2022 Annual Report

Employees
Customers
Shareholders

Local
Regional
Stewardship

Service
Solutions
Performance

Merchants
Financial Group

Having previously worked here, the Merchants '**rope**' *pulled me back home.*

Like the rope in our logo, this organization is truly **strong**, *yet very flexible. I'm proud to work for a wonderful community partner.*

– Ann, Commercial Banking

Story of the Merchants Bank Logo

Representing our commitment to fulfilling hopes and dreams since 1875.

The Merchants Bank logo possesses a streamlined, forward and rhythmic motion which conveys the message that Merchants Bank is a strong organization with an eye on the future. The three shapes, which together create the letter M, are interlocking and woven together giving the appearance of a rope which implies strength and flexibility.

The three shapes which compose the M also represent characteristics inherent to Merchants Bank. Each builds off another:

- Our employees, customers and shareholders
- The local and regional aspects of our organization and stewardship responsibilities
- Quality solutions, outstanding service and performance
- Volunteers, community and relationships

Volunteers
Community
Relationships

A rope is an amazing tool.

Its strength allows one to lift heavy loads, span great distances and tow precious cargo, yet it is flexible enough to secure valuable packages with a simple knot. This tremendous strength and flexibility is made possible by the thousands of individual strands bound together for one purpose.

A rope could teach us a lot about life.

A Letter From Our Chief Executive Officer

Gregory M. Evans
President &
Chief Executive Officer

The healthy diversification of our business and strong fundamental disciplines associated with balance sheet management were the primary drivers of another record earnings performance year for Merchants Financial Group, Inc. Net income for 2022 was $30.4 million, an increase of 5.72% compared to 2021.

A record year:

$30.4

million net income

Net income of $28.78 million in 2021 was a bit of a historic outlier for Merchants with a marked 33.8% year-over-year improvement from a record earnings year in 2020. Earnings for both 2020 and 2021 were bolstered by extraordinary fee income associated with residential mortgage loans and the Small Business Administration Paycheck Protection Program, sources of revenue we knew would not recur in 2022.

Commercial Banking Contribution Strong

Budgeting for a return to a more normal post-pandemic business environment was unpredictable and taking a Plan for 2022 to your Board of Directors for approval that was more reflective of pre-pandemic earnings levels was uncomfortable. Our year-end performance far exceeded that Plan because of how we were strategically positioned and adapted to a rapidly changing market environment. I'm tremendously proud of our team and its continued drive for excellence.

In 2022, a rebound in commercial banking was the revenue driver that offset the significant slowdown we anticipated in residential mortgage lending. New commercial loan activity totaled $608.5 million. To provide context new commercial loan origination in 2019, the most recent pre-pandemic performance year, was $330.9 million. The result was a year-over-year increase in total loans of 16.6% to $1.88 billion.

"As first-time home buyers and new to the area we had many questions, which Dawn answered expertly." - Ashton, mortgage customer

The profit contribution from commercial banking activity was critical because mortgage loan volume of $394.69 million for the year was just 47% of 2021 origination volume. At year-end our pipeline for new mortgage loans was an anemic $11.9 million – that number has never been lower and, unfortunately, is likely indicative of another very soft market in 2023.

Our Tried & True Approach Continues to Pay Off

We continue to manage these asset components of the business, and the entire loan portfolio, in our usual disciplined manner. Underwriting of new business was not compromised to accommodate loan growth expectations. In fact, we enhanced our loan portfolio and credit renewal underwriting stress testing as the interest rate environment changes unfolded throughout the year.

We have experienced no credit deterioration but are mindful about the impact of high inflation on consumers and higher interest rates on borrowers' ability to service debt obligations. All quantified levels of credit risk in the form of non-performing (3.53% of capital), classified (31.46% of capital) and criticized (55.70% of capital) loans remain manageable and our total Allowance for Loan/Lease Loss Reserves (ALLR) remains conservatively positioned at 1.39% of total loans.

Disciplined balance sheet management through the volatility of the past three years was rewarded in 2022. Our Plan did not reflect the dramatic pivot by the Federal Reserve Bank to raise interest rates with aggression to curb inflation. Because we did not chase short-term yield and take on duration risk in our investment portfolio, our excess liquidity from surge deposits in 2020-21 remained largely in cash held in overnight funds with the Federal Reserve. Interest income increased 656.6% on those excess deposits and totaled $7.07 million last year. Chief Financial Officer Sue Savat, Controller Shannon Thrune and our investment portfolio advisors continue to do an outstanding job of managing liquidity, interest rate risk and portfolio income optimization.

Another market force is virtually no unemployment throughout our footprint and the workforce challenges that creates. Even with significant increases in health care insurance costs and wages to retain talent throughout the year, our overall personnel expense declined year-over-year by 9.36%. This was mostly driven by lower incentive compensation expense, but also reflective of employee recruitment challenges, the time it takes to fill positions and a resulting unplanned reduction in employee headcount.

Looking Ahead

At Merchants, while we take great pride in our results, we know that consistent and repeatable earnings performance is driven by embracing our strategic priorities and execution with zeal. We have an ambitious roadmap we will hold ourselves accountable to in 2023. We anticipate there will be headwinds – a potential recession and resulting loan delinquencies would be the most alarming of the possibilities – but we will adapt as we always have.

I believe the core business battleground in 2023 will be on the deposit front. Unlike Merchants, the excess liquidity for many banks evaporated by year-end 2022. Combined with a dramatically different interest rate environment from a year ago, protection of our strong deposit franchise while managing increased funding costs' impact on margin will require very intense and disciplined focus.

Our strategic emphasis on optimal utilization of technology and re-engineering of legacy processes and systems is in total alignment with protecting and growing the deposit franchise. Secure digital enhancements for 2023 include continued development of treasury management solutions, improved digital card payment utility, accelerated rollout of e-signature capabilities for new account documents, omni-channel customer care access and support (email, chat, co-browse, web, text and telephone), automated teller machine (ATM) replacement, and end-to-end online account opening.

We remain absolute in our commitment to grow and prosper as an independent community bank. Our long-term viability and relevance depend on our ability to perform at levels that exceed the median performance of our peer group, which is what we know you expect. Our resolve to continue to meet your expectations is uncompromised. Thank you for your continued loyalty. Our mission to help our customers and communities achieve hopes and dreams would not be possible without your continued investment and support.

Gregory Evans

Gregory M. Evans
President & Chief Executive Officer
Merchants Financial Group, Inc. and Merchants Bank, NA

A Letter From Our Chief Financial Officer

Susan M. Savat
Senior Vice President &
Chief Financial Officer

It is exciting and an honor to share with you the financial results for Merchants Financial Group, Inc. for 2022. As I have stated to my teammates many times when we are working through a challenge in the finance area, "it is not life or death, it is just numbers." That being said, it is very gratifying when the hard work and discipline of all of our teammates to do the best for our customers and our organization (and a little good luck) pays off for us all. Greg shared some of the key highlights in his letter, but here are some additional key reference points for 2022.

Balance Sheet Highlights

For the year, our balance sheet saw a decrease in deposit balances of 10.4%, an increase in net loans of 17.3% and a focus on adding investments as yields rose that created a 45.4% year-over-year increase. With these changes, our total excess overnight funds at the Federal Reserve decreased 77%, although we still held $191.9 million in overnight excess funds at year-end. The yield received on these funds increased from .15% at the beginning of the year to 4.40% at year-end.

As has been covered quite a bit by the media, banks have seen significant increase in unrealized losses in their investment portfolios. Many have losses near 40% of the book value. While these losses are not reflected in income, they are recognized net of taxes in the equity of the banks. In 2021, Merchants was disciplined in our investment choices and in 2022 as rates rose, we purposefully made additional small purchases to take advantage of the rising yields. At year-end, our unrealized losses were only 7.7% of our portfolio balance.

The largest percentage increases in the loan portfolio were growth of 26% in commercial real estate, 70% in dealer floor plan lines (which were down significantly in 2021 due to supply chain issues) and 16% in commercial loans. Deposits saw money markets decrease 40%, most of which were public entity deposits sitting in an Insured Cash Sweep reciprocal program that provides FDIC insurance on those funds, and a decrease in nearly all certificates of deposit (CD) categories. Our demand deposits (checking accounts),

"There's so much I didn't know and Shelly was with us every step of the way. It was a real partnership." - Daniel, mortgage customer interest bearing checking and savings accounts were relatively steady throughout the year.

While total equity was only up 4.6% from the previous year, much of that was driven by the increase in unrealized losses of the investment portfolio reflected in equity. Core capital balances were up nearly 11.3%. Graphs on the following page show trends in our regulatory and tangible capital ratios.

Income Statement Highlights

The increase in interest rates allowed us to begin paying customers more interest and our overall expense on checking and savings accounts increased 19.2%, even though balances were down. Interest income earned on our loans and leases was up 8.8%, some due to growth in loan balances and some due to an increase in rates on loans that repriced as rate indexes like prime adjusted upward. By far the most significant driver of strong income was the rate received on excess funds at the Federal Reserve, with a year-over-year increase of over $6.1 million or 656.6%. Our average balance in excess funds for the year was nearly $538 million with balances down to $191.9 million at year-end.

As a community bank, over 70% of our net income typically comes from net interest income. Our ability to earn more on loans and investments, as we strive to pay more to our deposit customers that have lived with anemic rates for the past several years is critical to everyone's success.

The focus on non-interest income and expenses continued to be strong in 2022, although low mortgage volume put significant pressure on that area. We had minimal Paycheck Protection Program fee income, however commercial loan fees were up 37.5% compared to 2021. Our leasing division, Merchants Bank Equipment Finance, had a great year due to credit quality improvements post-pandemic and recognized net income of $4.3 million or 36.3% over 2021.

Mortgage fee income from our retail production was down 47.8% and net income from secondary market mortgage activity and mortgage servicing was down 61.5% from the previous year. Other key categories included computer expense, which was up 12%, and loan-related expenses which were down 39%, primarily driven by lower mortgage servicing costs and recovery of funds due to us from government-sponsored entities of Fannie Mae and Freddie Mac.

Celebrating Our Successes

Your Board approved a 200% stock dividend (3-for-1 stock split) that was effective on May 13, 2022 and subsequently approved cash dividends equating to $0.63 per share for the year, an increase of 14.5% compared to the regular semi-annual dividends paid in 2021. While we are likely not the most exciting investment in our shareholders' portfolios, we are pleased that once again our stock value grew 16% in a year where bank stock indexes saw a decline of nearly 20%.

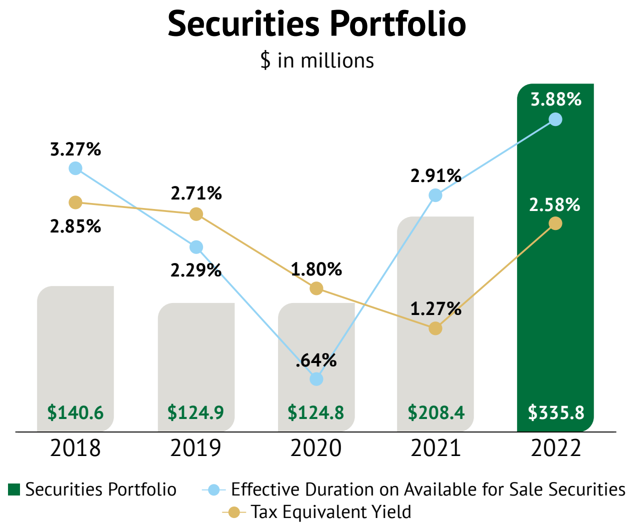
I am writing this note on January 1, 2023 and am truly grateful to look back on a very successful and satisfying 2022 and have great hope and belief that 2023 will be just as good. Why do I have this belief? Because each day I get to work with and hear about our team members who are focused on doing the right thing and committed to the long-term success of Merchants Bank and Merchants Financial Group, our customers and our communities.

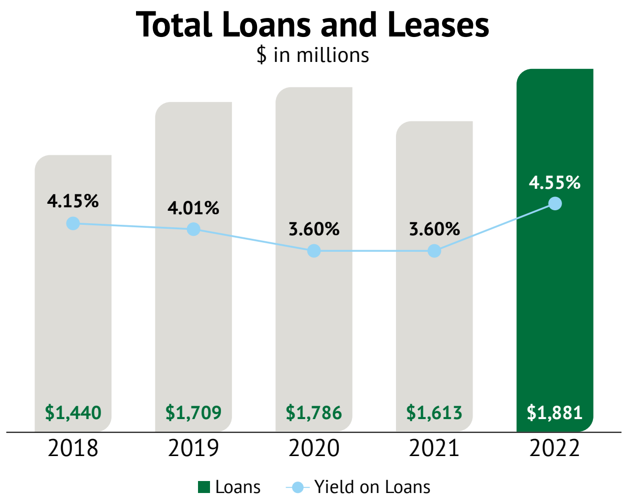
Susan M Savat

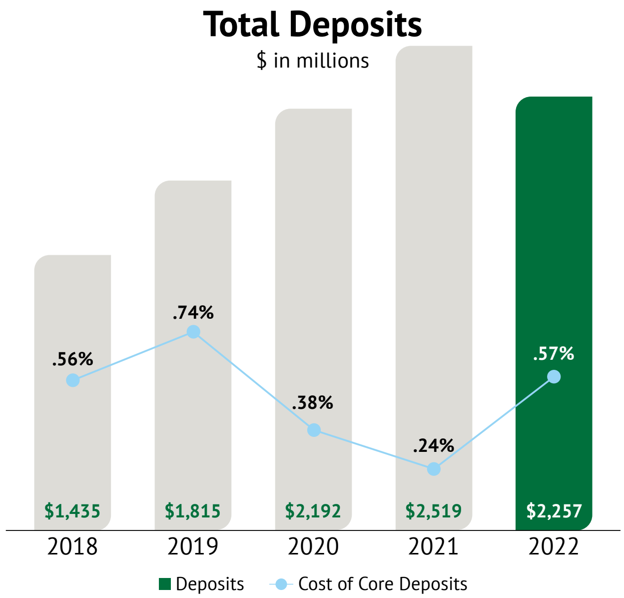
Susan M. Savat
Senior Vice President & Chief Financial Officer
Merchants Financial Group, Inc.

