a loan's life. However, to offset this risk, the Bank makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully amortized (i.e. balloon payment loans usually 5 to 7 years). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Bank to unusual credit risk.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Concentrations of credit risk, continued:

The Bank's investment portfolio consists principally of obligations of the United States, its agencies or its corporations. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Bank places its deposits and correspondent accounts with other financial institutions. Management monitors credit risk associated with correspondent accounts.

Cash and cash equivalents:

The Bank considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Securities available-for-sale:

Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in stockholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of securities available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Securities held-to-maturity:

Securities held-to-maturity are carried at amortized cost adjusted for the amortization of premiums and the accretion of discounts. In order to qualify as held-to-maturity, the Bank must have the ability and intent to hold the securities to maturity. Security transfers to the held-to-maturity classification are recorded at fair value as of the date of transfer, which becomes the new cost basis for the securities held-to-maturity. Unrealized gains or losses from the transfer of available-for-sale securities continue to be reported in cumulative other comprehensive income and are amortized into earnings over the remaining life of the security.

Nonmarketable equity securities:

Nonmarketable equity securities include the cost of the Bank's investment in the stock of the Federal Home Loan Bank (FHLB). The stock has no quoted market value and no ready market exists. Investment in FHLB stock is a condition of borrowing from the FHLB, and the stock is pledged to collateralize the borrowings. The Bank's investment in FHLB stock was \$955,400 and \$149,600 at December 31, 2023 and 2022, respectively.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Loans receivable:

Loans are stated at their unpaid principal balance, less any charge-offs. Interest income is computed using the simple interest method and is recorded in the period earned.

When serious doubt exists as to the collectability of a loan or when a loan becomes contractually 90 days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed. Management may elect to continue the accrual of interest when the estimated net realizable value of the collateral is sufficient to ensure collection of the principal balance and accrued interest. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and the loan has been performing according to the contractual terms for a period of no less than six months.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using the straight-line method.

The Bank identifies impaired loans through its normal internal loan review process. Loans on the Bank's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected.

Mortgage loans held-for-sale:

The Bank's residential mortgage lending activities for sale in the secondary market are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgages, and selling mortgages to investors under pre-existing commitments. The commitments to originate fixed rate mortgage loans and the commitments to sell these loans to a third party are both derivative contracts. The fair value of these derivative contracts is immaterial and has no effect on the recorded amounts in the financial statements. Funded residential mortgages held temporarily for sale to investors are recorded at the lower of cost or estimated market value. Application and origination fees collected by the Bank are recognized as income upon sale to the investor. There were no loans held for sale outstanding as of December 31, 2023 and 2022.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Accounting standards adopted in 2023:

On January 1, 2023, the Bank adopted ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (ASC 326). This standard replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (“CECL”) methodology. CECL requires an estimate of credit losses for the remaining estimated life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts and generally applies to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities, and some off-balance sheet credit exposures such as unfunded commitments to extend credit. Financial assets measured at amortized cost will be presented at the net amount expected to be collected by using an allowance for credit losses.

In addition, CECL made changes to the accounting for available-for-sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities if management does not intend to sell and does not believe that it is more likely than not they will be required to sell.

The Bank adopted ASC 326 and all related subsequent amendments thereto effective January 1, 2023, using the modified retrospective approach for all financial assets measured at amortized cost and off-balance sheet credit exposures. The transition of the adoption of CECL did not result in an adjustment for the recorded allowance for credit losses as of January 1, 2023 as management considered the adjustment to be insignificant. Results for reporting periods beginning after January 1, 2023, are presented under CECL while prior period amounts continue to be reported in accordance with previously applicable accounting standards (“Incurred Loss”).

The Bank elected not to measure an allowance for credit losses for accrued interest receivable and instead elected to reverse interest income on loans or securities that are placed on nonaccrual status, which is generally when the instrument is 90 days past due, or earlier if the Bank believes the collection of interest is doubtful. The Bank has concluded that this policy results in the timely reversal of uncollectible interest.

The Bank adopted ASC 326 using the prospective transition approach for debt securities for which other-than-temporary impairment had been recognized prior to January 1, 2023. As of December 31, 2022, the Bank did not have any other-than-temporarily impaired investment securities. Therefore, upon adoption of ASC 326, the Bank determined that an allowance for credit losses on available-for-sale securities was not deemed material.

Allowance for credit losses – available-for-sale securities:

For available-for-sale securities, management evaluates all investments in an unrealized loss position on at least an annual basis, and more frequently when economic or market conditions warrant such evaluation. If the Bank has the intent to sell the security, or it is more likely than not that the Bank will be required to sell the security, the security is written down to fair value, and the entire loss is recorded in earnings.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for credit losses – available-for-sale securities, continued:

If either of the above criteria is not met, the Bank evaluates whether the decline in fair value is the result of credit losses or other factors. In making the assessment, the Bank may consider various factors including the extent to which fair value is less than amortized cost, performance on any underlying collateral, downgrades in the ratings of the security by a rating agency, the failure of the issuer to make scheduled interest or principal payments and adverse conditions specifically related to the security. If the assessment indicates that a credit loss exists, the present value of cash flows expected to be collected is compared to the amortized cost basis of the security and any excess is recorded as an allowance for credit loss, limited to the amount that the fair value is less than the amortized cost basis. Any amount of unrealized loss that has not been recorded through an allowance for credit loss is recognized in other comprehensive income.

Changes in the allowance for credit loss are recorded as provision for credit loss expense. Losses are charged against the allowance for credit loss when management believes an available-for-sale security is confirmed to be uncollectible or when either of the criteria regarding intent or requirement to sell is met. At December 31, 2023, there was no allowance for credit loss related to the available-for-sale portfolio.

Allowance for credit losses – held-to-maturity securities:

Management measures expected credit losses on held-to-maturity debt securities on a collective basis by major security type. Accrued interest receivable on held-to-maturity debt securities totaled \$17,165 at December 31, 2023 and was excluded from the estimate of credit losses.

The estimate of expected credit losses is primarily based on the ratings assigned to the securities by debt rating agencies and the average of the annual historical loss rates associated with those ratings. The Bank then multiplies those loss rates, as adjusted for any modifications to reflect current conditions and reasonable and supportable forecasts as considered necessary, by the remaining lives of each individual security to arrive at a lifetime expected loss amount. The Bank did not identify any allowance for credit losses on held-to-maturity securities at adoption of CECL as of January 1, 2023. There was no recorded allowance for credit losses on held-to-maturity securities as of December 31, 2023.

