

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2023

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-41232

NSTS BANCORP, INC.

(Exact name of the registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

87-2522769
(I.R.S. Employer
Identification Number)

700 S. Lewis Ave. Waukegan, Illinois
(Address of principal executive offices)

60085
(Zip Code)

(847) 336-4430

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	NSTS	NASDAQ Capital Market

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
		Emerging growth company	<input checked="" type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 6, 2023, the Registrant had 5,585,159 shares issued and 5,315,261 shares of its common stock outstanding.

NSTS Bancorp, Inc.

Form 10Q

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Explanatory Note

NSTS Bancorp, Inc. was formed to serve as the stock holding company for North Shore Trust and Savings (the “Bank”) in connection with the conversion of North Shore Trust and Savings, NSTS Financial Corporation and North Shore MHC, into the stock form of organization, which was completed on January 18, 2022. Accordingly, certain financial statements and other financial information at or prior to January 18, 2022, contained in this Form 10-Q relate solely to the consolidated financial results of North Shore MHC and its consolidated subsidiaries, NSTS Financial Corporation and North Shore Trust and Savings. See also NSTS Bancorp, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2022.

Part I. Financial Information
Item 1. Consolidated Financial Statements

NSTS BANCORP, INC.
Consolidated Balance Sheets

	September 30, 2023 (unaudited)	December 31, 2022
	(Dollars in thousands)	
Assets:		
Cash and due from banks	\$ 1,174	\$ 1,583
Interest-bearing bank deposits	9,515	11,564
Cash and cash equivalents	10,689	13,147
Time deposits with other financial institutions	1,742	4,477
Securities available for sale	109,526	121,205
Federal Home Loan Bank stock (FHLB)	550	550
Loans held for sale	177	—
Loans, net of unearned income	107,871	103,983
Allowance for credit losses on loans	(1,061)	(624)
Loans, net	106,810	103,359
Premises and equipment, net	4,921	5,035
Accrued interest receivable	805	852
Bank-owned life insurance (BOLI)	9,390	9,249
Other assets	7,176	6,332
Total assets	\$ 251,786	\$ 264,206
Liabilities:		
Deposits:		
Noninterest bearing	\$ 12,261	\$ 12,977
Interest-bearing		
Demand and NOW checking	15,234	18,659
Money market	33,788	42,624
Savings	43,486	49,068
Time deposits over \$250,000	8,959	8,801
Other time deposits	51,602	46,585
Total deposits	165,330	178,714
Escrow deposits	805	1,253
Other borrowings	5,000	—
Accrued expenses and other liabilities	3,490	3,697
Total liabilities	\$ 174,625	\$ 183,664
Stockholders' equity:		
Common Stock (\$0.01 par value; 10,000,000 shares authorized; 5,585,159 and 5,397,959 shares issued and 5,432,478 and 5,397,959 shares outstanding at September 30, 2023 and December 31, 2022, respectively)	56	54
Treasury Stock (152,681 shares at September 30, 2023)	(1,355)	—
Additional paid-in capital	50,606	50,420
Retained earnings	44,824	45,291
Unallocated common shares held by ESOP	(3,936)	(4,098)
Accumulated other comprehensive loss, net	(13,034)	(11,125)
Total stockholders' equity	77,161	80,542
Total liabilities and stockholders' equity	\$ 251,786	\$ 264,206