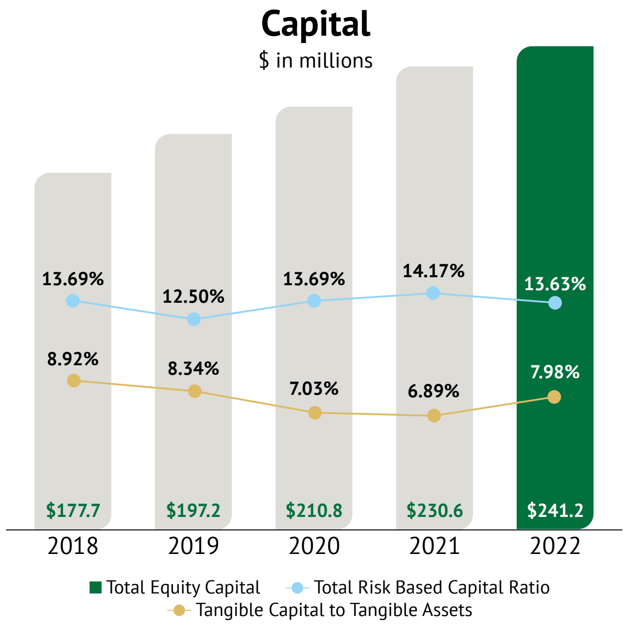
Core Capital Growth	Stock Value Growth	Interest Income Increase on Federal Reserve Funds
11.3%	**16%**	**$6.1 million**

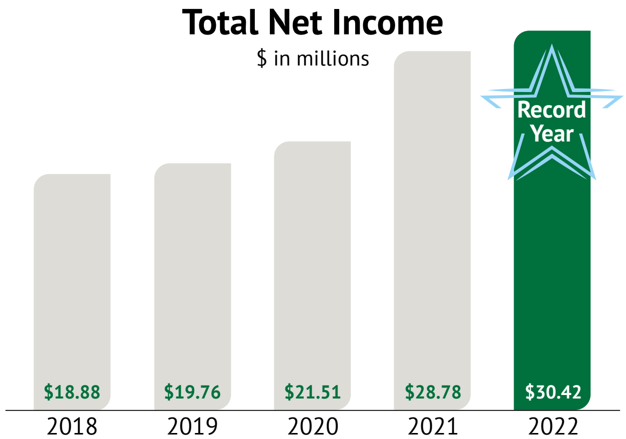
2022 Financial Charts











"My banker authentically shares my business dreams and has the expertise to help me achieve them." - Matt, commercial customer

Consolidated Financials

Condensed Consolidated
Statement of Condition

Assets	12/31/22	12/31/21
Cash and Cash Equivalents	$ 227,190,992	$ 849,408,153
Investments	312,200,627	204,084,584
Loans and Leases, Net	1,851,957,842	1,579,275,344
Banking Houses, Furniture and Fixtures	26,388,272	27,665,568
Other Assets	162,634,785	166,541,853
Total	2,580,372,518	2,826,975,502
Liabilities & Equity		
Deposits	$ 2,257,301,154	$ 2,518,563,755
Other Liabilities	81,912,018	77,772,176
Equity	241,159,346	230,639,571
Total	2,580,372,518	2,826,975,502

Condensed Consolidated
Statement of Income

Income	12/31/22	12/31/21
Interest Income	$ 94,271,379	$ 85,651,891
Interest Expense	8,323,695	8,311,229
Net Interest Income	85,947,684	77,340,662
Other Operating Income	27,986,487	40,929,081
Other Operating Expense	72,939,704	79,102,012
Income Before Taxes	40,994,467	39,167,731
Income Taxes	10,570,000	10,390,000
Net Income	$ 30,424,467	$ 28,777,731
Earnings Per Share*	$ 3.85	$ 3.65
Book Value Per Share*	$ 30.55	$ 29.22
Shares Outstanding	8,178,741	8,178,741

**Based on weighted average of shares outstanding for the year.*

The Value Your Board of Directors and Advisory Boards Bring to Merchants

When reflecting on the past year, it's a privilege to celebrate the success of a record year with our valued shareholders. Not only did our net income reflect the strength of the Merchants organization, but stock price and other key indicators shared in this report by Greg and Sue demonstrate our resilience as a safe, sound, and growing community bank in the face of a shifting and unpredictable economy.

As your Board Chair, I want to thank you for your continued support. Please know that the full Board is focused on delivering a valuable return on your investment as we look to the future. The Merchants Executive Leadership Team is well poised to tackle the challenges ahead with a strategic roadmap that is in alignment with the priorities necessary to continue to deliver ongoing enhancement of shareholder value.

Richard T. Lommen, Jr.
Chair of the Merchants Financial Group Board and Merchants Bank Charter Board

Meet Your Newest Directors

Staying relevant, competitive, and strongly positioned for the future requires leadership aligned at every level of the Merchants organization, and that starts with the business acumen and engagement of our Directors. In 2022, the MFGI Board of Directors enhanced the depth and talent of our governing Board with two new members, Molly Jungbauer and Jim Rogers. They share their thoughts on their experience so far and what they envision next.

Molly K. Jungbauer, CPA
Chief Executive Officer

Hollstadt Consulting, Inc.

- Represents Apple Valley, Cottage Grove, Hastings, Lakeville and Rosemount markets
- Expertise in technology consulting, accounting and finance

James A. Rogers III
Chief Business Development Officer

Mayo Clinic

- Represents Rochester market and has been a member of our Rochester Advisory Board since 2016
- Expertise in business development, non-profit administration, legal and innovation

"It's nice working with bankers who are active in the community. I couldn't imagine banking anywhere else."
- Suzanne, commercial customer

Q: What motivated you to be part of the continued mission of MFGI?

A: **Jim:** I have been part of Merchants Bank's Rochester Advisory Board since 2016 and through that work, it became clear to me that the Bank is a values-driven organization. As a community bank, the team is fully engaged with the people in the community to the point that it actually makes an impact. So, when there was an opportunity to join the MFGI Board, it was an easy decision for me.

Molly: As a business owner, you expect your business to go through challenging and opportunistic times, so it is important to partner with a bank that will be there through both. As I learned more about Merchants, I came to understand that the Bank values their clients as much as their clients value them - a bank that will be there when their clients need them most. When I had the opportunity to join the Board it was easy to say yes because I found Merchants to be a well-run organization, dedicated to its clients, always seeking to improve, and lives their values.

Q: What do you see as MFGI's biggest opportunities going into 2023?

A: **Molly:** First, a continued focus on exceptional customer service. Many clients consider banks to be key partners, and most don't change that relationship frequently, if ever, during their lifetime. It is a deeply trusted relationship, so it is important for Merchants to maintain a high level of service.

Additionally, it is critical to retain top talent in a highly competitive labor market to meet the needs of Merchants' clients. With record low unemployment, organizations that offer career growth opportunities will have an upper hand in the war on talent. It is evident that this is a priority at Merchants.

Q: How does the diverse industry experience of Board Directors aid in driving strategic direction and thinking for the company?

A: **Jim:** I'm really impressed with the backgrounds of everyone on the Board and the way they lean in. I've found that this group has a willingness to discuss and debate and really put in the work to ensure we're fully engaged in our leadership role as Board members. If you look at the years of experience we as Board members have in the various industries, it's pretty remarkable. Just as other Directors bring their unique background to Board work, I can bring a perspective through business development and innovation that's different and valuable.

Q: How do you feel your work on the MFGI board helps set the company up for future success?

A: **Molly:** As the co-owner of a technology consulting company, I am always exploring new and improved ways to use technology to drive my business forward, so my intent is to provide that consumer voice to the Board like many fellow Directors. As a CPA, I also have a mindset for internal controls and regulation, so I can assist the Board with keeping abreast of the ever-changing regulatory environment.

Jim: I would add that overall, as a Board, we'll work to continue ensuring appropriate oversight for the organization and a focus on the future, while maintaining our values and community leadership commitment. I feel that our Board work has been rightly focused on what is relevant at a strategic level and we trust the Executive Team to tackle the operations side. It's obvious to me that Merchants has built a strong culture that will serve the organization well as it moves into the future.

"I've worked with Tina to finance many houses over 20 years. I couldn't ask for a better banker." - Ernie, mortgage customer

Executive Leadership Team

With decades of industry experience, our Executive Leadership Team knows that the heart of a successful organization is its people. The Team drives forward our community banking mission, oversees the strategic direction of Merchants and upholds the service-above-self culture that defines the experience of every stakeholder.

Greg Evans
President & Chief Executive Officer, Merchants Financial Group, Inc. and Merchants Bank, NA

- In banking since 1989
- Joined Merchants in 1989

Serves on the Board of Directors for Winona Health and Chairs its Finance/Audit Committee; Board of Trustees, Finance Committee, and Development Committee for the Winona State University Foundation; Minnesota Bankers Association (MBA) Board of Directors and MBA Government Relations Council and American Bankers Association Government Relations Council.

Cat Breet
Chief Human Resource Officer

- In human resources since 1997
- Joined Merchants in 2022

Has served national banks and global financial services firms since 1997. Active in human resources, leadership, workforce development and higher education communities. Founder and co-leader of 14-year professional networking group in Twin Cities, MN. Member of the Wipfli Human Resources Forum.

Andrew Guzzo
Chief Banking Officer & President (Winona)

- In banking since 2006
- Joined Merchants in 2017

Serves on the Board of Directors for the Winona Family YMCA, Winona Community Foundation and Family & Children's Center, the Community Leadership Advisory Board for Winona State University College of Business and the President's Advisory Committee for Minnesota State College Southeast, and the Minnesota Chamber of Commerce Transportation Policy Committee.

Cindy Harrison
Chief Credit Officer

- In banking since 1992
- Joined Merchants in 1992

Serves on the St. Martin's Lutheran Church Call Committee (Chair), volunteers for Junior Achievement and founding member of Hope Lutheran High School.

Erick Maki
Regional President, South Region

- In banking since 2001
- Joined Merchants in 2022

Member of the Three Rivers Community Action, Rotary Club of La Crosse and West Salem Hockey Association.

Dan Massett
Regional President, North Region

- In banking since 1989
- Joined Merchants in 2014

Serves on the Board of Directors for the Jones Family Foundation (Board Chair), Economic Initiative Corporation of Cannon Falls, Red Wing Downtown Philanthropy Collaborative; Finance Committee for Cannon Falls Schools and Elks Association.

"Merchants empowered me to achieve my career goals while still valuing work/life balance." - Nick, Commercial Banking

Sue Savat
Chief Financial Officer

- In banking since 1996
- Joined Merchants in 2000 (also from 1992-1995)

Serves on the Board of Directors for the Winona Area Catholic Schools Foundation (Vice President/Treasurer), Habitat for Humanity serving Winona County (Treasurer) and Executive and Finance Committees, Department of Business Finance Advisory Board for Winona State University and Winona Health Finance and Retirement Committees.

Dave Schlauderaff
President, Merchants Bank Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022

Volunteers for Lakeville youth and high school programs.

Stephen Swenson
Chief Information Officer

- In information technology since 1984
- Joined Merchants in 2020

Serves on the Board of Directors for Winona County Historical Society and the Minnesota State College Southeast Information Technology Advisory Committee.

Recognizing our 2022 Executive Team Retirees

Throughout the year we celebrated retirements for several members of our Executive Leadership Team. We'd like to say a heartfelt thank you for their contributions and dedicated years of service to our Merchants' customers, employees and our local communities.

Richard Barry
President
Merchants Bank Equipment Finance

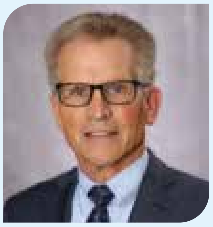
With Merchants from 2016-2022

Beth Ede
Chief Human Resource Officer

With Merchants from 2019-2022

Mark McGrory
Chief Credit Officer

With Merchants from 1986-2022



Lawrence (Skip) Stovern
Regional President, Twin Cities

With Merchants from 2007-2022

"I am provided growth opportunities and get to serve our community daily. It doesn't get better." - Amy, Mortgage Banking

Merchants Bank Local Leadership

Our local leaders understand that mutual success is the key to a thriving community and Bank – we all succeed together. That's why it's important to Merchants to have leadership in every market we serve and something that makes us different from other organizations. We believe that understanding local economies, issues and community values is key to building lifelong, trusting relationships with those we serve.