All the mortgage-backed securities held by the Bank are issued by government-sponsored enterprises and agencies. These securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies and have a long history of no credit losses. The state and local governments securities held by the Bank are highly rated by major rating agencies. As a result, no allowance for credit losses was recorded on held-to-maturity at December 31, 2023.

Allowance for credit losses – loans:

The allowance for credit losses is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Accrued interest receivable is excluded from the estimate of credit losses.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for credit losses – loans, continued:

The allowance for credit losses represents management's estimate of lifetime credit losses inherent in loans as of the balance sheet date. The allowance for credit losses is estimated by management using relevant available information, from both internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts.

The Bank measures expected credit losses for loans on a pooled basis when similar risk characteristics exist. The Bank has identified the following portfolio segments and calculates the allowance for credit losses for each using a scaled CECL allowance for loss estimator (SCALE) methodology:

- *Commercial and industrial* – Commercial and industrial business loans consist of loans or lines of credit to finance accounts receivable, inventory or other general business needs, business credit cards, and lease financing agreements for equipment, vehicles, or other assets. The primary risk associated with commercial and industrial and lease financing loans is the ability of borrowers to achieve business results consistent with those projected at origination. Failure to achieve these projections presents risk the borrower will be unable to service the debt consistent with the contractual terms of the loan.
- *Real estate – commercial* – Owner occupied commercial mortgages consist of loans to purchase or re-finance owner occupied nonresidential properties. This includes office buildings, other commercial facilities, and farmland. Commercial mortgages secured by owner occupied properties are primarily dependent on the ability of borrowers to achieve business results consistent with those projected at loan origination. While these loans and leases are collateralized by real property in an effort to mitigate risk, it is possible the liquidation of collateral will not fully satisfy the obligation. Non-owner occupied commercial mortgages consist of loans to purchase or refinance investment nonresidential properties. This includes office buildings and other facilities rented or leased to unrelated parties, as well as farmland and multifamily properties. The primary risk associated with income producing commercial mortgage loans is the ability of the income-producing property that collateralizes the loan to produce adequate cash flow to service the debt. While these loans are collateralized by real property in an effort to mitigate risk, it is possible the liquidation of collateral will not fully satisfy the obligation.
- *Real estate – residential* – Residential mortgages consist of loans to purchase or refinance the borrower's primary dwelling, second residence or vacation home and are secured by 1-4 family residential property. Significant and rapid declines in real estate values can result in borrowers having debt levels in excess of the current market value of the collateral.
- *Real estate – construction* – Consists of loans to finance the ground up construction or improvement of owner occupied and non-owner occupied residential and commercial properties and loans secured by raw or improved land. The repayment of C&D loans is generally dependent upon the successful completion of the improvements by the builder for the end user, the leasing of the property, or sale of the property to a third party. Repayment of land secured loans is dependent upon the successful development and sale of the property, the sale of the land as is, or the outside cash flow of the owners to support the retirement of the debt. The Bank's construction loans may convert to real estate-secured loans once construction is completed or principal amortization payments begin, assuming the borrower retains financing with the Bank.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for credit losses – loans, continued:

- *Consumer and other* – Consumer loans consist of loans to finance unsecured home improvements, student loans, automobiles and revolving lines of credit that can be secured or unsecured. The value of the underlying collateral within this class is at risk of potential rapid depreciation which could result in unpaid balances in excess of the collateral.

Additionally, the allowance for credit losses calculation includes subjective adjustments for qualitative risk factors that are likely to cause estimated credit losses to differ from historical experience. These qualitative adjustments may increase or reduce reserve levels and include adjustments for changes in volume and severity of past due loans and actual or expected changes in regional and local economic business conditions.

Loans that do not share risk characteristics are evaluated on an individual basis. When the borrower is experiencing financial difficulty and repayment is expected to be provided through operation or sale of the collateral, the expected credit losses are based on the fair value of collateral at the reporting date, adjusted for selling costs as appropriate. When the borrower possesses the ability to service debt through regular payments and foreclosure is not probable, the Bank assesses discounted cash flows at the reporting date.

Allowance for credit losses – unfunded commitments:

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit issued to meet customer financing needs. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for off-balance sheet loan commitments is represented by the contractual amount of those instruments. Such financial instruments are recorded when they are funded.

The Bank records an allowance for credit losses on off-balance sheet credit exposures and unfunded commitments, unless the commitments to extend credit are unconditionally cancelable, through a charge to provision for credit losses in the Bank's statements of operations. The allowance for credit losses on off-balance sheet credit exposures is estimated by loan segment at each balance sheet date under the current expected credit loss model using the same methodologies as portfolio loans, taking into consideration the likelihood that funding will occur as well as any third-party guarantees. The allowance for unfunded commitments is included in other liabilities on the Bank's balance sheets.

Income and expense recognition and revenue from contracts with customers:

The accrual method of accounting is used for all significant categories of income and expense. Immaterial amounts of miscellaneous fees are reported when received.

The Bank records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Bank must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Bank satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Income and expense recognition and revenue from contracts with customers, continued:

The Bank's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Bank has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Statements of Operations was not necessary. The Bank generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity.

The following is a discussion of revenues within the scope of the guidance:

- *Service charges on deposit accounts* – The Bank earns fees from its deposit clients for various transaction based, account maintenance, and overdraft or non-sufficient funds (“NSF”) services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Bank fulfills the client's request. Account maintenance fees, which relate primarily to monthly maintenance and account management, are earned over the course of a month, representing the period over which the Bank satisfies the performance obligation. Overdraft and NSF fees are recognized at the point in time that the overdraft occurs or the NSF item is presented. Service charges on deposits are withdrawn from the client's account balance.
- *Other service fees and commissions* – This category represents the revenue earned by the Bank from mortgage loans held for sale and mortgage loan origination fees. Revenue is derived from the sale of loans in the secondary market and fees charged for originating new loans. It encompasses gains from the sale of loans at a premium to their carrying value, as well as fees earned for facilitating the loan origination process. Revenue from mortgage loans held for sale is recognized at the time of sale. Mortgage loan origination fees are recognized as revenue either upon loan origination or upon completion of the necessary tasks associated with the loan origination process.