See accompanying notes to consolidated unaudited financial statements

NSTS BANCORP, INC.
Consolidated Statements of Operations (unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2023	2022	2023	2022
	(Dollars in thousands)			
Interest income:				
Loans, including fees	\$ 1,079	\$ 877	\$ 3,119	\$ 2,603
Securities				
Taxable	633	578	1,923	1,340
Tax-exempt	100	104	302	298
Federal funds sold and other	99	111	210	213
Time deposits with other financial institutions	21	14	75	25
FHLB Stock	7	4	16	11
Total interest income	1,939	1,688	5,645	4,490
Interest expense:				
Deposits	362	192	845	574
Other borrowings	61	—	68	—
Total interest expense	423	192	913	574
Net interest income	1,516	1,496	4,732	3,916
Provision for (reversal of) credit losses	50	(84)	52	(100)
Net interest income after provision for credit losses	1,466	1,580	4,680	4,016
Noninterest income:				
Gain on sale of mortgage loans	—	30	9	99
Rental income on office building	16	16	48	37
Service charges on deposits	70	75	203	222
Increase in cash surrender value of BOLI	49	45	141	132
Other non-interest income	15	19	43	572
Total noninterest income	150	185	444	1,062
Noninterest expense:				
Salaries and employee benefits	1,162	938	3,095	2,842
Equipment and occupancy	166	154	499	496
Data processing	159	159	481	461
Professional services	150	141	394	411
Advertising	14	29	65	67
Supervisory fees and assessments	49	33	123	111
Loan expenses	25	16	69	65
Deposit expenses	56	61	163	149
Director fees	56	59	168	172
Other non-interest expense	116	88	353	383
Total noninterest expense	1,953	1,678	5,410	5,157
(Loss) income before income taxes	(337)	87	(286)	(79)
Income tax benefit	(105)	(31)	(98)	(67)
Net (loss) income	\$ (232)	\$ 118	\$ (188)	\$ (12)
Basic and diluted (loss) earnings per share	\$ (0.05)	\$ 0.02	\$ (0.04)	\$ (0.00)
Weighted average shares outstanding	5,093,587	4,971,930	5,020,262	4,644,521

See accompanying notes to consolidated unaudited financial statements

NSTS BANCORP, INC.
Consolidated Statements of Comprehensive Income (Loss) (unaudited)

	For the three months ended September 30,	
	2023	2022
	(Dollars in thousands)	
Net (loss) income	\$ (232)	\$ 118
Unrealized net holding loss on securities		
Unrealized net holding loss on securities arising during period, net of realized gains on sales of \$0 in the three months ended September 30, 2023 and 2022	(3,081)	(6,321)
Tax effect	878	1,802
Other comprehensive loss, net of taxes	(2,203)	(4,519)
Comprehensive loss	\$ (2,435)	\$ (4,401)
	For the nine months ended September 30,	
	2023	2022
	(Dollars in thousands)	
Net loss	\$ (188)	\$ (12)
Unrealized net loss on securities		
Unrealized net holding loss on securities arising during period, net of realized gains on sales of \$0 in the nine months ended September 30, 2023 and 2022	(2,671)	(17,195)
Tax effect	762	4,902
Other comprehensive loss, net of taxes	(1,909)	(12,293)
Comprehensive loss	\$ (2,097)	\$ (12,305)

See accompanying notes to consolidated unaudited financial statements

NSTS BANCORP, INC.
Consolidated Statements of Stockholders' Equity (unaudited)

	Common Shares	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained earnings	Accumulated other comprehensive loss	Unallocated Common Shares Held by ESOP	Total
(Dollars in thousands)								
Quarter ended September 30, 2022								
Balance at June 30, 2022	5,397,959	\$ 54	\$ —	\$ 50,411	\$ 45,134	\$ (7,855)	\$ (4,232)	\$ 83,512
Net income	—	—	—	—	118	—	—	118
ESOP shares committed to be released	—	—	—	5	—	—	43	48
Change in net unrealized loss on securities available for sale, net	—	—	—	—	—	(4,519)	—	(4,519)
Balance at September 30, 2022	5,397,959	\$ 54	\$ —	\$ 50,416	\$ 45,252	\$ (12,374)	\$ (4,189)	\$ 79,159
Quarter ended September 30, 2023								
Balance at June 30, 2023	5,510,864	\$ 56	\$ (649)	\$ 50,440	\$ 45,056	\$ (10,831)	\$ (3,990)	\$ 80,082
Net loss	—	—	—	—	(232)	—	—	(232)
ESOP shares committed to be released	—	—	—	(4)	—	—	54	50
Purchase of treasury stock from stock repurchase program	(78,386)	—	(706)	—	—	—	—	(706)
Compensation cost for stock options and restricted stock	—	—	—	170	—	—	—	170
Change in net unrealized loss on securities available for sale, net	—	—	—	—	—	(2,203)	—	(2,203)
Balance at September 30, 2023	5,432,478	\$ 56	\$ (1,355)	\$ 50,606	\$ 44,824	\$ (13,034)	\$ (3,936)	\$ 77,161