Larry Accola
President, Eau Claire

- In banking since 1971
- Joined Merchants in 2015

Serves on the Board of Directors for the Eau Claire Kiwanis Club (President), Advisory Board for the Chippewa Valley Technical College, City of Eau Claire Revolving Loan Funds Committee (Board Chairperson) and volunteers for the Eau Claire Community Table, Wisconsin Logging Museum, and Adopt a Highway.

Larry Bodin
President, La Crescent and Onalaska

- In banking since 1986
- Joined Merchants in 2020

Serves on the Board of Directors for Chileda, Inc., VARC, Inc., VARC Foundation Inc., Bethany Church (Audit Committee), Holmen Area Rotary Club (President-elect) and volunteers for the Boys & Girls Club of Greater La Crosse.

Jon Dahl
President, Cannon Falls

- In banking since 1983
- Joined Merchants in 2020

Serves on the Board of Directors for Cannon Falls Rotary (Scholarship Committee), Cannon Falls Library Foundation, Cannon Arts (Treasurer), United Way of Goodhue, Wabasha, and Pierce Counties, and the Cannon Falls Economic Development Authority.

Bruce Goblirsch
President, Cottage Grove and Hastings

- In banking since 1986
- Joined Merchants in 2002

Serves on the Hastings Economic Development and Redevelopment Authority (HEDRA) (Commissioner), a member of the Hastings Area Chamber of Commerce and a member of the Hastings Area Rotary.

Ken Graner
President, Lanesboro and Rushford

- In banking since 1981
- Joined Merchants in 2009

Serves as a volunteer for Lanesboro Fire Department and Lanesboro Ambulance and is a member of the Lanesboro Chamber of Commerce and Sons of the American Legion.

Andrew Guzzo
Chief Banking Officer & President (Winona)

- In banking since 2006
- Joined Merchants in 2017

Serves on the Board of Directors for the Winona Family YMCA, Winona Community Foundation and Family & Children's Center, the Community Leadership Advisory Board for Winona State University College of Business and the President's Advisory Committee for Minnesota State College Southeast, and the Minnesota Chamber of Commerce Transportation Policy Committee.

"It's a privilege to work for a company where employees focus on providing the best customer service." - Robb, Mortgage Banking

Jarett Jones
President, Rochester

- In banking since 1999
- Joined Merchants in 2020

Serves on the Board of Directors for Rochester Area Chamber of Commerce, Rochester Area Economic Development, Inc. (Treasurer), Rochester Area Builders Assoc., Stewartville Nursing Home (President), Stewartville Fireman's Relief Assoc. (Treasurer), Stewartville Drift Skippers (Treasurer). Member of the Stewartville Sportsman's Club, St. Bernard's Finance Council and Stewartville Fire Department (volunteer).

Erick Maki
Regional President, South Region

- In banking since 2001
- Joined Merchants in 2022

Member of the Three Rivers Community Action, Rotary Club of La Crosse and West Salem Hockey Association.

Dan Massett
Regional President, North Region

- In banking since 1989
- Joined Merchants in 2014

Serves on the Board of Directors for the Jones Family Foundation (Board Chair), Economic Initiative Corporation of Cannon Falls, Red Wing Downtown Philanthropy Collaborative; Finance Committee for Cannon Falls Schools and Elks Association.

Kirk Muhlenbruck
President, Northfield

- In banking since 1988
- Joined Merchants in 2021

Serves on the Board of Directors for Healthy Community Initiative and the Finance Committee of the Northfield Retirement Community, a member of Northfield Area Chamber of Commerce and Northfield Rotary.

Tom Pasch
President, Red Wing

- In banking since 2009
- Joined Merchants in 2021

Serves on the Board of Directors for the Red Wing Downtown Mainstreet Program (Treasurer), Minnesota State College Southeast Foundation (Treasurer) and Red Wing Family YMCA. Member of the Red Wing Economic Development Committee and Red Wing Chamber Government Affairs and Advocacy Committee.

Dave Schlauderaff
President, Merchants Bank Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022

Volunteers for Lakeville youth and high school programs.

Matt Schuldt
President, Caledonia and Spring Grove

- In banking since 2009
- Joined Merchants in 2014

Serves on the City of Caledonia Economic Development Association (President), Houston County Economic Development Association (President), ISD 299 Foundation Board and volunteers as a member of the Houston County Airport Commission, Caledonia Rotary, Caledonia Warriors Club Court, Caledonia Founder's Day Committee and Immanuel Lutheran Scholarship Committee.

Dan Vlasak
President, Apple Valley, Lakeville and Rosemount

- In banking since 1989
- Joined Merchants in 2009

Serves on the Board of Directors for the SBA 504 Development Corporation (President) and the Lakeville Rotary.

"I'm proud to be part of the Merchants team." - Atinaf, Customer Service

Merchants Financial Group Board of Directors

Richard T. Lommen, Jr.
Chair of the Board
President & Owner

Courtesy Corporation

Michael F. Cichanowski
Founder & Chief Executive Officer

Wenonah Canoe, Inc.

Molly K. Jungbauer, CPA
Chief Executive Officer

Hollstadt Consulting, Inc.

Bradley J. Peterson
Chairman

Mississippi Welders Supply Co., Inc.

Bruce E. Ryan
President

Ryan Windows & Siding, Inc.

Ann E. Merchlewitz
Vice Chair of the Board
Senior Vice President & General Counsel

Saint Mary's University of Minnesota

Gregory M. Evans
President & Chief Executive Officer

Merchants Financial Group, Inc. and Merchants Bank, NA

John H. Killen
President

WinCraft, a Fanatics brand

James A. Rogers III
Chief Business Development Officer

Mayo Clinic

James A. Trenda, CPA
President

CP Advisors, LLC

"Merchants Bank is more than just an employer, it cares strongly about its employees." - Chris, Mortgage Banking

Merchants Bank Charter Board of Directors

Richard T. Lommen, Jr.
Chair of the Board
President & Owner
Courtesy Corporation

Ann E. Merchlewitz
Vice Chair of the Board
Senior Vice President & General Counsel
Saint Mary's University of Minnesota

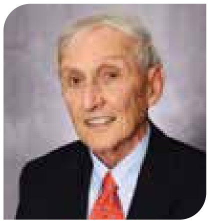
Michael F. Cichanowski
Founder & Chief Executive Officer
Wenonah Canoe, Inc.

Gregory M. Evans
President & Chief Executive Officer
Merchants Financial Group, Inc. and Merchants Bank, NA

Richard J. Falck
Owner, Falck Financial Services
President, RJF, Inc.

Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.

John H. Killen
President
WinCraft, a Fanatics brand



Timothy A. Murphy
Partner
Murphy Law Office, P.L.L.P.

Bradley J. Peterson
Chairman
Mississippi Welders Supply Co., Inc.

James A. Rogers III
Chief Business Development Officer
Mayo Clinic

Bruce E. Ryan
President
Ryan Windows & Siding, Inc.

Jennifer R. Sawyer
Co-Founder & Partner, Rebound Partners
CEO/President, boardBOS

James A. Trenda, CPA
President
CP Advisors, LLC

"Company values are expressed through every decision, directly impacting employees and customers." - Sami, Human Resources

Merchants Bank Advisory Boards

North Region/Cannon Falls Area

John O. Althoff
Retired Owner, Althoff Hardware

Mayor, Cannon Falls

Leslie M. Anderson
Farmer & Real Estate Broker

Anderson Realty, LLC

Lisa M. Lundell
Real Estate Broker/ Owner

Cannon Realty

Richard A. Peterson
Owner

Peterson Turkey Hatchery, Inc.

Mark A. Poss
Director

Big Fish Ventures

Brenda A. Stelter
Owner

Anchor Promotions, Apparel & Signage

North Region/Northfield

Cheryl A. Buck
Director - Business Development

Professional Risk Managers' International Association

Matthew T. Christensen
Commercial Risk Advisor

WA Group

Richard J. Falck
Owner, Falck Financial Services

President, RJF, Inc.

Chris J. Kennelly
Chief Investment Officer, REVocity

CEO, NCC Builders

President, G&H Management/ Bluewater Properties

Jennifer R. Sawyer
Co-Founder & Partner, Rebound Partners

CEO/President, boardBOS

Kristin L. Yahnke
Attorney & Partner

Schmitz Ophaug, LLP

North Region/Twin Cities Area

Ben E. Gathje
Owner/Operator

Culver's of Cottage Grove

Peggy P. Johnson
Community Relations Director

Dakota Electric Association

James A. Trenda
President

CP Advisors, LLC

Richard H. Welshons
Twin Cities Manager

The Title Team/ DCA Title

"Merchants' leadership excels at mentoring and helping you define your career path." - Hayley, Marketing

Merchants Bank Advisory Boards

South Region/La Crosse Market Area

Dean L. Ashbacher
President & Chief Executive Officer
Truss Specialists, Inc.

Derek S. Cortez, Ph.D.
Chief Executive Officer
Chileda, Inc.

Stephen D. Loehr
Vice President of Government & Industry Relations
Kwik Trip, Inc.

Richard T. Lommen, Jr.
President & Owner
Courtesy Corporation

South Region/Rochester

John C. Beatty
Attorney
Dunlap & Seeger, PA

Aaron J. Benike
President
Benike Construction

Joselyn A. Raymundo
Founder/CEO
Rochester Home Infusion

James A. Rogers III
Chief Business Development Officer
Mayo Clinic

Bruce E. Ryan
President
Ryan Windows & Siding, Inc.

South Region/Rural Market Area

John D. Diersen
Owner & Farmer
Minnigan Hills Farm

Creighton M. Horihan
Owner
Horihan Companies

Timothy A. Murphy
Partner
Murphy Law Office, P.L.L.P.

Joel B. Nelson
Farmer & Owner
Lanesboro Sales Commission
Decorah Sales Commission

"I love that Merchants is like a family. We take care of each other and the community." - Larissa, Credit Administration

Consolidated Financial Report

December 31, 2022
Merchants Financial Group, Inc. and Subsidiaries

CONTENTS

Merchants Financial Group

102 East Third Street • Winona, MN 55987
(507) 457-1100 • www.merchantsbank.com

RSM US LLP

Independent Auditor's Report

Audit Committee and Board of Directors
Merchants Financial Group, Inc. and Subsidiary

Report on the Audit of the Financial Statements

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

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

We have also audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the Company's internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 8, 2023, expressed an unmodified opinion on the effectiveness of the Company's internal control over financial reporting.

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

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

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

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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information Included in the Annual Report
Management is responsible for the other information included in the annual report. The other information comprises the information included in the annual report but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

RSM US LLP

Sioux Falls, South Dakota
February 8, 2023

Merchants Financial Group, Inc. and Subsidiary

Consolidated Balance Sheets
December 31, 2022 and 2021
(In Thousands, Except Share Information)

Assets	**2022**	2021
Cash and cash equivalents (Note 2)	**$ 227,191**	$ 849,408
Federal funds sold	**277**	413
Available-for-sale securities (Notes 3 and 10)	**275,131**	193,644
Held-to-maturity securities (Notes 3 and 10)	**37,070**	10,440
Loans held for sale (Note 4)	**6,202**	24,071
Loans and direct financing leases, net (Notes 5, 10, 14 and 16)	**1,851,958**	1,579,275
Operating lease assets, net (Note 6)	**21,558**	17,450
Premises and equipment, net (Note 7)	**26,388**	27,666
Investment in restricted stock	**7,163**	6,880
Other real estate and other personal property owned (Note 8)	**806**	1,123
Accrued interest receivable and other assets	**15,331**	14,209
Cash surrender value of life insurance	**58,197**	48,986
Mortgage servicing rights, net (Note 4)	**16,638**	16,251
Goodwill (Note 1)	**35,665**	35,665
Intangibles (Note 1)	**797**	1,494
Total assets	**$ 2,580,372**	$ 2,826,975
Liabilities and Stockholders' Equity		
Liabilities		
Deposits (Note 9):		
Noninterest-bearing	**$ 635,853**	$ 620,988
Interest-bearing	**1,621,448**	1,897,575
Total deposits	**2,257,301**	2,518,563
Repurchase agreements (Note 10)	**12,019**	1,700
Notes payable (Note 11)	**12,120**	14,540
Subordinated debentures (Note 12)	**41,254**	41,254
Deferred taxes (Note 13)	**3,233**	3,370
Accrued interest payable and other liabilities (Note 13)	**13,286**	16,909
Total liabilities	**2,339,213**	2,596,336
Commitments, Contingencies and Credit Risk (Note 14)		
Stockholders' Equity (Note 1 and 17)		
Common stock, par value $0.008 per share; 25,000,000 shares authorized; shares issued: 8,178,741 in 2022 and 2021	**68**	68
Additional paid-in capital	**10,255**	10,135
Retained earnings	**254,087**	228,632
Accumulated other comprehensive loss (Note 3)	**(14,899)**	(791)
Unearned ESOP shares (Note 15)	**(8,352)**	(7,405)
Total stockholders' equity	**241,159**	230,639
Total liabilities and stockholders' equity	**$ 2,580,372**	$ 2,826,975