Income taxes:

Income taxes are the sum of amounts currently payable to taxing authorities and the net changes in income taxes payable or refundable in future years (deferred income tax). Income taxes deferred to future years are determined utilizing a liability approach. This method gives consideration to the future tax consequences associated with differences between financial accounting and tax bases of certain assets and liabilities which are principally the allowance for loan losses, depreciable premises and equipment, and the net operating loss carryforward. Deferred tax assets are reduced by a valuation allowance if based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Bank believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustment that will result in a material adverse impact on the Bank's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Premises, furniture and equipment:

Land is carried at cost. The Bank's premises, furniture and equipment are carried at cost, less accumulated depreciation computed by the straight-line method between 3 – 10 years. Maintenance and repairs are charged to current expense. The cost of major renewals and improvements are capitalized between 5 – 40 years.

Per-share data:

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding for the period. The weighted average number of shares outstanding was 1,012,755 in both 2023 and 2022. The Bank has no instruments which are dilutive; therefore, only basic net income per share of common stock is presented.

Accumulated other comprehensive income:

Comprehensive income includes net income and all changes to the Bank's equity, with the exception of transactions with stockholders. The Bank's other comprehensive income and accumulated other comprehensive income are comprised of unrealized gains and losses on certain investments in debt securities.

Off-balance-sheet financial instruments:

In the ordinary course of business, the Bank enters into off-balance-sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Marketing expense:

The Bank expenses the cost of marketing as incurred. Marketing expenses totaled \$20,147 and \$13,079 for the years ended December 31, 2023 and 2022, respectively.

Risks and uncertainties:

In the normal course of its business, the Bank 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 Bank is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default on the Bank's loan portfolio that results from a borrower's 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 Bank.

The Bank is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Bank 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.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 1. Summary of Significant Accounting Policies, Continued

Reclassifications:

Certain captions and amounts in the 2022 financial statements were reclassified to conform with the 2023 presentation. These reclassifications had no effect on stockholders' equity or results of operations as previously presented.

Note 2. Equity Investments

During 2021, the Bank was granted 2,950 Class A shares of MasterCard stock following a class action lawsuit that resulted in all Class B shares being transferred to Class A which are actively traded. The Class B shares were not recorded on the Bank's balance sheet prior to 2021 due to the nonmarketable nature of the shares. Upon issuance of the Class A shares the Bank recorded income in the amount of the fair value of the shares. These shares are marked to fair value on a quarterly basis. Realized and unrealized gains and losses are included in noninterest income. During the year ended December 31, 2021, 1,450 shares were sold for \$552,098, all of which was recorded as a gain on sale of equity investments. The value of the remaining shares was \$538,980 as of December 31, 2021.

During 2022, the Bank sold the remaining 1,500 shares for \$572,570 which was netted against the fair value recorded of \$538,980. The result was a \$33,590 gain which was recorded as a gain on sale of equity investments.

There were no transactions related to equity investments during the year ended December 31, 2023.

Note 3. Securities Available-for-Sale

The amortized cost and estimated fair values of securities available-for-sale were:

	<u>December 31, 2023</u>			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
Government-sponsored enterprises	\$ 11,914,478	\$ -	\$ 743,678	\$ 11,170,800
Mortgage-backed securities	2,971,839	-	206,005	2,765,834
Municipal securities	723,599	-	23,890	699,709
Total	<u>\$ 15,609,916</u>	<u>\$ -</u>	<u>\$ 973,573</u>	<u>\$ 14,636,343</u>

	<u>December 31, 2022</u>			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
Government-sponsored enterprises	\$ 15,162,994	\$ 1,550	\$ 1,038,592	\$ 14,125,952
Mortgage-backed securities	3,610,368	-	235,041	3,375,327
Municipal securities	1,176,566	-	38,393	1,138,173
Total	<u>\$ 19,949,928</u>	<u>\$ 1,550</u>	<u>\$ 1,312,026</u>	<u>\$ 18,639,452</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 3. Securities Available-for-Sale, Continued

The following table shows investments with gross unrealized losses and their related fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2023 and 2022.

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2023						
Government-sponsored securities	\$ -	\$ -	\$ 11,170,800	\$ (743,678)	\$ 11,170,800	\$ (743,678)
Mortgage-backed securities	-	-	2,765,834	(206,005)	2,765,834	(206,005)
Municipal securities	-	-	699,709	(23,890)	699,709	(23,890)
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,636,343</u>	<u>\$ (973,573)</u>	<u>\$ 14,636,343</u>	<u>\$ (973,573)</u>

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2022						
Government-sponsored securities	\$ 7,667,590	\$ 230,019	\$ 5,556,812	\$ 808,573	\$ 13,224,402	\$ 1,038,592
Mortgage-backed securities	2,960,982	170,142	414,345	64,899	3,375,327	235,041
Municipal securities	1,138,173	38,393	-	-	1,138,173	38,393
Total	<u>\$ 11,766,745</u>	<u>\$ 438,554</u>	<u>\$ 5,971,157</u>	<u>\$ 873,472</u>	<u>\$ 17,737,902</u>	<u>\$ 1,312,026</u>

Securities classified as available-for-sale are recorded at fair market value. There were 36 securities classified as available-for-sale in an unrealized loss position for twelve months or more at December 31, 2023. The Bank does not intend to sell these securities while in a loss position and it is more likely than not that the Bank will not be required to sell the securities prior to recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The issuers continue to make timely principal and interest payments and the fair value is expected to recover as the bonds approach maturity.

The amortized costs and fair values of investment securities at December 31, 2023, by contractual maturity, are shown in the following chart. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due after one through five years	\$ 11,272,693	\$ 10,682,253
Due after five years but within ten years	2,250,267	2,019,234
Due after ten years	2,086,956	1,934,856
Total securities	<u>\$ 15,609,916</u>	<u>\$ 14,636,342</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 3. Securities Available-for-Sale, Continued

Proceeds from sales of securities available-for-sale were \$2,945,608 resulting in realized losses of \$39,651 during the year ended December 31, 2023. There were no sales of investment securities during the year ended December 31, 2022.

Investment securities with a par value of \$173,851 and \$213,469 and a fair market value of \$166,306 and \$205,709 were pledged as collateral to secure public deposits at December 31, 2023 and 2022, respectively.