	Common Shares	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained earnings	Accumulated other comprehensive loss	Unallocated Common Shares Held by ESOP	Total
(Dollars in thousands)								
Nine months ended September 30, 2022								
Balance at December 31, 2021	—	\$ —	\$ —	\$ —	\$ 45,264	\$ (81)	\$ —	\$ 45,183
Net loss	—	—	—	—	(12)	—	—	(12)
Proceeds of stock offering and issuance of common shares (net of issuance costs of \$2.5 million)	5,290,000	53	—	49,387	—	—	—	49,440
Issuance of common shares donated to the NSTS Charitable Foundation	107,959	1	—	1,008	—	—	—	1,009
Purchase of common shares by the ESOP (431,836 shares)	—	—	—	—	—	—	(4,319)	(4,319)
ESOP shares committed to be released	—	—	—	21	—	—	130	151
Change in net unrealized loss on securities available for sale, net	—	—	—	—	—	(12,293)	—	(12,293)
Balance at September 30, 2022	5,397,959	\$ 54	\$ —	\$ 50,416	\$ 45,252	\$ (12,374)	\$ (4,189)	\$ 79,159
Nine months ended September 30, 2023								
Balance at December 31, 2022	5,397,959	\$ 54	\$ —	\$ 50,420	\$ 45,291	\$ (11,125)	\$ (4,098)	\$ 80,542
Cumulative impact of ASU 2016-13	—	—	—	—	(279)	—	—	(279)
Net loss	—	—	—	—	(188)	—	—	(188)
ESOP shares committed to be released	—	—	—	(10)	—	—	162	152
Purchase of treasury stock from stock repurchase program	(152,681)	—	(1,355)	—	—	—	—	(1,355)
Compensation cost for stock options and restricted stock	—	—	—	198	—	—	—	198
Issuance of common shares for the restricted stock plan	187,200	2	—	(2)	—	—	—	—
Change in net unrealized loss on securities available for sale, net	—	—	—	—	—	(1,909)	—	(1,909)
Balance at September 30, 2023	5,432,478	\$ 56	\$ (1,355)	\$ 50,606	\$ 44,824	\$ (13,034)	\$ (3,936)	\$ 77,161

See accompanying notes to consolidated unaudited financial statements

NSTS BANCORP, INC.
Consolidated Statements of Cash Flows (unaudited)

	For the nine months ended September 30,	
	2023	2022
	(Dollars in thousands)	
Cash flows from operating activities:		
Net loss	\$ (188)	\$ (12)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	193	200
Securities amortization and accretion, net	412	803
Loans originated for sale	(880)	(7,457)
Proceeds from sales of loans held for sale	712	7,556
Gain on sale of mortgage loans	(9)	(99)
Provision for (reversal of) credit losses	52	(100)
Earnings on bank owned life insurance	(141)	(132)
Issuance of common shares donated to North Shore Trust and Savings Charitable Foundation	—	1,009
ESOP expense	152	151
Stock based compensation	198	—
Net change in accrued interest receivable and other assets	74	524
Net change in accrued expenses and other liabilities	(212)	999
Net cash provided by operating activities	<u>363</u>	<u>3,442</u>
Cash flows from investing activities:		
Net change in portfolio loans	(3,887)	(1,112)
Principal repayments on mortgage-backed securities	6,517	13,853
Purchases of securities available for sale	—	(57,473)
Maturities and calls of securities available for sale	2,080	1,305
Net change in time deposits with other financial institutions, net	2,735	(750)
Purchases of premises and equipment, net	(79)	(214)
Net cash provided by (used in) investing activities	<u>7,366</u>	<u>(44,391)</u>
Cash flows from financing activities:		
Net change in deposits	(13,384)	(102,160)
Net change in escrow deposits	(448)	(506)
Repayment of FHLB Advance	—	(5,000)
Proceeds from FHLB Advance	5,000	—
Proceeds from issuance of common stock, net of costs	—	49,440
Purchase of treasury shares (152,681 shares)	(1,355)	—
Loan to ESOP	—	(4,319)
Net cash used in financing activities	<u>(10,187)</u>	<u>(62,545)</u>
Net change in cash and cash equivalents	(2,458)	(103,494)
Cash and cash equivalents at beginning of period	13,147	121,611
Cash and cash equivalents at end of period	\$ 10,689	\$ 18,117
Supplemental disclosures of cash flow information:		
Cash paid during the period for Interest	\$ 879	\$ 580