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Income
Years Ended December 31, 2022 and 2021
(In Thousands, Except Per Share Information)

	2022	2021
Interest income:		
Loans	$ 77,706	$ 77,953
Securities	5,545	2,327
Direct financing leases	2,512	3,180
Other	8,508	2,192
	94,271	85,652
Interest expense:		
Deposits	6,101	6,663
Notes payable, federal funds purchased and repurchase agreements	382	415
Subordinated debentures	1,841	1,233
	8,324	8,311
Net interest income	85,947	77,341
Provision for loan and lease losses (Note 5)	(2,276)	(2,210)
Net interest income after provision for loan and lease losses	88,223	79,551
Noninterest income:		
Trust department	2,368	2,248
Service charges and other fees	5,476	5,499
Loan servicing fees	7,216	7,124
Net gain on sale of loans	3,389	16,822
Net gain (loss) on sale of other real estate and other personal property owned including writedowns (Note 8)	(161)	450
Other	9,699	8,785
	27,987	40,928
Noninterest expenses:		
Salaries and employee benefits (Note 15)	42,326	46,698
Occupancy	16,834	14,810
Net loss on disposal of premises and equipment	15	565
Mortgage servicing rights (Note 4)	3,379	5,575
Other	12,662	13,664
	75,216	81,312
Income before income taxes	40,994	39,167
Provision for income taxes (Note 13)	10,570	10,390
Net income	$ 30,424	$ 28,777
Basic earnings per common share (Note 1)	$ 3.85	$ 3.65

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2022 and 2021
(In Thousands)

	2022	2021
Net income	$ 30,424	$ 28,777
Other comprehensive income (loss), net of reclassification adjustments and income tax effect:		
Change in unrealized loss on securities	(15,495)	(2,908)
Unrealized gain on interest rate swap	1,387	606
Total other comprehensive loss	(14,108)	(2,302)
Comprehensive income	$ 16,316	$ 26,475

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2022 and 2021
(In Thousands, Except Per Share Information)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance, December 31, 2020	$ 68	$ 10,063	$ 206,822	$ 1,511	$ (7,675)	$ 210,789
Net income	-	-	28,777	-	-	28,777
Other comprehensive loss (Note 3)	-	-	-	(2,302)	-	(2,302)
ESOP shares purchased	-	-	-	-	(851)	(851)
ESOP shares released for allocation (Note 15)	-	72	-	-	1,121	1,193
Cash dividends declared ($0.88 per share)	-	-	(6,967)	-	-	(6,967)
Balance, December 31, 2021	$ 68	$ 10,135	$ 228,632	$ (791)	$ (7,405)	$ 230,639
Net income	-	-	30,424	-	-	30,424
Other comprehensive loss (Note 3)	-	-	-	(14,108)	-	(14,108)
ESOP shares purchased	-	-	-	-	(2,410)	(2,410)
ESOP shares released for allocation (Note 15)	-	120	-	-	1,463	1,583
Cash dividends declared ($0.63 per share)	-	-	(4,969)	-	-	(4,969)
Balance, December 31, 2022	**$ 68**	**$ 10,255**	**$ 254,087**	**$ (14,899)**	**$ (8,352)**	**$ 241,159**

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Cash Flows
Years Ended December 31, 2022 and 2021
(In Thousands)

	2022	2021
Cash Flows From Operating Activities		
Net income	**$ 30,424**	$ 28,777
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization and accretion of bond premiums and discounts	**372**	1,053
Provision for loan and lease losses (Note 5)	**(2,276)**	(2,210)
Net gain on sale of loans	**(3,389)**	(16,822)
Net change in fair value of loans held for sale	**(37)**	(845)
Proceeds from sales of loans held for sale	**312,125**	792,510
Originations and purchases of loans held for sale	**(293,286)**	(765,077)
Mortgage servicing rights (Note 4)	**3,379**	5,575
Depreciation expense	**5,896**	4,928
Net charge-offs/write-downs of OREO (Note 8)	**161**	-
Loss on disposal of fixed assets	**15**	565
Deferred income taxes (Note 13)	**5,874**	(3,965)
Release of shares to ESOP	**1,583**	1,193
Increase in cash value of life insurance	**(1,361)**	(1,015)
Net gain on sale of OREO (Note 8)	**-**	(675)
Other	**(2,662)**	1,362
Net cash provided by operating activities	**56,818**	45,354
Cash Flows From Investing Activities		
Cash flows from securities (Note 18)	**(129,994)**	(85,314)
Purchases of restricted stock	**(283)**	(276)
Net (increase) decrease in federal funds sold	**136**	(18)
Net (increase) decrease in loans and direct financing leases	**(270,523)**	166,733
Purchases of operating lease assets	**(8,325)**	(6,021)
Purchases of premises and equipment	**(456)**	(1,187)
(Purchases) proceeds of life insurance	**(7,850)**	-
Purchases of mortgage servicing rights	**(1,310)**	(3,336)
Proceeds from sales of equipment	**40**	993
Proceeds from sales of OREO and foreclosed assets	**272**	3,828
Net cash provided by (used in) investing activities	**(418,293)**	75,402
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	**(261,262)**	326,791
Net increase (decrease) in short-term borrowings (Note 10)	**10,319**	(11,016)
Repayment of long-term borrowings	**(2,420)**	(2,880)
ESOP shares purchased	**(2,410)**	(851)
Cash dividends paid	**(4,969)**	(6,967)
Net cash provided by (used in) investing activities	**(260,742)**	305,077
Increase (decrease) in cash and cash equivalents	**(622,217)**	425,833
Cash and Cash Equivalents		
Beginning	**849,408**	423,575
Ending	**$ 227,191**	$ 849,408

See Supplemental Cash Flow Disclosures (Note 18)

Note 1. Basis of Presentation

Nature of business: Merchants Financial Group, Inc. is a bank holding company with one wholly owned bank subsidiary, Merchants Bank, National Association (the Bank). The Bank has branch operations in Winona, Goodview, Rushford, Lanesboro, St. Charles, Rochester, La Crescent, Caledonia, Spring Grove, Cannon Falls, Red Wing, Hampton, Hastings, Apple Valley, Lakeville, Cottage Grove, Rosemount, and Northfield, Minnesota; and Onalaska and Eau Claire, Wisconsin. The Bank provides retail, commercial loan and deposit services principally to customers within a 50-mile radius of its locations. The Bank has a leasing division, Merchants Bank Equipment Finance, which operates in the Minneapolis–St. Paul, Minnesota metropolitan area.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Merchants Financial Group, Inc. and its wholly owned Subsidiary. These entities are collectively referred to herein as the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of accounting estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term due to economic and legislative changes relate to the determination of the allowance for loan and lease losses, valuation of goodwill, valuation of securities and the fair value of mortgage servicing rights.

Trust and investment assets: The Bank operates trust and investment services. Assets under management by the trust and investment departments, other than trust cash on deposit at the Bank, are not included in these consolidated financial statements because they are not assets of the Company. Total managed trust assets were $283,251 and $311,325 as of December 31, 2022 and 2021, respectively.

Cash, cash equivalents and cash flows: For purposes of reporting cash flows, cash and cash equivalents includes cash on hand and amounts due from banks, including interest-bearing deposits in the Federal Reserve Bank. Cash flows from loans, federal funds sold/purchased, deposits and repurchase agreements are reported net. The Bank maintains cash in deposit accounts which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts. The Bank's primary correspondent bank account is with U.S. Bank.

Federal funds: The Company has federal funds sold/purchased with correspondent financial institutions intended to support short-term liquidity needs. Interest income and expense on federal funds sold/purchased is included in other interest income and notes payable, federal funds sold, and repurchase agreement interest expense in the consolidated statement of income.

Note 1. Basis of Presentation (Continued)

Securities: Debt securities for which the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Amortization of premiums and accretion of discounts, computed by the interest method over their contractual lives, are included in interest income.

Securities classified as available-for-sale include debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value with unrealized gains or losses reported net of the related deferred tax effect in other comprehensive income. The amortization of premiums and accretion of discounts, computed by the interest method over their contractual lives, are recognized in interest income. Purchase premiums are recognized in interest income using the effective interest method to the first call date. Realized gains or losses, determined on the basis of the amortized cost of specific securities sold, are included in net income.

Declines in the fair value of individual securities classified as either held-to-maturity or available-for-sale, below their amortized cost, that are determined to be other than temporary result in realized losses on the individual securities. If the Company (a) has the intent to sell a debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery, then the Company recognizes the entire unrealized loss in earnings as an other-than-temporary loss. If neither of these conditions are met, the Company evaluates whether a credit loss exists. The impairment is separated into (a) the amount of the total impairment related to the credit loss and (b) the amount of the total impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings, and the amount related to all other factors is recognized in other comprehensive income.

The assessment of whether such impairment has occurred is based on management's case-by-case evaluation of the underlying reasons for the decline in fair value. Management considers a wide range of factors in making this assessment. Those factors include, but are not limited to, the length and severity of the decline in value and changes in the credit quality of the issuer or underlying assets.

Loans held for sale: Loans the Company originates with the intent to sell in the secondary market are classified as held for sale. Loans held for sale consist of first mortgage loans that are secured by residential real estate. The Company elected the fair value option for loans held for sale, and accordingly, all loans held for sale are recorded at fair value.

The fair value of the loans held for sale also includes the fair value of mandatory delivery commitments to an end investor that are considered derivatives. These commitments include the investor's purchase price of a specific loan or pool of loans to be delivered to an investor by a certain date.

The fair value of loans held for sale is determined using current secondary market prices for loans with similar coupons, maturities and credit quality.

Loans and direct lease financing receivables (loans): Loans are stated at the amount of unpaid principal reduced by unearned income and an allowance for loan and lease losses.

Note 1. Basis of Presentation (Continued)

Interest on loans is recognized over the terms of the loans using the simple-interest method on principal amounts outstanding. The Company determines a loan to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. Accrual of interest is discontinued when management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. The accrual of interest is generally discontinued at the time the loan is 90 days delinquent, unless the credit is well-secured and in the process of collection. Cash collections on nonaccrual loans are credited to the loan receivable balance, and no interest income is recognized on those loans until the past-due principal balance has been collected. Accrual of interest is generally resumed when the customer is current on all principal and interest payments and has been paying on a timely basis for a period of time.

The Company's leasing operations consist of the leasing of various types of equipment and trucks used in manufacturing, construction and agricultural operations. For direct financing leases, the total net rentals receivable and the estimated residual value of the leased equipment, net of unearned income, are recorded as a net investment in direct financing leases, and the unearned income is recognized each month as it is earned so as to provide a constant periodic rate of return on the unrecovered investment.

Accrual of interest on impaired loans and leases is discontinued when management believes the borrower's financial condition is such that collection of interest is doubtful. Impaired loans also include loans that have been renegotiated in a troubled debt restructuring. Cash collections on impaired loans are generally credited to the loan balance, and no interest income is recognized on those loans until the principal balance has been determined to be collectible.

A loan or lease is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that lead to a restructuring of the loan or lease, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include rate reductions, principal forgiveness, extension of maturity date, and other actions intended to minimize potential losses. A loan or lease that is modified at a market rate of interest may no longer be classified as a troubled debt restructuring in the calendar year subsequent to the restructuring if it is in compliance with the modified terms. Performance prior to the restructuring is considered when assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual at the time of the restructuring or after a shorter performance period.

Allowance for loan and lease losses: The allowance for loan and lease losses is established through a provision for loan and lease losses charged to expense. Loans and direct financing leases are charged against the allowance for loan and lease losses when management believes that collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans, based on evaluation of the collectability of loans and prior loan loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan and lease losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examination.

Note 1. Basis of Presentation (Continued)

The allowance for loan and lease losses consists of specific and general components:

Specific components: The Company considers a loan impaired when it is probable the Company will be unable to collect all principal and interest payments due in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment is based on the fair value of the collateral less estimated costs to sell.

General components: Nonimpaired loans are categorized into pools of loans with similar risk and loss characteristics and assessed for probable losses. These loan pools include commercial; commercial real estate; agricultural, including real estate; residential real estate; consumer; and direct financing leases. Historical loss experience, adjusted for qualitative factors, is multiplied by the total of each loan pool to determine an appropriate level of allowance by loan type.

These qualitative factors include consideration of the following: changes in the lending policies and procedures, including underwriting standards and collection, charge off, and recovery practices; changes in the national and local economic and business conditions and developments, including the condition of various market segments and COVID-19; changes in the nature and volume of the loan portfolio; changes in the experience, ability and depth of lending management and staff; changes in the trend of the volume and severity of past due and classified loans, nonaccrual loans, troubled debt restructurings and other loan modifications; changes in the quality of the institution’s loan review system and the degree of oversight of the institution’s board of directors; the existence and effect of any concentrations of credit, and changes in the level of such concentrations; the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution’s current portfolio; foreclosure and personal bankruptcy trends; changes in levels and trends in charge offs and recoveries with consideration given to the year-to-date trends.