Note 4. Securities Held-to-Maturity

During the year ended December 31, 2022, the Bank reclassified \$14.4 million securities from available-for-sale designation to held-to-maturity in two separate transactions as of April 30, 2022 and September 30, 2022. These securities were transferred at fair value at the time of the transfer, which became the new cost basis for the securities held-to-maturity. The pretax unrealized net holding loss on the available for sale securities on the date of transfer totaled approximately \$1.5 million and continued to be reported as a component of accumulated other comprehensive loss. There were no gains or losses recognized as a result of this transfer. The remaining pretax unrealized net holding loss on these investments was \$1.3 million at December 31, 2022. Held-to-maturity investments totaled \$13.1 million and represented approximately 41.2% of total investments at December 31, 2022. There were no transfers between AFS and HTM for the year ended December 31, 2023.

Held-to-maturity (HTM) securities are recorded at amortized cost. The amortized cost, gross unrealized gains and (losses) and estimated fair values of securities HTM were:

	December 31, 2023			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government-sponsored enterprises	\$ 9,493,414	\$ -	\$ 698,341	\$ 8,795,073
Mortgage-backed securities	1,462,749	-	125,236	1,337,513
Municipal securities	<u>2,178,195</u>	<u>-</u>	<u>209,879</u>	<u>1,968,316</u>
Total	<u>\$ 13,134,358</u>	<u>\$ -</u>	<u>\$ 1,033,456</u>	<u>\$ 12,100,902</u>

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government-sponsored enterprises	\$ 9,336,626	\$ -	\$ 813,680	\$ 8,522,946
Mortgage-backed securities	1,550,592	-	102,234	1,448,358
Municipal securities	<u>2,157,966</u>	<u>-</u>	<u>284,236</u>	<u>1,873,730</u>
Total	<u>\$ 13,045,184</u>	<u>\$ -</u>	<u>\$ 1,200,150</u>	<u>\$ 11,845,034</u>

At December 31, 2023, there were no pledged securities held-to-maturity as collateral for certain deposit accounts, FHLB advances or other borrowings.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 4. Securities Held-to-Maturity, Continued

The following tables summarize gross unrealized losses and their related fair value, aggregated by investment category and length of time that individual HTM securities have been in a continuous unrealized loss position at December 31, 2023 and 2022, respectively:

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2023						
Government-sponsored securities	\$ -	\$ -	\$ 8,795,073	\$ 698,341	\$ 8,795,073	\$ 698,341
Mortgage-backed securities	-	-	1,337,513	125,236	1,337,513	125,236
Municipal securities	-	-	1,968,316	209,879	1,968,316	209,879
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,100,902</u>	<u>\$ 1,033,456</u>	<u>\$ 12,100,902</u>	<u>\$ 1,033,456</u>

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2022						
Government-sponsored securities	\$ -	\$ -	\$ 8,522,946	\$ 813,680	\$ 8,522,946	\$ 813,680
Mortgage-backed securities	-	-	1,448,358	102,234	1,448,358	102,234
Municipal securities	-	-	1,873,730	284,236	1,873,730	284,236
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,845,034</u>	<u>\$ 1,200,150</u>	<u>\$ 11,845,034</u>	<u>\$ 1,200,150</u>

At December 31, 2023 and 2022, all HTM securities were in an unrealized loss position for twelve months or more. The Bank believes, based on industry analyst reports and credit ratings that the deterioration in value is attributable to changes in market interest rates and the lack of liquidity in individual securities and is not in the credit quality of the issuer. All securities are AAA rated bonds or backed by the full faith of the U.S. government and the Bank has the ability and intent to hold these securities to maturity.

At December 31, 2023, the Bank had no securities held-to-maturity that were past due 30 days or more as to principal or interest payments. The Bank had no securities held-to-maturity classified as nonaccrual or collateral dependent at December 31, 2023.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses

Major classifications of loans receivable at December 31 are summarized as follows:

	<u>2023</u>	<u>2022</u>
Real estate - commercial	\$ 1,162,887	\$ 1,276,681
Real estate - residential	101,468,490	81,425,615
Real estate - construction	14,374,274	9,847,254
Commercial and industrial	81,025	83,272
Consumer and other	<u>1,052,371</u>	<u>1,123,225</u>
Total gross loans	118,139,047	93,756,047
Less: Allowance for credit losses	<u>937,560</u>	<u>850,945</u>
Total loans, net	<u>\$ 117,201,487</u>	<u>\$ 92,905,102</u>

Loans serviced for others at December 31, 2023 and 2022 were \$69,823,326 and \$78,525,242, respectively. Custodial escrow balances maintained in connection with the loan servicing were approximately \$382,397 and \$348,525 at December 31, 2023 and 2022, respectively.

The Bank primarily originates residential loans to customers in Walterboro, South Carolina, and the surrounding communities, including the Edisto Beach area. The Bank's ability to collect these balances depends substantially upon the economic conditions and real estate market in the region.

The following table summarizes the activity related to the allowance for credit losses - loans for the year ended December 31, 2023 under the CECL methodology.

	<u>Real Estate Commercial</u>	<u>Real Estate Residential</u>	<u>Real Estate Construction</u>	<u>Commercial and Industrial</u>	<u>Consumer and Other</u>	<u>Total</u>
Balance, December 31, 2022	\$ 10,252	\$ 715,370	\$ 79,074	\$ 627	\$ 45,622	\$ 850,945
Charge offs	-	-	-	-	(10,028)	(10,028)
Recoveries	-	-	-	-	1,643	1,643
Provision for Credit Losses	<u>1,390</u>	<u>(9,695)</u>	<u>114,501</u>	<u>183</u>	<u>(11,379)</u>	<u>95,000</u>
Ending balance	<u>\$ 11,642</u>	<u>\$ 705,675</u>	<u>\$ 193,575</u>	<u>\$ 810</u>	<u>\$ 25,858</u>	<u>\$ 937,560</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses, Continued

Prior to the adoption of ASC 326 on January 1, 2023, the Bank calculated the allowance for loan losses under the incurred loss methodology. The following tables are disclosures related to the allowance for loan losses in prior periods.