See accompanying notes to consolidated unaudited financial statements

Note 1: Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to practices within the banking industry. Except as set forth below in this Note 1, the accounting policies followed in the preparation of the interim consolidated financial statements are consistent with those used in the preparation of the annual financial statements. The interim consolidated financial statements reflect all normal and recurring adjustments that are necessary, in the opinion of management, for fair statement of results for the interim periods presented. Results for the three and nine month periods ended September 30, 2023, are not necessarily indicative of the results that may be expected for the year ending December 31, 2023.

Nature of Operations

NSTS Bancorp, Inc. ("NSTS" or the "Company", "we" or "our") was formed to serve as the stock holding company for North Shore Trust and Savings (the "Bank") in connection with the conversion of North Shore Trust and Savings, NSTS Financial Corporation and North Shore MHC, into the stock form of organization, which was completed on January 18, 2022. Accordingly, certain financial statements and other financial information at or prior to January 18, 2022, contained in this Form 10-Q relate solely to the consolidated financial results of North Shore MHC and its consolidated subsidiaries, NSTS Financial Corporation and North Shore Trust and Savings.

NSTS Bancorp, Inc. completed its stock offering on January 18, 2022. The Company sold 5,290,000 shares of common stock at \$10.00 per share in its subscription offering for gross proceeds of approximately \$53.0 million. In connection with the subscription offering, NSTS Bancorp, Inc. also issued 107,959 shares of common stock and \$150,000 in cash to NSTS Charitable Foundation. Shares of NSTS Bancorp, Inc. stock began trading on January 19, 2022 on the Nasdaq Capital Market under the trading symbol "NSTS."

The Bank operates primarily in the northern suburbs of Chicago, Illinois. During the third quarter of 2023, we established two additional loan production offices in Aurora and Plainfield, Illinois to expand our loan originations within the Chicagoland area. The lending teams operating in the Aurora and Plainfield, Illinois loan production offices originate as Oak Leaf Community Mortgage, a division of North Shore Trust and Savings, which will complement the existing loan production office in Chicago. The Bank offers a variety of financial services to customers in our surrounding community. Financial services consist primarily of 1-4 family mortgage loans, savings accounts, and certificate of deposit accounts. There are no significant concentrations of loans to any one industry or customer. The Bank's exposure to credit risk is significantly affected by changes in the economy in the Bank's market area.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements were prepared in accordance with GAAP and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with NSTS Bancorp, Inc.'s Consolidated Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2022. The unaudited Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may vary from those estimates. Material estimates that could significantly change in the near-term include the adequacy of the allowance for credit losses, determination of the valuation allowance on deferred tax assets and the valuation of investment securities and the related tax effect. The results of operations for the three and nine months ended September 30, 2023, are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2023. Certain amounts in prior year financial statements have been reclassified to conform to the current presentation. Subsequent events have been evaluated through the date of issuance of the unaudited Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.