Acquired loans: Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date without a carryover of the related allowance for loan and lease losses. Purchased loans that are not impaired are accounted for in accordance with *FASB Accounting Standards Codification* (ASC) Topic 310-20, Nonrefundable Fees and Others Costs, as these loans do not have evidence of credit deterioration since origination. Purchased loans that have become impaired after origination but before acquisition (PCI Loans) are accounted for in accordance with ASC Topic 310-30. For nonimpaired purchased loans, the difference between the estimated fair value of the loans (computed on a loan-by-loan basis) and the principal outstanding is accreted or amortized into interest income over the remaining life of the loans.

In accordance with ASC 310-30, for PCI Loans, the difference between contractually required payments at acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. Loans with no accretable yield are placed on nonaccrual and any payments received are credited to principal first, before any income will be recognized.

Note 1. Basis of Presentation (Continued)

Operating leases: For operating leases in which the Company is the lessor, the cost of the equipment is recorded as an asset and is depreciated over its estimated useful life and the rental income is recognized ratably as the lease rental payments are earned. Rental income is included in the caption, other noninterest income, in the consolidated statements of income.

Investment in restricted stock: The Company is a member of the Federal Home Loan Bank of Des Moines (FHLB) and, as such, is required to maintain a minimum investment in capital stock of the Federal Home Loan Bank that varies with the level of advances outstanding. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and, as such, is classified as restricted stock, carried at cost, and evaluated for impairment in accordance with guidance for depository and lending institutions. In accordance with this guidance, the stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management has determined that the FHLB stock and Federal Reserve Bank stock were not impaired at December 31, 2022 and 2021.

Premises and equipment: Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided principally on a straight-line basis over the estimated useful lives of the assets.

Gain on sale of loans: Mortgage banking activity revenue recognition begins when the Company is committed to originate a loan with a borrower at an agreed-upon interest rate (interest rate loan commitment, IRLC). The revenue recognition ends when the Company sells the loan to an investor (Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815). The IRLC is considered a derivative and is recorded as an asset at its estimated fair value. The fair value of the IRLC is determined after considering the contractual loan origination-related fees, estimated sales premium, direct loan origination costs and the estimated fair value of the expected net future cash flows associated with servicing the loan. Also included in gain on sale of loans are the unrealized gains and losses from the various derivative instruments utilized by the Company to hedge the interest rate risk associated with its mortgage banking activities. These derivatives include the fair value of loan sales commitments and forward sale commitments. Further, the gain also includes the unrealized gains and losses on loans held for sale that occur during the period from the date of its funding through the date of its sale to an end investor.

Loans are accounted for as sold when control of the mortgage loans is surrendered. Control over mortgage loans is deemed to be surrendered when (1) the mortgage loans have been isolated from the Company, (2) the buyer has the right (free of conditions that constrain the buyer from taking advantage of that right) to pledge or exchange the mortgage loans, and (3) the Company does not maintain effective control of the mortgage loans through either (a) an agreement that entitles and obligates the Company to repurchase or redeem the mortgage loans before maturity or (b) the ability to unilaterally cause the buyer to return specific mortgage loans.

(In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Loan servicing: The Company sells loans to investors in the secondary market and generally retains the right to service mortgage loans originated or purchased from unaffiliated correspondent banks. Mortgage servicing rights retained are initially measured at fair value and have been recognized as a separate asset and are being amortized in proportion to and over the period of estimated net servicing income.

Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized mortgage servicing rights based on the interest rates of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceeds their fair value.

The Company recognizes it could experience some make-whole costs for loans serviced that are sold on the secondary market. If those mortgages go through foreclosure and there is a loss, the government sponsored entity may require the Company to cover any losses if it is proven that the Company failed to follow underwriting requirements at the time. In order to estimate the necessary reserve for this loss, management analyzed the historical claims rate and the loss severity for the origination years from 2000 through 2021 and applied that to the outstanding balances. As the government sponsored entities are no longer reviewing loans they acquired prior to 2009, a discount was applied to those remaining balances. Finally, management analyzed the improvement in the economy from 2009 to 2021 and applied an adjustment factor to recognize the improvement. The secondary market buyback reserve at December 31, 2022 and 2021 was $175.

Derivative assets and liabilities: All derivatives are recognized as either assets or liabilities in the consolidated balance sheets, measured at fair value, and are reported in accrued interest receivable and other assets on the balance sheet.

Goodwill: Represents the excess of the purchase price over the fair value of net assets acquired in business combinations. Goodwill is subject to an impairment test at least on an annual basis. The Company's goodwill impairment assessments in 2022 and 2021 concluded no impairment existed. Any future impairment will be recorded as noninterest expense in the period of assessment.

Intangibles: The core deposit intangible represents the capacity of the deposit accounts acquired in an acquisition to generate future income. The core deposit intangible is being amortized over the estimated three to eight year lives attributed to the deposits acquired. The amortization of the core deposit intangible was $697 and $914 in 2022 and 2021, respectively. Future amortization of the core deposit intangible is as follows:

Years Ending December 31,		
2023	$	480
2024		263
2025		54
	$	797

Note 1. Basis of Presentation (Continued)

Bank-owned life insurance: The Company owns life insurance policies on certain key employees. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized if lower.

Interest rate swap on trust preferred securities: The Company uses derivative instruments to primarily protect against the risk of adverse interest rate movements on the cash flows of certain liabilities. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based upon a notional amount and an underlying asset as specified in the contract. A notional amount represents the number of units of a specific item, such as currency units. An underlying represents a variable, such as an interest rate or price index. The amount of cash or other asset delivered from one party to the other is determined based upon the interaction of the notional amount of the contract with the underlying. Derivatives can also be implicit in certain contracts and commitments and are reported in accrued interest receivable and other assets on the balance sheet.

Other real estate and other personal property owned: Other real estate owned (OREO) and other personal property owned represent properties acquired through foreclosure or other proceedings. OREO and other personal property owned are initially recorded at fair value of the properties less estimated costs of disposal. Any write-down to fair value less estimated costs of disposal at the time of transfer to OREO and other personal property owned is charged to the allowance for loan and lease losses. Property is evaluated regularly to ensure that the recorded amount is supported by its current fair value less estimated costs of disposal. Subsequent write-downs are charged to other noninterest expenses.

Deferred taxes: Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Employee stock ownership plan: The Company has a leveraged, noncontributory employee stock ownership plan (ESOP) covering substantially all employees eligible as to age and length of service. The amount of the contribution to the plan is determined annually at the discretion of the Board of Directors. Contributions are allocated to participants based on the ratio of each participant’s compensation to total compensation of all participants.

Salary 401(k) plan: The Company provides a 401(k) plan, which covers substantially all of the Company’s employees who are eligible as to age and length of service. A participant may elect to make contributions of up to the maximum allowed by law of the participant’s annual compensation. The Company makes matching contributions up to three hundred dollars for each participant. Matching contributions of $134 were made in 2022 and 2021.

Note 1. Basis of Presentation (Continued)

Earnings per common share: Basic earnings per share is calculated by dividing net income by the weighted-average common shares outstanding during the year. ESOP shares allocated to participants and shares released for allocation are treated as outstanding for purposes of computing weighted-average common shares outstanding. The weighted-average number of shares of common stock used to compute basic earnings per share was 7,894,867 and 7,894,545 in 2022 and 2021, respectively. Effective May 13, 2022, the Company effected a three-for-one stock split for shareholders of record as of May 5, 2022. All share amounts and per share financial data contained in these financial statements related to periods prior to this stock split have been adjusted to reflect the split.

Comprehensive income: Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported on the consolidated statement of comprehensive income. Such items, along with net income, are components of comprehensive income. Gains and losses on available-for-sale securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges are reclassified to net income at the time of the charge.

New Accounting Pronouncements:

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which creates a new credit impairment standard for financial assets measured at amortized cost and available-for-sale debt securities. The ASU requires financial assets measured at amortized cost (including loans, trade receivables and held-to-maturity debt securities) to be presented at the net amount expected to be collected, through an allowance for credit losses that are expected to occur over the remaining life of the asset, rather than incurred losses. The ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct writedown. The measurement of credit losses for newly recognized financial assets (other than certain purchased assets) and subsequent changes in the allowance for credit losses are recorded in the statement of income as the amounts expected to be collected change. The ASU is effective January 1, 2023. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

Reclassified accounts: Certain 2021 balances in the consolidated balance sheet and statement of income were reclassified to conform to the 2022 presentation. There was no effect on net income or stockholders' equity.

Subsequent events: In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through February 8, 2023, the date the consolidated financial statements were available to be issued.

Note 2. Restrictions on Cash and Cash Equivalents

The Bank is required to maintain reserve balances, in cash on premises or on deposit with the Federal Reserve Bank, based upon a percentage of deposits. The total restricted cash balance as of December 31, 2022 and 2021, was $0.

(In Thousands, Except Share Information)

Note 3. Securities

Government-sponsored enterprises (GSE), include entities such as Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC). The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
GSE residential mortgage-backed securities	$ 82,836	$ 562	$ (3,297)	$ 80,101
GSE collateralized residential mortgage obligations	119,298	-	(16,170)	103,128
Obligations of states and political subdivisions	184	-	-	184
US government corporations and agencies	38,500	-	(751)	37,749
GSE commercial mortgage-backed securities	56,444	-	(2,475)	53,969
Total securities available for sale	$ 297,262	$ 562	$ (22,693)	$ 275,131
Securities held to maturity:				
GSE residential mortgage-backed securities	$ 23,470	$ -	$ (2,086)	$ 21,384
GSE collateralized residential mortgage obligations	13,003	-	(1,645)	11,358
Obligations of states and political subdivisions	597	-	-	597
Total securities held to maturity	$ 37,070	$ -	$ (3,731)	$ 33,339

	December 31, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
GSE residential mortgage-backed securities	$ 45,874	$ 1,794	$ (63)	$ 47,605
GSE collateralized residential mortgage obligations	125,706	131	(2,355)	123,482
Obligations of states and political subdivisions	403	10	-	413
US government corporations and agencies	5,584	47	-	5,631
GSE commercial mortgage-backed securities	16,703	65	(255)	16,513
Total securities available for sale	$ 194,270	$ 2,047	$ (2,673)	$ 193,644
Securities held to maturity:				
GSE residential mortgage-backed securities	$ 6,032	$ 18	$ -	$ 6,050
GSE collateralized residential mortgage obligations	3,809	153	(17)	3,945
Obligations of states and political subdivisions	599	15	-	614
Total securities held to maturity	$ 10,440	$ 186	$ (17)	$ 10,609

(In Thousands, Except Share Information)

Note 3. Securities (Continued)

Contractual maturities at December 31, 2022:

	Securities Held to Maturity		Securities Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$ 85	$ 85	$ 60	$ 60
Due after one year through five years	164	164	46	46
Due after five years through ten years	348	348	78	78
Due after ten years	-	-	-	-
	597	597	184	184
GSE residential mortgage-backed securities	23,470	21,385	82,836	80,101
US government corporations and agencies	-	-	38,500	37,749
GSE collateralized residential mortgage obligations	13,003	11,357	119,298	103,128
GSE commercial mortgage-backed securities	-	-	56,444	53,969
	$ 37,070	$ 33,339	$ 297,262	$ 275,131

Maturities of residential mortgage-backed securities and collateralized residential mortgage obligations are not readily determinable, since they may be prepaid without penalty.

There were no realized gains or losses in 2022 or 2021.

Changes in accumulated other comprehensive income related to the unrealized gain (loss) on available-for-sale securities, net of the related deferred tax effects:

	Years Ended December 31	
	2022	2021
Balance, beginning	$ (451)	$ 2,457
Unrealized gain (loss) during the year	(21,505)	(4,037)
Deferred tax effect of unrealized gain (loss)	6,011	1,129
Balance, ending	$ (15,945)	$ (451)

Changes in accumulated other comprehensive income related to the unrealized gain (loss) on interest rate swap on trust preferred securities, net of the related deferred tax effects:

	Years Ended December 31	
	2022	2021
Balance, beginning	$ (340)	$ (946)
Unrealized gain (loss) during the year	1,924	841
Deferred tax effect of unrealized gain (loss)	(538)	(235)
Balance, ending	$ 1,046	$ (340)

(In Thousands, Except Share Information)

Note 3. Securities (Continued)

Summary of accumulated other comprehensive income (loss):

	December 31 2022	December 31 2021
Available-for-sale securities	$ (15,945)	$ (451)
Interest rate swap on trust preferred securities (Note 19)	1,046	(340)
Balance, ending	$ (14,899)	$ (791)

The following tables summarize the Company's investments in an unrealized loss position, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2022 and 2021, that are not deemed to be other-than-temporarily impaired:

December 31, 2022	12 Months or Less		Greater Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Securities available for sale:						
GSE residential mortgage-backed securities	$ 41,149	$ (2,721)	$ 2,693	$ (576)	$ 43,842	$ (3,297)
GSE collateralized residential mortgage obligations	21,184	(1,694)	81,944	(14,476)	103,128	(16,170)
Obligations of state and political subdivisions	-	-	-	-	-	-
US government corporations and agencies	37,749	(751)	-	-	37,749	(751)
GSE commercial mortgage-backed securities	47,941	(1,335)	6,028	(1,140)	53,969	(2,475)
Total securities available for sale	$ 148,023	$ (6,501)	$ 90,665	$ (16,192)	$ 238,688	$ (22,693)
Securities held to maturity:						
GSE residential mortgage-backed securities	$ 20,703	$ (1,948)	$ 681	$ (138)	$ 21,384	$ (2,086)
GSE collateralized residential mortgage obligations	11,358	(1,645)	-	-	11,358	(1,645)
Total securities held to maturity	$ 32,061	$ (3,593)	$ 681	$ (138)	$ 32,742	$ (3,731)

December 31, 2021	12 Months or Less		Greater Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Securities available for sale:						
GSE residential mortgage-backed securities	$ 3,757	$ (63)	$ -	$ -	$ 3,757	$ (63)
GSE collateralized residential mortgage obligations	116,054	(2,355)	-	-	116,054	(2,355)
GSE commercial mortgage-backed securities	7,879	(255)	-	-	7,879	(255)
Total securities available for sale	$ 127,690	$ (2,673)	$ -	$ -	$ 127,690	$ (2,673)
Securities held to maturity:						
GSE collateralized residential mortgage obligations	$ 820	$ (17)	$ -	$ -	$ 820	$ (17)

(In Thousands, Except Share Information)

Note 3. Securities (Continued)

There were 101 and 19 securities in unrealized loss positions at December 31, 2022 and 2021, respectively. The Company believes the unrealized loss position in GSE residential and commercial mortgage-backed securities is temporary, as based on current estimated prepayment speeds the Company intends to hold these securities until paid-off, at which time the investments will pay face value. The Company does not believe there to be any deterioration in the credit quality of the bonds that would indicate other-than-temporary impairment, but rather, the unrealized loss is the result of either an increase in the general level of interest rates or other external economic factors.