	Real Estate Commercial	Real Estate Residential	Real Estate Construction	Commercial and Industrial	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	\$ 14,033	\$ 698,493	\$ 90,035	\$ 1,682	\$ 69,406	\$ 873,649
Charge-offs	-	-	-	-	(14,964)	(14,964)
Recoveries	-	-	-	-	4,760	4,760
Provisions	(3,781)	16,877	(10,961)	(1,055)	(13,580)	(12,500)
Ending balance	<u>\$ 10,252</u>	<u>\$ 715,370</u>	<u>\$ 79,074</u>	<u>\$ 627</u>	<u>\$ 45,622</u>	<u>\$ 850,945</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ -</u>	<u>\$ 2,568</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,568</u>
Collectively evaluated for impairment	<u>\$ 10,252</u>	<u>\$ 712,802</u>	<u>\$ 79,074</u>	<u>\$ 627</u>	<u>\$ 45,622</u>	<u>\$ 848,377</u>
Loans receivable:						
Ending balance - total	<u>\$ 1,276,681</u>	<u>\$ 81,425,615</u>	<u>\$ 9,847,254</u>	<u>\$ 83,272</u>	<u>\$ 1,123,225</u>	<u>\$ 93,756,047</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ -</u>	<u>\$ 684,103</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 684,103</u>
Collectively evaluated for impairment	<u>\$ 1,276,681</u>	<u>\$ 80,741,512</u>	<u>\$ 9,847,254</u>	<u>\$ 83,272</u>	<u>\$ 1,123,225</u>	<u>\$ 93,071,944</u>

The Bank identifies problem loans through its normal internal loan review process. Loans on the Bank's problem loan watch list are considered potentially problem loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered a problem loan if a minimal delay occurs and all amounts due including accrued interest at the contractual interest rate for the period of delay are expected to be collected.

Credit Quality Indicators

The Bank uses a risk-based approach based on the following credit quality measures when analyzing the loan portfolio: pass, watch and special mention, substandard, and doubtful. These indicators are used to rate the credit quality of loans for the purposes of determining the Bank's allowance for credit losses.

Pass loans are loans that are performing and are deemed adequately protected by the net worth of the borrower or the underlying collateral value. These loans are considered the least risky in terms of determining the allowance for credit losses.

Watch loans have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard loans typically have an identified weakness or weaknesses and are inadequately protected by the net worth of the borrower or collateral value.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses, Continued

The following is an analysis of the portfolio by credit quality indicators at December 31, 2023:

	<u>Real Estate Commercial</u>	<u>Real Estate Residential</u>	<u>Real Estate Construction</u>	<u>Commercial and Industrial</u>	<u>Consumer and Other</u>	<u>Total</u>
Pass	\$ 1,162,887	\$ 100,796,190	\$ 14,374,274	\$ 81,025	\$ 1,052,371	\$ 117,466,747
Watch	-	130,457	-	-	-	130,457
Substandard	-	541,843	-	-	-	541,843
	<u>\$ 1,162,887</u>	<u>\$ 101,468,490</u>	<u>\$ 14,374,274</u>	<u>\$ 81,025</u>	<u>\$ 1,052,371</u>	<u>\$ 118,139,047</u>

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2022:

	<u>Real Estate Commercial</u>	<u>Real Estate Residential</u>	<u>Real Estate Construction</u>	<u>Commercial and Industrial</u>	<u>Consumer and Other</u>	<u>Total</u>
Pass	\$ 1,276,681	\$ 80,590,910	\$ 9,847,254	\$ 83,272	\$ 1,123,225	\$ 92,921,342
Watch	-	372,019	-	-	-	372,019
Substandard	-	462,686	-	-	-	462,686
	<u>\$ 1,276,681</u>	<u>\$ 81,425,615</u>	<u>\$ 9,847,254</u>	<u>\$ 83,272</u>	<u>\$ 1,123,225</u>	<u>\$ 93,756,047</u>

The following table is a summary of the Bank's nonaccrual loans by major categories for the periods indicated.

	<u>CECL</u>			<u>Incurred Loss</u>
	<u>December 31, 2023</u>			<u>December 31,</u>
	<u>Nonaccrual Loans with No Allowance</u>	<u>Nonaccrual Loans with an Allowance</u>	<u>Total Nonaccrual Loans</u>	<u>2022</u>
			<u>Nonaccrual Loans</u>	
Real Estate Commercial	\$ -	\$ -	\$ -	\$ -
Real Estate Residential	-	99,319	99,319	149,994
Real Estate Construction	-	-	-	-
Commercial and Industrial	-	-	-	-
Consumer and Other	-	-	-	-
Total loans	<u>\$ -</u>	<u>\$ 99,319</u>	<u>\$ 99,319</u>	<u>\$ 149,994</u>

The Bank did not recognize interest income on nonaccrual loans and there were no additions to the nonaccrual listing during the year ended December 31, 2023.

There were no loans added to non-accrual status and therefore no reversal of loan interest income during the year ended December 31, 2023.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses, Continued

The following is an aging analysis of our loan portfolio at December 31, 2023:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable
Real estate-commercial	\$ -	\$ -	\$ -	\$ -	\$ 1,162,887	\$ 1,162,887
Real estate-residential	930,516	16,828	-	947,344	100,521,146	101,468,490
Real estate-construction	-	-	-	-	14,374,274	14,374,274
Commercial and industrial	-	-	-	-	81,025	81,025
Consumer and other	-	-	-	-	1,052,371	1,052,371
	<u>\$ 930,516</u>	<u>\$ 16,828</u>	<u>\$ -</u>	<u>\$ 947,344</u>	<u>\$ 117,191,703</u>	<u>\$118,139,047</u>

The following is an aging analysis of our loan portfolio at December 31, 2022:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans Receivable
Real estate-commercial	\$ -	\$ -	\$ -	\$ -	\$ 1,276,681	\$ 1,276,681
Real estate-residential	668,309	84,376	10,039	762,724	80,662,891	81,425,615
Real estate-construction	-	-	-	-	9,847,254	9,847,254
Commercial and industrial	-	-	-	-	83,272	83,272
Consumer and other	9,503	-	-	9,503	1,113,722	1,123,225
	<u>\$ 677,812</u>	<u>\$ 84,376</u>	<u>\$ 10,039</u>	<u>\$ 772,227</u>	<u>\$ 92,983,820</u>	<u>\$93,756,047</u>

There were no loans past due ninety days or more and still accruing interest as of December 31, 2023 or 2022.