With the exception of the following new significant accounting and reporting policies, the Company has not changed its significant accounting and reporting policies from those disclosed in the Company's Form 10-K for the year ended December 31, 2022.

Stock Based Compensation

The Company maintains an equity incentive plan under which restricted stock and stock options may be granted to employees and directors, see Note 12.

The Company recognizes the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards in accordance with ASC 718, "Compensation-Stock Compensation". The Company estimates the per share fair value of option grants on the date of grant using the Black-Scholes option pricing model using assumptions for the expected dividend yield, expected stock price volatility, risk-free interest rate and expected option term. These assumptions are subjective in nature, involve uncertainties and, therefore, cannot be determined with precision. The Black-Scholes option pricing model also contains certain inherent limitations when applied to options that are not traded on public markets.

The per share fair value of options is highly sensitive to changes in assumptions. In general, the per share fair value of options will move in the same direction as changes in the expected stock price volatility, risk-free interest rate and expected option term, and in the opposite direction as changes in the expected dividend yield. For example, the per share fair value of options will generally increase as expected stock price volatility increases, risk-free interest rate increases, expected option term increases and expected dividend yield decreases. The use of different assumptions or different option pricing models could result in materially different per share fair values of options.

The Company recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards. The Company's accounting policy is to recognize forfeitures as they occur. Forfeited shares are added back to the pool of shares available for future grants.

Treasury Stock

Treasury stock acquired is recorded at cost and is carried as a reduction of stockholders' equity in the Consolidated Balance Sheets. Treasury stock issued is valued based on the "last in, first out" inventory method. The difference between the consideration received upon issuance and the carrying value is charged or credited to additional paid-in capital.

Accounting Developments

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*,” also known as Current Expected Credit Losses, or CECL. ASU 2016-13 was issued to provide financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date to enhance the decision making process. The CECL model utilizes a lifetime “expected credit loss” measurement objective for the recognition of credit losses for loans, held-to-maturity securities, and other receivables at the time the financial asset is originated or acquired. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. For available for-sale securities where fair value is less than cost, credit-related impairment, if any, will be recognized in an allowance for credit losses and adjusted each period for changes in expected credit risk. This model replaces the multiple existing impairment models, which generally require that a loss be incurred before it is recognized.

We adopted ASU 2016-13 using the current expected credit loss (“CECL”) methodology for financial assets measured at amortized cost, effective January 1, 2023. Results for the periods beginning after January 1, 2023 are presented under ASU 2016-13, while prior period amounts are reported in accordance with the previously applicable accounting standards. The Company recorded a reduction to retained earnings of approximately \$279,000 upon adoption of ASU 2016-13. The transition adjustment included an increase to the allowance for credit losses on loans of \$384,000 and an increase to the allowance for credit losses on off-balance sheet credit exposure of approximately \$5,000. The transition adjustment included a corresponding increase in deferred tax assets.

The following table illustrates the impact of ASU 2016-13 adoption:

	<u>Allowance for credit losses as reported under ASU 2016-13</u>	<u>Allowance pre-ASU 2016-13 Adoption</u>	<u>Impact on Allowance of ASU 2016-13 Adoption</u>
	(Dollars in thousands)		
Assets:			
First mortgage loans			
1-4 family residential	\$ 916	\$ 581	\$ 335
Multi-family	42	19	23
Commercial	48	19	29
Consumer loans	2	5	(3)
Allowance for credit losses for all loans	<u>\$ 1,008</u>	<u>\$ 624</u>	<u>\$ 384</u>
Liabilities:			
Allowance for credit losses on off-balance sheet exposures	<u>\$ 5</u>	<u>\$ —</u>	<u>\$ 5</u>

In March 2022, FASB issued ASU 2022-02, *Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*. The amendments in this update eliminate the accounting guidance and related disclosures for TDRs by creditors in Subtopic 310-40, *Receivables—Troubled Debt Restructurings by Creditors*, while enhancing disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty and requiring an entity to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, *Financial Instruments—Credit Losses—Measured at Amortized Cost*. The amendments in this update are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years and are applied prospectively, except with respect to the recognition and measurement of TDRs, where an entity has the option to apply a modified retrospective transition method. Early adoption of the amendments in this update is permitted. An entity may elect to early adopt the amendments regarding TDRs and related disclosure enhancements separately from the amendments related to vintage disclosures.