Pledged securities: Securities with a carrying value of $156,268 and $86,219 at December 31, 2022 and 2021, respectively, were pledged to secure public deposits, FHLB repurchase agreements, and for other purposes as required or permitted by law.

Note 4. Loans Held for Sale and Loan Servicing

Loans held for sale consist of the following:

	December 31	
	2022	2021
Loans held for sale, unpaid principal balance	$ 6,239	$ 23,912
Fair value adjustment	(37)	159
Total loans held for sale	$ 6,202	$ 24,071

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans are as follows:

	December 31	
	2022	2021
Mortgage loan portfolios serviced for:		
FNMA	$ 2,077,301	$ 2,173,091
FHLMC	547,284	476,128
	$ 2,624,585	$ 2,649,219
Outstanding commitments at year-end:		
Commitments to fund loans	$ 7,283	$ 53,183
Commitments to sell loans	8,504	43,960

(In Thousands, Except Share Information)

Note 4. Loans Held for Sale and Loan Servicing (Continued)

Mortgage servicing rights, net of valuation allowance, are summarized as follows:

	Years Ended December 31	
	2022	2021
Balance at beginning of year, net	$ 16,251	$ 13,954
Mortgage servicing rights capitalized:		
Loans originated	2,457	4,536
Loans purchased	1,309	3,336
Amortization expense, net of valuation allowance	(3,379)	(5,575)
Balance at end of year, net	$ 16,638	$ 16,251

The valuation allowance at December 31, 2022 and 2021, was $1 and zero, respectively. The estimated fair value of the servicing assets aggregated $32,490 and $24,570 at December 31, 2022 and 2021, respectively. Fair value is estimated by discounting estimated future cash flows from the servicing assets using discount rates that approximate current market rates and using current expected future prepayment rates.

Note 5. Loans and Direct Financing Leases

Composition of loans and direct financing leases receivable:

	December 31	
	2022	2021
Commercial	$ 404,029	$ 371,513
Commercial real estate	1,007,923	797,599
Agricultural, including real estate	146,104	137,301
Residential real estate	227,673	199,195
Consumer	54,231	49,313
Direct financing leases	41,457	58,326
Total loans	1,881,417	1,613,247
Less unearned income on loans and leases	3,350	5,321
Less allowance for loan and lease losses	26,109	28,651
Loans receivable, net	$ 1,851,958	$ 1,579,275

Note 5. Loans and Direct Financing Leases (Continued)

Commercial loans also include loans originated under the Paycheck Protection Program (PPP). The PPP is a small business loan program established by the 2020 US Federal government Coronavirus Aid Relief, and Economic Security Act (CARES Act) to help certain businesses continue paying their workers. The PPP allows entities to apply for low-interest private loans to pay for their payroll and certain other costs. The loans may be partially or fully forgiven if the business keeps its employee counts and wages stable. Given the program is guaranteed by the Small Business Administration, the Company does not expect to realize credit losses on these loans. As such, no provision for loan losses has been reserved for the loans originated under the PPP. As of December 31, 2022 and 2021, the Company had $575 and $20,897 of loans outstanding under this program, respectively. The Company's unearned income on loans and leases includes $12 and $729 of net deferred loan fees related to SBA PPP loans at December 31, 2022 and 2021, respectively.

Loans pledged to the Federal Home Bank of Des Moines for notes payable are discussed at Note 11.

Loans are made to individuals as well as commercial and tax-exempt entities. Specific loan terms vary as to interest rate, repayment and collateral requirements based on the type of loan requested and the creditworthiness of the prospective borrower. Credit risk tends to be geographically concentrated in that a majority of the loan customers are located in the markets serviced by the Company.

The Company's extension of credit is governed by the individual loan policies that were established to control the quality of the Company's loans. These policies and procedures are reviewed and approved by the Board of Directors on a regular basis.

Commercial loans: Commercial operating and term loans are originated in the Company's primary service area. These loans are made to individuals, partnerships, corporations, limited liability partnerships and limited liability companies for the purpose of assisting in the development of a business enterprise. Loans to closely held businesses will generally be guaranteed in full or for a meaningful amount by the business' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not perform as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all commercial loan types.

Commercial real estate loans: The Company's goal is to create and maintain a high-quality portfolio of commercial real estate loans with customers who meet the quality and relationship profitability objectives of the Company. Commercial real estate loans are subject to underwriting standards and processes similar to commercial operating and term loans. These loans are analyzed using projected cash flows, and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market, such as geographic location and property type.

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Agricultural, including real estate: Agricultural operating and term loans are originated in the Company's primary service area and are generally used to purchase agricultural equipment or crop inputs. These loans are primarily secured by agricultural real estate and agricultural equipment or crops. Agricultural term and operating loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all agricultural loan types.

The Company originates loans secured by agricultural real estate in its service area. Agricultural land in the Company's service area is considered to be prime agricultural land. These loans are underwritten using both a cash flow analysis and appraised values.

Residential real estate loans: The Company originates residential real estate loans in its service area. The underwriting process consists of a credit analysis, employment history, and an analysis of the secured real estate property. A significant portion of the residential real estate loans originated is sold in the secondary market and is required to meet the underwriting standards of the purchaser.

Consumer loans: The Company originates direct consumer loans, including personal, credit cards, recreational and vehicle loans, using a credit analysis as part of the underwriting process. Each loan type has a separate specified scoring that consists of several factors, including debt to income, type of collateral, loan to collateral value, credit history and the Company's relationship with the borrower.

Direct financing leases: Direct financing leases are originated in the Company's primary service area, and the equipment leased consists primarily of trucks, construction and agricultural equipment.
Direct financing leases are made based primarily on the historical and projected cash flow of the lessee and secondarily on the underlying equipment leased to the lessee. The cash flows of lessees, however, may not perform as forecasted, and collateral securing these leases may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all direct financing leases.

Minimum lease payments: At December 31, 2022, the minimum future lease payments, including guaranteed residual values, unearned initial direct costs and unearned amounts, due under the direct financing leases are as follows:

Years Ending December 31,	
2023	$ 16,058
2024	11,522
2025	8,571
2026	3,007
2027	1,244
Thereafter	1,055
Total lease payments receivable	41,457
Unearned lease residual income	(2,636)
Net investment in direct financing leases	$ 38,821

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Loans receivable aging by class:

	December 31, 2022					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	$ 401,249	$ 2,241	$ 7	$ 532	$ 2,780	$ 404,029
Commercial real estate	1,005,263	2,540	-	120	2,660	1,007,923
Agricultural, including real estate	145,411	390	303	-	693	146,104
Residential real estate	225,032	1,770	366	505	2,641	227,673
Consumer	53,694	460	10	67	537	54,231
Direct financing leases	40,890	567	-	-	567	41,457
Total loans	$ 1,871,539	$ 7,968	$ 686	$ 1,224	$ 9,878	$ 1,881,417
Nonperforming loans	$ 5,043	$ 2,187	$ 68	$ 1,224	$ 3,479	$ 8,522

	December 31, 2021					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	$ 369,113	$ 1,698	$ 279	$ 423	$ 2,400	$ 371,513
Commercial real estate	796,726	184	635	54	873	797,599
Agricultural, including real					-	-
estate	137,301	-	-	-	-	137,301
Residential real estate	197,718	762	436	279	1,477	199,195
Consumer	48,878	287	-	148	435	49,313
Direct financing leases	57,993	333	-	-	333	58,326
Total loans	$ 1,607,729	$ 3,264	$ 1,350	$ 904	$ 5,518	$ 1,613,247
Nonperforming loans	$ 13,697	$ 201	$ 1,023	$ 904	$ 2,128	$ 15,825

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Recorded investment in nonaccrual loans and loans past due 90 days or more and still accruing by class of loans as of December 31, 2022 and 2021, were as follows:

	Nonaccrual	Loans Past Due 90 Days or More and Still Accruing
2022		
Commercial	$ 604	$ 14
Commercial real estate	4,936	66
Agricultural, including real estate	518	-
Residential real estate	1,987	154
Consumer	180	63
Direct financing leases	-	-
Total	$ 8,225	$ 297
2021		
Commercial	$ 2,849	$ 6
Commercial real estate	5,500	-
Agricultural, including real estate	3,032	-
Residential real estate	3,324	-
Consumer	228	117
Direct financing leases	769	-
Total	$ 15,702	$ 123

The Company utilizes an internal asset classification system as a means of reporting problem and potential problem loans. Under the Company's risk rating system, the Company classifies problem and potential problem loans as "special mention," "substandard" and "doubtful." Substandard loans include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management's close attention, are deemed to be special mention. Risk ratings are updated any time the situation warrants.

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass-rated loans. Residential real estate and consumer loans are included in groups of homogeneous loans with similar risk and loss characteristics that are not rated. The following table presents the risk category of loans by class of loans based on the most recent analysis performed as of December 31, 2022:

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 378,500	$ 18,107	$ 7,422	$ -	$ 404,029
Commercial real estate	920,947	30,153	56,823	-	1,007,923
Agricultural, including real estate	138,860	1,572	5,672	-	146,104
Direct financing leases	40,819	-	638	-	41,457
Total	$ 1,479,126	$ 49,832	$ 70,555	$ -	$ 1,599,513

The following table presents the risk category of loans by class of loans based on the most recent analysis performed as of December 31, 2021:

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 359,997	$ 2,326	$ 9,190	$ -	$ 371,513
Commercial real estate	728,321	18,410	50,868	-	797,599
Agricultural, including real estate	125,847	3,423	8,031	-	137,301
Direct financing leases	56,311	-	2,015	-	58,326
Total	$ 1,270,476	$ 24,159	$ 70,104	$ -	$ 1,364,739

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Commercial, commercial real estate, and agricultural, including real estate loans and direct financing leases are individually evaluated to determine if they are impaired. The Company generally evaluates residential real estate and consumer loans collectively for impairment, but such loans can be individually evaluated when included in a relationship with commercial, commercial real estate and agricultural-type loans. The Company evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. Loans for which credit quality or aging indicates potential weakness are placed on nonaccrual and are deemed to be nonperforming.

Impaired loans by class as of December 31, 2022 and 2021 were as follows:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment
2022:				
Evaluated for impairment with a related allowance recorded:				
Commercial	$ 125	$ 125	$ 132	$ 798
Commercial real estate	3,502	3,502	845	3,560
Agricultural, including real estate	25	25	-	13
Residential real estate	44	44	32	172
Consumer	28	28	15	37
Direct financing leases	-	-	-	760
Evaluated for impairment with no related allowance recorded:				
Commercial	180	180	-	305
Commercial real estate	2,136	2,136	-	2,077
Agricultural, including real estate	1,977	1,977	-	3,351
Residential real estate	2,277	2,277	-	2,711
Consumer	151	151	-	156
Direct financing leases	-	-	-	321
Total	$ 10,445	$ 10,445	$ 1,024	$ 14,261
2021:				
Evaluated for impairment with a related allowance recorded:				
Commercial	$ 1,470	$ 1,470	$ 719	$ 1,669
Commercial real estate	3,618	3,618	856	2,840
Agricultural, including real estate	-	-	-	28
Residential real estate	301	301	11	227
Consumer	46	46	23	74
Direct financing leases	1,519	1,519	797	2,278
Evaluated for impairment with no related allowance recorded:				
Commercial	429	429	-	383
Commercial real estate	2,017	2,017	-	2,217
Agricultural, including real estate	4,724	4,724	-	6,666
Residential real estate	3,145	3,145	-	2,937
Consumer	161	161	-	86
Direct financing leases	642	642	-	352
Total	$ 18,072	$ 18,072	$ 2,406	$ 19,757

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Impaired loans also include loans modified in a troubled debt restructuring where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collections.