The Bank has certain loans for which repayment is dependent upon the operation or sale of collateral, as the borrower is experiencing financial difficulty. The underlying collateral can vary based upon the type of loan.

The following table details the amortized cost of collateral dependent loans:

(Dollars in thousands)

	<u>December 31, 2023</u>
Real estate-commercial	\$ -
Real estate-residential	672,300
Real estate-construction	-
Commercial and industrial	-
Consumer and other	-
Total loans	<u>\$ 672,300</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses, Continued

Prior to the adoption of ASU 2016-13, loans were considered impaired when, based on current information and events, it was probable the Bank would be unable to collect all amounts due in accordance with the original contractual terms of the loan agreements. Impaired loans include loans on nonaccrual status and accruing troubled debt restructurings. When determining if the Bank would be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement, the Bank considered the borrower's capacity to pay, which included such factors as the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations and an evaluation of secondary sources of repayment, such as guarantor support and collateral value. The tables below include all loans deemed impaired, whether or not individually assessed for impairment. If a loan was deemed impaired, a specific valuation allowance was allocated, if necessary, so that the loan was reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment was expected solely from the collateral. Interest payments on impaired loans were typically applied to principal unless collectability of the principal amount was reasonably assured, in which case interest was recognized on a cash basis.

The following table presents loan individually evaluated for impairment by class of loans, as of December 31, 2022:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>
With no related allowance needed:				
Real estate - commercial	\$ -	\$ -	\$ -	\$ -
Real estate - residential	468,828	485,925	-	497,769
Real estate - construction	-	-	-	-
Commercial and industrial	-	-	-	-
Consumer and other	-	-	-	-
With an allowance recorded:				
Real estate - commercial	-	-	-	-
Real estate - residential	215,275	230,245	2,568	246,244
Real estate - construction	-	-	-	-
Commercial and industrial	-	-	-	-
Consumer and other	-	-	-	-
Total:				
Real estate - commercial	-	-	-	-
Real estate - residential	684,103	716,170	2,568	744,013
Real estate - construction	-	-	-	-
Commercial and industrial	-	-	-	-
Consumer and other	-	-	-	-
	<u>\$ 684,103</u>	<u>\$ 716,170</u>	<u>\$ 2,568</u>	<u>\$ 744,013</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 5. Loans Receivable and Allowance for Credit Losses, Continued

Modifications made to borrowers experiencing financial difficulty

The allowance for credit losses incorporates an estimate of lifetime expected credit losses and is recorded on each asset upon asset origination or acquisition. The starting point for the estimate of the allowance for credit losses is historical loss information, which includes losses from modifications of receivables to borrowers experiencing financial difficulty. An assessment of whether a borrower is experiencing financial difficulty is made on the date of a modification.

Because the effect of most modifications made to borrowers experiencing financial difficulty is already included in the allowance for credit losses because of the measurement methodologies used to estimate the allowance, a change to the allowance for credit losses is generally not recorded upon modification. Occasionally, the Bank modifies loans by providing principal forgiveness on certain amounts of a customer's outstanding balance. When principal forgiveness is provided, the amortized cost basis of the asset is written off against the allowance for credit losses. The amount of the principal forgiveness is deemed to be uncollectible; therefore, that portion of the loan is written off, resulting in a reduction of the amortized cost basis and a corresponding adjustment to the allowance for credit losses.

In some cases, the Bank will modify a certain loan by providing multiple types of concessions. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted. The Bank may grant multiple types of modifications on the same loan within the current reporting period using a combination of at least two of the following: a term extension, principal forgiveness, and interest rate reduction. As of December 31, 2023, the Bank had no modifications to borrowers experiencing financial difficulty. The Bank had no loans default that were modified in the previous twelve months as of December 31, 2023.

Unfunded commitments:

The Bank maintains a separate reserve for credit losses on off-balance-sheet credit exposures, including unfunded loan commitments, which is included in other liabilities on the balance sheet. The reserve for credit losses on off-balance-sheet credit exposures is adjusted as a provision (reversal) for credit losses in the statement of operations. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life, utilizing the same models

and approaches for the Bank's loan portfolio segments described above, as these unfunded commitments share similar risk characteristics as its loan portfolio segments. The Bank has identified the unfunded portion of certain lines of credit as unconditionally cancellable credit exposures, meaning the Bank can cancel the unfunded commitment at any time. No credit loss estimate is reported for off-balance-sheet credit exposures that are unconditionally cancellable by the Bank or for undrawn amounts under such arrangements that may be drawn prior to the cancellation of the arrangement.

At December 31, 2023, the liability for unfunded commitments included in other liabilities was \$7,500.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 6. Premises, Furniture and Equipment

Premises, furniture and equipment consisted of the following at December 31:

	<u>2023</u>	<u>2022</u>
Land and improvements	\$ 1,247,866	\$ 1,247,865
Buildings and improvements	1,690,431	1,690,431
Furniture and equipment	<u>950,145</u>	<u>912,298</u>
	3,888,442	3,850,594
Less, accumulated depreciation	<u>2,136,797</u>	<u>2,035,326</u>
	<u>\$ 1,751,645</u>	<u>\$ 1,815,268</u>

Depreciation expense for the years ended December 31, 2023 and 2022 was \$101,471 and \$110,755, respectively.

Note 7. Deposits

At December 31, 2023, the scheduled maturities of certificates of deposit were as follows:

<u>Maturing in year ending December 31:</u>	<u>Amount</u>
2024	\$ 23,691,382
2025	1,770,618
2026 and thereafter	<u>205,368</u>
Total	<u>\$ 25,667,368</u>

The aggregate amount of certificates of deposit with a minimum denomination of \$250,000 was \$7,097,613 and \$1,052,789 at December 31, 2023 and 2022, respectively.