Allowance for Credit Losses

The allowance for credit losses (“ACL”) is an estimate of the expected credit losses on the loans held for investment, unfunded loan commitments, and available-for-sale debt securities portfolios.

Allowance for Credit Losses on Loans

The ACL is calculated according to GAAP standards and is maintained by management at a level believed adequate to absorb estimated credit losses that are expected to occur within the existing loan portfolio through their contractual terms. The ACL is a valuation account that is deducted from the loans’ amortized cost basis to present the net amount expected to be collected on loans. Determination of the ACL is inherently subjective in nature since it requires significant estimates and management judgment, and includes a level of imprecision given the difficulty of identifying and assessing the factors impacting loan repayment and estimating the timing and amount of losses. While management utilizes its best judgment and information available, the ultimate adequacy of the ACL is dependent upon a variety of factors beyond the Company’s direct control, including, but not limited to, the performance of the loan portfolio, consideration of current economic trends, changes in interest rates and property values, estimated losses on pools of homogeneous loans based on an analysis that uses historical loss experience for prior periods that are determined to have like characteristics with the current period such as pre-recessionary, recessionary, or recovery periods, portfolio growth and concentration risk, management and staffing changes, the interpretation of loan risk classifications by regulatory authorities and other credit market factors. While each component of the ACL is determined separately, the entire balance is available for the entire loan portfolio.

The ACL methodology consists of measuring loans on a collective (pool) basis when similar risk characteristics exist. The Company has identified five loan portfolios and measures the ACL using the Scaled CECL Allowance for Losses Estimator (“SCALE”) method. The loan portfolios are 1-4 family residential real estate, commercial real estate, multi-family real estate, construction and consumer. The SCALE method uses publicly available data from Schedule RI-C of the Call Report to derive the initial proxy expected lifetime loss rates. These proxy expected lifetime loss rates are then adjusted for bank-specific facts and circumstances to arrive at the final ACL estimate that adequately reflects the Company’s loss history and credit risk within our portfolio.

The qualitative factors applied to each loan portfolio consist of the impact of other internal and external qualitative and credit market factors as assessed by management through a detailed loan review, ACL analysis and credit discussions. These internal and external qualitative and credit market factors include:

- changes in lending policies and procedures, including changes in underwriting standards and collections, charge-offs and recovery practices;
- changes in international, national, regionally and local conditions (specific factors which impact portfolios or discrepancies with national economic factors which are utilized within the economic forecast);
- changes in the experience, depth and ability of lending management;
- changes in the volume and severity of past due loans and other similar loan conditions;
- changes in the nature and volume of the loan portfolio and terms of loans;
- the existence and effect of any concentrations of credit and changes in the levels of such concentrations;
- effects of other external factors, such as competition, legal or regulatory factors, on the level of estimated credit losses;
- changes in the quality of our loan review functions; and
- changes in the value of underlying collateral for collateral dependent loans.

The impact of the above listed internal and external qualitative and credit market risk factors is assessed within predetermined ranges to adjust the ACL totals calculated.

In addition to the pooled analysis performed for the majority of our loan and commitment balances, we also review those loans that have collateral dependency or nonperforming status which requires a specific review of that loan, per our individually analyzed CECL calculations.

Loans are charged off against the ACL when management believes the uncollectibility of a loan balance is confirmed, while recoveries of amounts previously charged-off are credited to the ACL. Approved releases from previously established ACL reserves authorized under our ACL methodology also reduce the ACL. Additions to the ACL are established through the provision for credit losses on loans, which is charged to expense.