There were no loans modified by the Company during 2022 or 2021 that were classified as a troubled debt restructuring.

There were no troubled debt restructurings modified during 2022 or 2021 that subsequently defaulted.

Under Interagency Statement ("Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)") issued by Federal banking agencies, financial institutions generally do not need to categorize COVID-19-related modifications as TDRs. As a result, loans that have been restructured for short term through the Company's loan deferral program for COVID-19 related hardships and meet certain other criteria specified in the Interagency Statement are not categorized as TDRs until January 1, 2022. Federal banking agencies are required to defer to the determination of the banks making such suspension.

The change in the allowance for loan and lease losses for the years ended December 31, 2022 and 2021, was as follows:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Direct Financing Leases	Total
Allowance for loan and lease losses:							
December 31, 2020	$ 4,420	$ 15,008	$ 2,537	$ 3,368	$ 1,110	$ 5,177	$ 31,620
Charge-offs	(553)	(127)	-	-	(489)	(91)	(1,260)
Recoveries	144	-	-	23	238	96	501
Provision (benefit) for loan and lease losses	(758)	181	(517)	(490)	85	(711)	(2,210)
December 31, 2021	3,253	15,062	2,020	2,901	944	4,471	28,651
Charge-offs	(125)	-	-	(29)	(483)	(80)	(717)
Recoveries	163	59	-	77	125	27	451
Provision (benefit) for loan and lease losses	(550)	969	(673)	(434)	264	(1,852)	(2,276)
December 31, 2022	$ 2,741	$ 16,090	$ 1,347	$ 2,515	$ 850	$ 2,566	$ 26,109

(In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The allowance for loan and lease losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2021 and 2020, were as follows:

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
2022:			
Allowance for loan losses:			
Commercial	$ 132	$ 2,609	$ 2,741
Commercial real estate	845	15,245	16,090
Agricultural, including real estate	-	1,347	1,347
Residential real estate	32	2,483	2,515
Consumer	15	835	850
Direct financing leases	-	2,566	2,566
Total	$ 1,024	$ 25,085	$ 26,109
Loans balance:			
Commercial	$ 305	$ 403,724	$ 404,029
Commercial real estate	5,638	1,002,285	1,007,923
Agricultural, including real estate	2,002	144,102	146,104
Residential real estate	2,321	225,352	227,673
Consumer	179	54,052	54,231
Direct financing leases	-	41,457	41,457
Total	$ 10,445	$ 1,870,972	$ 1,881,417

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
2021:			
Allowance for loan losses:			
Commercial	$ 719	$ 2,534	$ 3,253
Commercial real estate	856	14,206	15,062
Agricultural, including real estate	-	2,020	2,020
Residential real estate	11	2,890	2,901
Consumer	23	921	944
Direct financing leases	797	3,674	4,471
Total	$ 2,406	$ 26,245	$ 28,651
Loans balance:			
Commercial	$ 1,899	$ 369,614	$ 371,513
Commercial real estate	5,635	791,964	797,599
Agricultural, including real estate	4,724	132,577	137,301
Residential real estate	3,446	195,749	199,195
Consumer	207	49,106	49,313
Direct financing leases	2,161	56,165	58,326
Total	$ 18,072	$ 1,595,175	$ 1,613,247

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)

Note 6. Operating Leases

Investment in operating lease assets includes the following as of December 31, 2022 and 2021:

	Years Ended December 31	
Operating lease assets	$ 30,288	$ 18,180
Less accumulated depreciation	8,730	5,156
Net investment in operating leases	$ 21,558	$ 13,024

Future minimum lease payments receivable under operating leases as of December 31, 2022, are as follows:

Years Ending December 31,	
2023	$ 4,350
2024	4,331
2025	5,409
2026	3,740
2027	2,186
Thereafter	248
Total lease payments receivable	$ 20,264

At December 31, 2022 and 2021, none of these operating leases were classified as nonaccrual.

Note 7. Premises and Equipment

	Useful Lives (Years)	December 31 2022	December 31 2021
Land and improvements	15–40	$ 7,138	$ 7,138
Buildings and improvements	10–40	35,517	35,364
Furniture and equipment	3–7	12,564	12,362
		55,219	54,864
Less accumulated depreciation		28,831	27,198
		$ 26,388	$ 27,666

(In Thousands, Except Share Information)

Note 8. Other Real Estate and Other Personal Property Owned

An analysis of activity for other real estate and other personal property owned is as follows:

	Years Ended December 31	
	2022	2021
Balance at beginning of year	$ 1,123	$ 2,713
Transfers from loans	116	1,563
Proceeds from sales	(272)	(3,828)
Net charge-offs/impairments	(161)	-
Net gain on sales	-	675
Balance at end of year	$ 806	$ 1,123

Expenses applicable to other real estate and other personal property owned assets include the following amounts reported in other noninterest expense:

	Years Ended December 31	
	2022	2021
Net gain on sales	$ -	$ (675)
Net charge-offs/impairments	161	-
Operating expenses, net of rental income	5	147
	$ 166	$ (528)

Note 9. Deposits

	December 31	
	2022	2021
Demand deposits	$ 635,853	$ 620,988
Savings and NOW accounts	1,398,884	1,639,170
Time deposits	222,564	258,405
	$ 2,257,301	$ 2,518,563

(In Thousands, Except Share Information)

Note 9. Deposits (Continued)

The aggregate amount of time deposit accounts that exceed the FDIC insurance limit were $48,705 and $59,253 at December 31, 2022 and 2021, respectively.

At December 31, 2022, the scheduled maturities of time deposits are as follows:

Years Ending December 31,	
2023	$ 144,481
2024	66,010
2025	10,012
2026	1,035
2027	1,026
	$ 222,564

The Company participates and is a member of the Certificate of Deposit Account Registry Service (CDARS) deposit product program. Through CDARS, the Company may accept deposits in excess of the FDIC insured maximum from a depositor and place the deposits through a network to other CDARS member banks in increments of less than the FDIC insured maximum to provide the depositor full FDIC insurance coverage. Where the Company receives an equal dollar amount of deposits from other CDARS member banks in exchange for the deposits the Company places into the network, the Company records these as CDARS reciprocal deposits. At December 31, 2022 and 2021, CDARS reciprocal deposits totaled zero and $965, respectively.

Note 10. Repurchase Agreements

	December 31	
	2022	2021
Customer repurchase agreements	$ 12,019	$ 1,700

Securities sold under agreements to repurchase are held by the Company. Customer repurchase agreements are due on demand with interest at 1.390 percent at December 31, 2022.

The Company has an option to borrow from the FHLB under agreements to repurchase securities sold. The Company has pledged to the FHLB its FHLB stock, certain debt securities and loans with a carrying value of $478,603 and $631,467 at December 31, 2022 and 2021, respectively, to secure any borrowings. These securities and loans also collateralize the fixed-rate advances outstanding to the FHLB (see Note 11).

(In Thousands, Except Share Information)

Note 11. Notes Payable

Federal Home Loan Bank (FHLB) advances consist of fixed-rate advances with interest rates ranging from 2.03 percent to 2.14 percent, due quarterly. Advances are subject to various prepayment, call and conversion provisions. Advances are secured by securities and loans.

The Company has an ESOP loan with US Bank that bears interest at the three-month LIBOR plus 2.25 (at December 31, 2022, the interest rate is approximately 7.01 percent).

Future annual maturities are as follows:

Years Ending December 31,		
2023	$	4,500
2024		4,500
2025		3,120
	$	12,120

Note 12. Subordinated Debentures

Subordinated debentures of $12,903 are owed to Merchants Capital Trust I and bear interest at the three-month LIBOR plus 3.35 percent, but not to exceed 12.00 percent (at December 31, 2022, the interest rate is approximately 8.11 percent). They mature December 31, 2032. Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

Subordinated debentures of $23,196 are owed to Merchants Capital Trust II and bear interest at the three-month LIBOR plus 1.30 percent (at December 31, 2022, the interest rate is approximately 6.06 percent). They mature October 31, 2037. Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

Subordinated debentures of $5,155 are owed to Merchants Capital Trust—Jerema, Inc. Capital Trust I and mature July 23, 2034. The interest rate is equal to the three-month LIBOR plus 2.70 percent (at December 31, 2022, the interest rate is approximately 7.46 percent). Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

The underlying capital securities of the trusts qualify under risk-based capital guidelines as Tier 1 capital for regulatory purposes to the extent they do not exceed 33 percent of Tier I capital, with the remainder allowed as Tier II capital.

(In Thousands, Except Share Information)

Note 13. Deferred Taxes

The cumulative tax effects of the temporary differences are shown in the following table:

	December 31	
	2022	2021
Deferred tax assets:		
Allowance for loan and lease losses	$ 6,595	$ 6,955
Deferred compensation	431	447
Other	-	586
Unrealized loss on available-for-sale securities	6,186	175
Total deferred tax assets	13,212	8,163
Deferred tax liabilities:		
Direct financing leases	(7,521)	(4,243)
Mortgage servicing rights	(3,087)	(2,671)
Premises and equipment	(1,354)	(875)
Intangibles	(4,437)	(3,744)
Other	(46)	-
Total deferred tax liabilities	(16,445)	(11,533)
Net deferred tax liabilities	$ (3,233)	$ (3,370)

At December 31, 2022 and 2021, there was no valuation allowance for deferred tax assets. The provision for income taxes charged to operations consists of the following:

	Years Ended December 31	
	2022	2021
Current tax expense	$ 4,696	$ 14,355
Deferred tax expense (benefit)	5,874	(3,965)
	$ 10,570	$ 10,390

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income as follows:

	Years Ended December 31	
	2022	2021
Computed “expected” tax expense	$ 8,609	$ 8,225
Increase (decrease) in income taxes resulting from:		
State income taxes, net of federal tax benefit	2,536	2,654
Tax-exempt interest income (net of disallowed expenses)	(243)	(247)
Other	(332)	(242)
	$ 10,570	$ 10,390

(In Thousands, Except Share Information)

Note 14: Commitments, Contingencies and Credit Risk

Financial instruments with off-balance-sheet risk: The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, credit card commitments and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of amounts recognized on the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of the instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments. These commitments were as follows:

	December 31	
	2022	2021
Commitments to extend credit	$ 755,053	$ 600,337
Credit card commitments	93,006	92,336
Standby letters of credit	9,229	12,285
	$ 857,288	$ 704,958

Commitments to extend credit and credit card commitments: Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. If deemed necessary upon extension of credit, the amount of collateral obtained is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income-producing commercial properties. Credit card commitments are unsecured.

Standby letters of credit: Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary.

Financial instruments with concentrations of credit risk:

Concentration by institution: The nature of the Company's business requires that it maintain amounts due from banks that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Note 15. Employee Stock Ownership Plan

During 2022, the ESOP purchased 68,850 shares of the Company's common stock at $35.00 per share. Of the 68,850 shares, 6,885 were released as of December 31, 2022.

During 2021, the ESOP purchased 27,180 shares of the Company's common stock at $31.33 per share. Of the 27,180 shares, 5,436 were released as of December 31, 2022 and 2,718 were released as of December 31, 2021, respectively.

During 2020, the ESOP purchased 201,189 shares of the Company's common stock at $30.00 per share. Of the 201,189 shares, 56,272 were released as of December 31, 2022 and 35,724 were released as of December 31, 2021, respectively.

During 2019, the ESOP purchased 13,950 shares of the Company's common stock at $27.20 per share. Of the 13,950 shares, 8,717 were released as of December 31, 2022 and 5,913 were released as of December 31, 2021, respectively.

During 2018, the ESOP purchased 72,729 shares of the Company's common stock at $25.15 per share. Of the 72,729 shares, 58,305 were released as of December 31, 2022 and 51,093 were released as of December 31, 2021, respectively.

During 2017, the ESOP purchased 148,206 shares of the Company's common stock at $20.07 per share. Of the 148,206 shares, 125,040 were released as of December 31, 2022 and 113,439 were released as of December 31, 2021, respectively.

The ESOP shares were pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to employees based on the proportion of loan principal paid during the year. The Company intends to make annual contributions to the ESOP sufficient for the ESOP to repay its loan, including interest. The shares pledged as collateral are deducted from stockholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. As shares are released from collateral, the Company reports compensation expense equal to the fair value of the shares, and the shares become outstanding for earnings per share computations.

(In Thousands, Except Share Information)

Note 15. Employee Stock Ownership Plan (Continued)

The Company obtains an annual independent appraisal of fair value of its common shares. The appraised fair value as of December 31, 2022 and 2021, was $35.00 per share and $31.33 per share, respectively.

Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; dividends on unallocated ESOP shares are recorded as compensation expense and may be used by the ESOP for debt service. Total ESOP compensation expense was $2,530 and $5,016 for the years ended December 31, 2022 and 2021, respectively.