The Bank did not have any individual deposit relationships greater than five percent of total deposits as of December 31, 2023 or 2022.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 8. Advances from Federal Home Loan Bank

Advances from the Federal Home Loan Bank (FHLB) consisted of the following at December 31, 2023 and 2022:

<u>Description</u>	<u>Current Interest Rate</u>	<u>2023 Balance</u>	<u>2022 Balance</u>
Fixed rate advances maturing:			
January 20, 2023	4.22%	\$ -	\$ 500,000
January 26, 2023	4.23%	-	600,000
January 3, 2024	5.53%	300,000	-
January 4, 2024	5.47%	250,000	-
January 5, 2024	5.50%	500,000	-
January 29, 2024	5.47%	400,000	-
January 31, 2024	5.46%	500,000	-
February 2, 2024	5.46%	500,000	-
February 2, 2024	5.47%	400,000	-
February 2, 2024	5.48%	500,000	-
February 29, 2024	5.57%	450,000	-
March 1, 2024	5.52%	450,000	-
March 15, 2024	5.51%	500,000	-
March 22, 2024	5.55%	350,000	-
March 29, 2024	5.55%	500,000	-
April 5, 2024	5.55%	700,000	-
April 10, 2024	4.97%	500,000	-
April 15, 2024	5.03%	750,000	-
April 19, 2024	5.10%	1,000,000	-
May 17, 2024	5.48%	500,000	-
May 28, 2024	5.47%	400,000	-
May 31, 2024	5.54%	400,000	-
May 31, 2024	5.55%	600,000	-
June 10, 2024	5.45%	750,000	-
June 10, 2024	5.52%	600,000	-
June 13, 2024	5.54%	600,000	-
June 14, 2024	5.44%	600,000	-
October 21, 2024	4.73%	1,000,000	-
December 13, 2024	5.57%	1,000,000	-
February 28, 2025	5.29%	1,000,000	-
May 7, 2025	5.26%	1,000,000	-
June 6, 2025	5.05%	1,000,000	-
		<u>\$ 18,000,000</u>	<u>\$ 1,100,000</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 8. Advances from Federal Home Loan Bank, Continued

As collateral, the Bank has pledged first mortgage loans on one to four family residential loans aggregating \$19,237,188 and \$1,219,728 at December 31, 2023 and 2022. In addition, the Bank's Federal Home Loan Bank stock is pledged to secure the borrowings. Certain advances are subject to prepayment penalties.

Note 9. Commitments and Contingent Liabilities

In conjunction with its lending activities, the Bank enters into various commitments to extend credit. Loan commitments (unfunded loans and unused lines of credit) are issued to accommodate the financing needs of the Bank's customers. Loan commitments are agreements by the Bank to lend monies at a future date, so long as there are no violations of any conditions established in the agreement.

The following table summarizes the Bank's off-balance-sheet financial instruments at December 31, 2023 and 2022 whose contract amounts represent credit risk:

	<u>2023</u>	<u>2022</u>
Commitments to extend credit	\$ 15,956,740	\$ 10,556,230
Letters of credit	<u>54,129</u>	<u>54,129</u>
	<u>\$ 16,010,869</u>	<u>\$ 10,610,359</u>

Outstanding commitments on mortgage loans not yet closed are reflected above. Such commitments, which are funded subject to certain limitations, extend over varying periods of time with the majority being funded within a twelve-month period.

These loan commitments are subject to the same credit policies and reviews as loans on the balance sheet. Collateral, both the amount and nature, is obtained based upon management's assessment of the credit risk. Since many of the extensions of credit are expected to expire without being drawn, the total commitment amounts do not necessarily represent future cash requirements.

In the ordinary course of business, the Bank may, from time to time, become a party to legal claims and disputes. Management is not aware of any pending or threatened litigation or unasserted claims or assessment that could result in losses, if any, that would be material to the financial statements.

Note 10. Regulatory Matters and Capital Requirements

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

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 10. Regulatory Matters and Capital Requirements, Continued

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios (as set forth in the table below) of Tier 1, Common Equity Tier 1 (CET1), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk weights ranging from 0% to 150%. Tier 1 capital of a Bank typically consists of common stockholders' equity, excluding the unrealized gain or loss on securities available for sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Bank is also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank is also required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will consist solely of CET1, but the buffer applies to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer was phased in incrementally over time, beginning January 1, 2016 and becoming fully effective on January 1, 2019, and ultimately consists of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements at December 31, 2023 and 2022:

<i>(Dollars in thousands)</i>	Actual		For capital adequacy purposes Minimum		To be well capitalized under prompt corrective action provisions Minimum	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2023						
Common equity tier 1 (to risk weighted assets)	\$ 12,321	14.76%	\$ 3,758	4.50%	\$ 5,428	6.50%
Total capital (to risk weighted assets)	13,259	15.88%	6,680	8.00%	8,350	10.00%
Tier 1 capital (to risk weighted assets)	12,321	14.76%	5,010	6.00%	6,680	8.00%
Tier 1 capital (to average assets)	12,321	7.93%	6,214	4.00%	7,767	5.00%
As of December 31, 2022						
Common equity tier 1 (to risk weighted assets)	\$ 11,694	16.84%	\$ 3,126	4.50%	\$ 4,515	6.50%
Total capital (to risk weighted assets)	12,545	18.06%	5,557	8.00%	6,946	10.00%
Tier 1 capital (to risk weighted assets)	11,694	16.84%	4,168	6.00%	5,557	8.00%
Tier 1 capital (to average assets)	11,694	8.32%	5,624	4.00%	7,030	5.00%

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 11. Income Taxes

The following is a summary of the provision for income taxes:

	<u>2023</u>	<u>2022</u>
Current payable		
Federal	\$ 159,109	\$ 75,674
State	<u>(3,760)</u>	<u>29,325</u>
Total current	<u>155,349</u>	<u>104,999</u>
Deferred income taxes		
Change in deferred income taxes	39,651	1
Valuation allowance for deferred income taxes	<u>-</u>	<u>-</u>
Total deferred	<u>39,651</u>	<u>1</u>
Total income tax expense	<u>\$ 195,000</u>	<u>\$ 105,000</u>

The Bank's effective tax rate differs from that computed at the statutory federal income tax rate of 21%, as follows:

	<u>2023</u>	<u>2022</u>
Tax expense at statutory rate	\$ 172,508	\$ 101,975
State taxes, net of federal benefit	38,999	23,078
Other	<u>(16,507)</u>	<u>(20,053)</u>
	<u>\$ 195,000</u>	<u>\$ 105,000</u>

The components of net deferred tax assets and deferred tax liabilities are as follows:

	<u>2023</u>	<u>2022</u>
Deferred tax assets:		
Allowance for loan losses	\$ 173,270	\$ 148,817
Net operating losses - federal	-	-
Net operating losses - state	-	-
Loan origination fees	13,148	9,682
Unrealized losses on securities available-for-sale	490,475	563,114
Other	<u>(41,945)</u>	<u>(2,294)</u>
Gross deferred tax assets	634,948	719,319
Less valuation allowance	<u>-</u>	<u>-</u>
Net deferred tax assets	634,948	719,319
Deferred tax liabilities:		
Unrealized gains on securities available-for-sale	-	-
Fixed assets	5,730	11,287
Other	<u>40,324</u>	<u>6,848</u>
Total gross deferred tax liabilities	<u>46,054</u>	<u>18,135</u>
Net deferred tax asset recognized	<u>\$ 588,894</u>	<u>\$ 701,184</u>

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 11. Income Taxes, Continued

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded tax asset to net realizable value. After review of all positive and negative factors and potential tax planning strategies, as of December 31, 2023 management has determined that there is no valuation allowance required.