The Company’s ACL methodology is intended to reflect all loan portfolio risk, but management recognizes the inability to accurately depict all future credit losses in a current ACL estimate, as the impact of various factors cannot be fully known. Accrued interest receivable on loans is excluded from the amortized cost basis of financing receivables for the purpose of determining the allowance for credit losses. All calculations conform to GAAP.

Allowance for Credit Losses on Unfunded Loan Commitments

The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk by a contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The ACL related to off-balance sheet credit exposures, which is within other liabilities on the Company's balance sheet, is estimated at each balance sheet date under the CECL model, and is adjusted as determined necessary through the provision for credit losses on the income statement. The estimate for ACL on unfunded loan commitments includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life.

Allowance for Credit Losses on Securities Available-for-Sale

For available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will sell, the security before recovery of its amortized cost basis. If either of the aforementioned criteria exists, the Company will record an ACL related to securities available-for-sale with an offsetting entry to the provision for credit losses on securities on the income statement. If either of these criteria does not exist, the Company will evaluate the securities individually to determine whether the decline in the fair value below the amortized cost basis (impairment) is due to credit-related factors or noncredit-related factors, such as market interest rate fluctuations.

In evaluating securities available-for sale for potential impairment, the Company considers many factors, including the financial condition and near-term prospects of the issuer, which for debt securities considers external credit ratings and recent downgrades; and its ability and intent to hold the security for a period of time sufficient for a recovery in value. The Company also considers the extent to which the securities are issued by the federal government or its agencies, and any guarantee of issued amounts by those agencies. The amount of the impairment related to other factors is recognized in other comprehensive income (loss).

Accrued interest receivable on securities available-for-sale is excluded from the amortized cost basis of those securities for the purpose of determining the allowance for credit losses. All calculations conform to GAAP.

Note 2: Securities

The amortized cost and estimated fair value of debt securities at September 30, 2023 and December 31, 2022, by contractual maturity, are shown below. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid without any penalties, therefore, these securities have been included in the below table based on average remaining life.

	U.S. Treasury Notes	U.S. government agency obligations	Municipal obligations	Mortgage- backed residential obligations	Collateralized mortgage obligations	Total available-for- sale
September 30, 2023						
	(Dollars in thousands)					
1 year or less	\$ 3,941	\$ —	\$ 1,285	\$ —	\$ —	\$ 5,226
1 to 5 years	1,925	14,748	4,177	10,883	22,513	54,246
5 to 10 years	—	5,100	3,180	19,281	8,846	36,407
After 10 years	—	—	9,496	795	3,356	13,647
Fair value	5,866	19,848	18,138	30,959	34,715	109,526
Gross unrealized gains	—	—	—	—	—	—
Gross unrealized losses	(112)	(2,015)	(3,834)	(6,530)	(5,740)	(18,231)
Amortized cost	\$ 5,978	\$ 21,863	\$ 21,972	\$ 37,489	\$ 40,455	\$ 127,757
December 31, 2022						
	(Dollars in thousands)					
1 year or less	\$ 2,433	\$ 1,007	\$ 528	\$ —	\$ —	\$ 3,968
1 to 5 years	4,855	11,511	5,394	20,033	22,809	64,602
5 to 10 years	—	8,872	2,655	15,046	11,848	38,421
After 10 years	—	—	11,060	659	2,495	14,214
Fair value	7,288	21,390	19,637	35,738	37,152	121,205
Gross unrealized gains	—	—	6	—	—	6
Gross unrealized losses	(155)	(1,870)	(2,972)	(5,464)	(5,105)	(15,566)
Amortized cost	\$ 7,443	\$ 23,260	\$ 22,603	\$ 41,202	\$ 42,257	\$ 136,765

As of September 30, 2023, and December 31, 2022, no securities were pledged to secure public deposits or for other purposes as required or permitted by law.