Participants who receive shares of stock under the plan have a put option requiring the Company to repurchase the shares at fair value for a 60-day period after distribution of the shares and during the first 60 days of the next plan year. In addition, if a participant receives an offer from a third party to purchase the shares, the participant must first give the Company the option of purchasing the shares. In 2022, 126,214 shares were purchased from participants and retained by the ESOP, and in 2021, 52,944 shares were purchased and retained by the ESOP. In the event a terminated ESOP participant desires to sell his/her shares of the Company's stock, or for certain employees who elect to diversify their account balances, the Company may be required to purchase the shares from the participant at their fair market value. As permitted, the ESOP elected to purchase the shares in lieu of the Company. In addition, at December 31, 2022, 94,134 shares of the Company's stock, with an aggregate fair market value of approximately $3,294 are held by ESOP participants who will be eligible to elect their diversification privileges under the ESOP during the year ending December 31, 2023.

Shares of the Company held by the ESOP at December 31, 2022 and 2021 are as follows:

	December 31	
	2022	2021
Allocated shares	1,179,630	1,203,534
Shares released for allocation	51,768	44,946
Unreleased (unearned) shares	271,449	254,367
Total shares held	1,502,847	1,502,847
Fair value of unreleased (unearned) shares	$ 8,167	$ 7,191

Note 15. Employee Stock Ownership Plan (Continued)

The Company restated the ESOP Plan document in January 2016 to be in compliance with Internal Revenue Service (IRS) guidance. As part of that restatement, plan language was modified such that distributions made to terminated employees should be based on the value at the subsequent year end valuation rather than the previous year end valuation date. Administrative changes were not made to comply with this change in the plan document and as such, participants terminated between January 1, 2016 and July 31, 2021 were paid at an incorrect valuation amount per share. This error was identified in the fourth quarter of 2021 and corrected distribution amounts, additional dividends that should have been paid, and estimated lost earnings per the IRS calculator have been calculated and total approximately $1,600. Former participants have been notified and were provided paperwork to direct these additional funds. Payments were made on January 29, 2022.

Note 16. Loans and Other Transactions With Related Parties

Shareholders, officers and directors of the Company, including their families and companies of which they are principal owners, are considered to be related parties. These related parties were loan customers of, and had other transactions with, the Company in the ordinary course of business. In management's opinion, these loans and transactions were on the same terms as those for comparable loans and transactions with nonrelated parties. Total loans to related parties were approximately $13,361 and $14,473 at December 31, 2022 and 2021, respectively. Total deposits with related parties were approximately $14,320 and $25,771 at December 31, 2022 and 2021, respectively.

Note 17. Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum ratios (set forth in the following table) of total and Tier I capital to risk-weighted assets, of Tier I capital to average assets, and common equity Tier 1 capital (all as defined in the regulations). Management believes, as of December 31, 2022, that the Company and Bank meet all capital adequacy requirements to which they are subject.

(In Thousands, Except Share Information)

Note 17. Regulatory Capital Requirements (Continued)

The following table presents regulatory capital information for the Company. The Basel III capital standard phased in through 2019 and revised the definition of capital, increased minimum capital ratios, introduced the regulatory capital buffers above those minimums, introduced a common equity Tier 1 capital ratio, and revised the rules for calculating risk-weighted assets. The conservation buffers for each measure of total capital, common equity Tier 1 capital, and Tier 1 capital are captured within the ratios below.

	Actual		Minimum Capital Requirements		Well Capitalized Standard	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2022:						
Total capital (to risk-weighted assets):						
Consolidated	$ 295,894	13.63%	$ 227,945	>10.50	N/A	N/A
Merchants Bank	297,020	13.20%	236,346	>10.50	$ 225,092	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	229,785	10.58%	152,032	>7.0%	141,172	>6.5%
Merchants Bank	270,910	12.04%	157,563	>7.0%	146,309	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	269,785	12.43%	184,487	>8.50%	N/A	N/A
Merchants Bank	270,910	12.04%	191,327	>8.50%	180,072	>8.0%
Leverage ratio:						
Consolidated	269,785	9.93%	108,675	>4.0%	N/A	N/A
Merchants Bank	270,910	10.05%	107,821	>4.0%	134,776	>5.0%
As of December 31, 2021:						
Total capital (to risk-weighted assets):						
Consolidated	$ 268,318	14.17%	$ 198,824	>10.50	N/A	N/A
Merchants Bank	270,634	14.30%	198,660	>10.50	$ 189,200	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	204,645	10.81%	132,518	>7.0%	122,485	>6.5%
Merchants Bank	246,922	13.05%	132,440	>7.0%	122,980	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	244,645	12.92%	160,951	>8.50%	N/A	N/A
Merchants Bank	246,922	13.05%	160,821	>8.50%	151,361	>8.0%
Leverage ratio:						
Consolidated	244,645	9.33%	104,885	>4.0%	N/A	N/A
Merchants Bank	246,922	9.13%	108,151	>4.0%	135,189	>5.0%

(In Thousands, Except Share Information)

Note 17. Regulatory Capital Requirements (Continued)

In order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer, as described in the previous paragraph, composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to risk-weighted assets.

Note 18. Additional Cash Flow Information

Cash flows from securities:

	Years Ended December 31	
	2022	2021
Available-for-sale securities:		
Maturities	$ 31,816	$ 46,787
Purchases	(135,209)	(130,126)
Held-to-maturity securities:		
Maturities	5,713	2,928
Purchases	(32,314)	(4,903)
	$ (129,994)	$ (85,314)
Supplemental disclosures of cash flow information:		
Cash payments for interest	$ 7,950	$ 8,631
Cash payments for income taxes	13,070	17,473
Supplemental schedule of noncash investing and financing activities:		
Other real estate and other personal property owned acquired in settlement of loans	$ 116	$ 1,563

Note 19. Interest Rate Swaps

The Company entered into an interest rate swap agreement in 2016 with a notional amount of $13.0 million. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants Trust II preferred securities throughout the ten year period beginning January 30, 2017 and ending January 30, 2027 from the risk of variability of those payments resulting from changes in the three-month LIBOR. Under the swap, the Company will pay a fixed interest rate of 3.463 percent and receive a variable interest rate of three-month LIBOR plus a margin of 1.30 percent on the notional amount, with quarterly settlements. The rate received by the Company as of December 31, 2022 was 5.71 percent.

The Company entered into an interest rate swap agreement in 2020 with an original notional amount of $3.8 million and current notional amount of $3.0 million. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants ESOP loan throughout the nine year period beginning July 22, 2020 and ending December 31, 2029 from the risk of variability of those payments resulting from changes in the three-month LIBOR. Under the swap, the Company will pay a fixed interest rate of 2.50 percent and receive a variable interest rate of one-month LIBOR plus a margin of 2.25 percent on the notional amount, with semi-annual settlements. The rate received by the Company as of December 31, 2021 was 5.14 percent.

The estimated fair value of the interest rate derivative contracts outstanding was a gain of $1,452 and a loss of $472 as of December 31, 2022 and 2021, respectively, and was included in other assets in the consolidated balance sheets.

The effective portion of the gain due to changes in the fair value of the derivative hedging instrument, a gain of $1,387 and $606 for the year ended December 31, 2022 and 2021, respectively, is included in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other noninterest income or other noninterest expense. No ineffectiveness related to the interest rate derivative was recognized during the reporting period. Therefore, changes in the fair value of the interest rate swap have had no impact on net income.

There were no net cash flows as a result of the interest rate swap agreement for the years ended December 31, 2021 and 2020. Cash is only disbursed or received upon exceeding contractual thresholds.

The Company received $840 and posted $850 cash as collateral related to the derivative contract at December 31, 2022 and 2021, respectively, due to fluctuations in the market.

There are no credit-risk-related contingent features associated with our derivative contract.

Note 20. Fair Value Measurements

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

ASC Topic 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert expected future amounts, such as cash flows or earnings, to a single present value amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

(In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Investment securities available for sale: The fair value of residential mortgage-backed securities and collateralized residential mortgage obligations is generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds. Fair values determined using matrix pricing are categorized as Level 2 in the fair value hierarchy.

The fair value of investments in obligations of states and political subdivisions is generally based on a discounted cash flow model that uses significant inputs, such as credit rating, coupon rate, maturity date and call features, some of which are unobservable in the markets. Fair values determined using a discounted cash flow analysis with significant unobservable inputs are categorized as Level 3 in the fair value hierarchy. The activity of investments in obligations of states and political subdivisions for the years ended December 31, 2022 and 2021 are as follows:

	Years Ended December 31	
	2022	2021
Balance, beginning	$ 413	$ 1,015
Maturities	(219)	(609)
Change in unrealized gain/loss	(10)	7
Balance, ending	$ 184	$ 413

Note 20. Fair Value Measurements (Continued)

Interest rate lock commitments and forward sale commitments: Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The Company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate plus the present value of estimated cash flow from servicing and marketing gains. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into a commitment to sell these loans at essentially the same time that the interest rate lock commitment on the loan is quoted. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. These commitments are not designated as hedging instruments and, therefore, changes in fair value are recognized immediately into income. The fair values of the Company's derivative instruments are deemed to be Level 2 measurements and are included in the caption, accrued interest receivable and other assets, in the consolidated balance sheets. The volume of derivative activity is disclosed in Note 4. The loss on the derivative instruments was $412 and $1,619 in 2022 and in 2021, respectively, and is included in the caption, gain on sale of loans, in the consolidated statements of income.

Loans held for sale: Fair value of loans held for sale is based on commitments on hand from investors or prevailing market prices and the fair value of expected future servicing. The fair values of the Company's loans held for sale are deemed to be Level 2 measurements, and the change in fair value is included in the caption, gain on sale of loans, in the consolidated statements of income.

Interest Rate Swap on Trust Preferred Securities: The Company utilizes an interest rate swap agreement to convert one of our variable rate trust preferred securities to a fixed rate. This has been designated as a cash flow hedge. This interest rate swap is recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data. The fair value of the Company's interest rate swap is deemed to be a Level 2 measurement and is included in other assets in the consolidated statements of financial condition.

(In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Fair Value Measurements at December 31, 2022	Level 1	Level 2	Level 3
Investment securities available for sale:				
GSE residential mortgaged-backed securities	$ 80,101	$ -	$ 80,101	$ -
GSE collateralized residential mortgage obligations	103,128	-	103,128	-
Obligations of states and political subdivisions	184	-	-	184
US government corporations and agencies	37,749	33,965	3,784	-
GSE commercial mortgage-backed securities	53,969		53,969	
Loans held for sale	6,202	-	6,202	-
Interest rate lock commitments	27	-	27	-
Forward sale commitments	21	-	21	-
Interest rate swaps	1,452	-	1,452	-
	$ 282,833	$ 33,965	$ 248,684	$ 184

	Fair Value Measurements at December 31, 2021	Level 1	Level 2	Level 3
Investment securities available for sale:				
GSE residential mortgaged-backed securities	$ 47,605	$ -	$ 47,605	$ -
GSE collateralized residential mortgage obligations	123,482	-	123,482	-
Obligations of states and political subdivisions	413	-	-	413
US government corporations and agencies	5,631	-	5,631	-
GSE commercial mortgage-backed securities	16,513	-	16,513	-
Loans held for sale	24,071	-	24,071	-
Interest rate lock commitments	491	-	491	-
Forward sale commitments	46	-	46	-
Interest rate swaps	(472)	-	(472)	-
	$ 217,780	$ -	$ 217,367	$ 413

(In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Financial instruments recorded at fair value on a nonrecurring basis: The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements in accordance with generally accepted accounting principles.

Impaired loans and leases: The specific reserves for collateral-dependent impaired loans and leases are determined based on the fair value of collateral method in accordance with ASC Topic 310. Under the fair value of collateral method, the specific reserve is equal to the difference between the carrying value of the loan or lease and the fair value of the collateral less estimated selling costs. When a specific reserve is required for an impaired loan or lease, the impaired loan is essentially measured at fair value. The fair value of collateral for impaired loans was determined based on appraisals with further adjustments made to the appraised values due to various factors, including the age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. The fair value of collateral for leases was determined based on comparable equipment values with further adjustments made due to various factors, including the age of comparables, and known changes in the market and on the collateral. The resulting fair value measurement is disclosed in the nonrecurring hierarchy table. Where estimates of fair value used for other collateral supporting commercial loans or leases are based on assumptions not observable in the marketplace, such valuations have been classified as Level 3.

Other real estate and other personal property owned: Other real estate and other personal property owned, upon initial recognition, is measured and reported at fair value less estimated costs of disposal through a charge-off to the allowance for possible loan losses based upon the fair value of the other real estate and other personal property acquired. The fair value of other real estate and other personal property owned is estimated based on assumptions not observable in the marketplace, and such valuations have been classified as Level 3.

Assets measured at fair value on a nonrecurring basis are included in the tables below:

	Fair Value at December 31, 2022			
	Total	Level 1	Level 2	Level 3
Collateral-dependent impaired loans and leases	$ 2,700	$ -	$ -	$ 2,700
Other real estate owned and other personal property owned	806	-	-	806
	$ 3,506	$ -	$ -	$ 3,506

	Fair Value at December 31, 2021			
	Total	Level 1	Level 2	Level 3
Collateral-dependent impaired loans and leases	$ 4,548	$ -	$ -	$ 4,548
Other real estate owned and other personal property owned	1,123	-	-	1,123
	$ 5,671	$ -	$ -	$ 5,671

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