Savings associations which meet certain definitional tests and operating requirements prescribed by the Internal Revenue Code have been allowed a special bad debt deduction and other special tax provisions. If a savings association did not continue to meet the federal income tax requirements necessary to meet these definitions, the savings association would lose the benefits of these special provisions.

In 1996, legislation was passed that eliminated the special bad debt deduction for thrift institutions effective for years beginning after 1995, or for the bank's fiscal year beginning October 1, 1996. For tax purposes, the Bank will be required to recapture \$173,463 of post-1987 additions ("excess reserves") to its tax bad debt reserves. Under the legislation, the association qualifies as a "small bank", and the excess reserves will be restored to taxable income ratably over the six years, beginning in the year the association no longer qualifies as a bank. Deferred taxes have been provided for the amount of these excess reserves. No deferred tax liability has been provided for the tax bad debt reserve amounting to \$348,021 that arose prior to 1987.

The Bank is included in a consolidated federal income tax return with First Carolina Bancshares, MHC. The tax provision is allocated among members of the group based upon the separate income of each entity. There were no tax related balances due to or from affiliates as of December 31, 2023 and 2022. Tax returns for 2020 and subsequent years are subject to examination by taxing authorities.

As of December 31, 2023, the Bank had no material unrecognized tax benefits or accrued interest and penalties. It is the Bank's policy to account for interest and penalties accrued relative to unrecognized tax benefits as a component of income tax expense.

Note 12. Related Party Transactions

Certain parties (principally certain directors and executive officers of the Bank, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Bank. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. As of December 31, 2023 and 2022, the Bank had related party loans totaling \$1,163,665 and \$1,199,560, respectively.

Deposits by directors, including their affiliates, and executive officers, totaled \$1,881,696 and \$1,954,195 at December 31, 2023 and 2022, respectively.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 13. Fair Value of Financial Instruments

Generally Accepted Accounting Principles (GAAP) provide a framework for measuring and disclosing fair value which requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, individually analyzed loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Bank utilizes fair value measurements to record fair value adjustments to certain assets 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 Bank 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.

Fair value hierarchy:

The Bank 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 the 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 the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities 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, 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.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 13. Fair Value of Financial Instruments, Continued

Loans:

The Bank does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered individually analyzed and an allowance for credit 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 are considered individually analyzed. Once a loan is identified as individually analyzed, management measures the loan for possible credit loss. The fair value of individually analyzed loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those individually analyzed loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2023 and 2022 all of the individually analyzed loans were evaluated based upon the fair value of the collateral or the discounted cash flows method. Individually analyzed loans where an allowance is established based on the fair value of collateral or the discounted cash flows method require classification in the fair value hierarchy. 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 Bank records the loan as nonrecurring Level 3.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2023 and 2022, by level within the hierarchy.

	December 31, 2023			
	Total	Level 1	Level 2	Level 3
Government-sponsored enterprises	\$ 11,170,800	\$ -	\$ 11,170,800	\$ -
Mortgage-backed securities	2,765,834	-	2,765,834	-
Municipal securities	699,709	-	699,709	-
Total	<u>\$ 14,636,343</u>	<u>\$ -</u>	<u>\$ 14,636,343</u>	<u>\$ -</u>

	December 31, 2022			
	Total	Level 1	Level 2	Level 3
Government-sponsored enterprises	\$ 14,125,952	\$ -	\$ 14,125,952	\$ -
Mortgage-backed securities	3,375,327	-	3,375,327	-
Municipal securities	1,138,173	-	1,138,173	-
Total	<u>\$ 18,639,452</u>	<u>\$ -</u>	<u>\$ 18,639,452</u>	<u>\$ -</u>

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of December 31, 2023 and 2022 for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2023 and 2022.

1st Federal Savings Bank of SC, Inc.

Notes to Financial Statements

December 31, 2023 and 2022

Note 13. Fair Value of Financial Instruments, Continued

	December 31, 2023			
	Total	Level 1	Level 2	Level 3
Individually analyzed loans, net	\$ 667,074	\$ -	\$ -	\$ 667,074
Total	<u>\$ 667,074</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 667,074</u>
	December 31, 2022			
	Total	Level 1	Level 2	Level 3
Impaired loans, net	\$ 681,535	\$ -	\$ -	\$ 681,535
Total	<u>\$ 681,535</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 681,535</u>

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2023 and 2022, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value as of December 31, 2023	Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Individually analyzed loans, net of specific reserve	\$ 667,074	Appraisal Value	Appraisals and/or sales of comparable properties	Appraisals discounted 6% to 20% for sales commissions and other holding cost
	Fair Value as of December 31, 2022	Valuation Technique	Significant Observable Inputs	Significant Unobservable Inputs
Impaired loans, net of specific reserve	\$ 681,535	Appraisal Value	Appraisals and/or sales of comparable properties	Appraisals discounted 6% to 20% for sales commissions and other holding cost

1st Federal Savings Bank of SC, Inc.***Notes to Financial Statements******December 31, 2023 and 2022***

Note 14. 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.

The Bank has disclosed its investment portfolio in Notes 3 and 4. There has been no significant deterioration in the investment portfolio through the date the financial statements were issued.

The Bank disclosed deposit concentrations in Note 7. In relation to current economic conditions, management has monitored deposit concentrations through the date the financial statements were issued, noting no significant changes to concentrations. Additionally, there has been no significant deposit deterioration through the date the financial statements were issued.

Management has reviewed events occurring through April 30, 2024, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.