Information pertaining to securities with gross unrealized losses at September 30, 2023 and December 31, 2022, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2023						
U.S. Treasury Notes	\$ —	\$ —	\$ 5,866	\$ 112	\$ 5,866	\$ 112
U.S. government agency obligations	3,657	67	16,191	1,948	19,848	2,015
Municipal obligations	3,104	155	15,034	3,679	18,138	3,834
Mortgage-backed residential obligations	—	—	30,959	6,530	30,959	6,530
Collateralized mortgage obligations	593	26	34,122	5,714	34,715	5,740
Total	\$ 7,354	\$ 248	\$ 102,172	\$ 17,983	\$ 109,526	\$ 18,231
December 31, 2022						
U.S. Treasury Notes	\$ 7,288	\$ 155	\$ —	\$ —	\$ 7,288	\$ 155
U.S. government agency obligations	17,274	1,296	4,116	574	21,390	1,870
Municipal obligations	16,823	2,349	2,037	623	18,860	2,972
Mortgage-backed residential obligations	14,365	1,618	21,373	3,846	35,738	5,464
Collateralized mortgage obligations	21,449	2,014	15,703	3,091	37,152	5,105
Total	\$ 77,199	\$ 7,432	\$ 43,229	\$ 8,134	\$ 120,428	\$ 15,566

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At September 30, 2023 and December 31, 2022, certain investment securities were in unrealized loss positions. There were no securities with identified credit losses at September 30, 2023 and December 31, 2022, respectively. Unrealized losses have not been recognized into income because, based on management's evaluation, the decline in fair value is largely due to increased market rates, temporary market conditions and trading spreads, and, as such, are considered to be temporary by the Bank. In addition, management has the intent and ability to hold the securities until they mature or they recover their carrying values.

All U.S. Treasuries, U.S. government agency obligations, mortgage-based residential obligations and collateralized mortgage obligations are agency-issued or government-sponsored enterprise issued. Agency-issued securities are generally guaranteed by a U.S. government agency, such as the Government National Mortgage Association. Government-sponsored enterprises, such as the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Small Business Administration, have either a direct or implied guarantee by the U.S. government.

The Bank holds two classifications of municipal bonds, general obligation bonds and revenue bonds. General obligation bonds are backed by the general revenue of the issuing municipality, while revenue bonds are supported by a specific revenue source. All general obligation and revenue bonds have a bond rating of investment grade by Standard and Poor's or Moody's Investor Services or are not rated. There have been no declines in investment grades on bonds in a loss position and as of September 30, 2023, all municipal bonds are paying as agreed.

There were no sales of securities available-for-sale during the three and nine months ended September 30, 2023 and 2022.

Note 3: Loans and allowance for credit losses

A summary of loans by major category as of September 30, 2023 and December 31, 2022 is as follows:

	September 30, 2023	December 31, 2022
	(Dollars in thousands)	
First mortgage loans		
1-4 family residential	\$ 97,934	\$ 95,584
Multi-family	3,142	3,237
Commercial	3,738	3,921
Construction	1,762	—
Total first mortgage loans	106,576	102,742
Consumer loans	265	249
Total loans	106,841	102,991
Net deferred loan costs	1,030	992
Allowance for credit losses on loans	(1,061)	(624)
Total loans, net	\$ 106,810	\$ 103,359

First mortgage loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balance of these loans totaled \$12.8 million and \$13.7 million at September 30, 2023 and December 31, 2022, respectively. Custodial escrow balances maintained in connection with the loans serviced were \$150,000 and \$231,000 at September 30, 2023 and December 31, 2022, respectively.

In the normal course of business, loans are made by the Bank to directors and officers of the Company and the Bank (related parties). The terms of these loans, including interest rate and collateral, are similar to those prevailing for comparable transactions with other customers and do not involve more than a normal risk of collectability. At September 30, 2023 and December 31, 2022, such borrowers were indebted to the Bank in the aggregate amount of \$522,000 and \$597,000, respectively.

The following tables present the activity in the allowance for credit losses and allowance for loan losses for the three and nine months ended September 30, 2023 and 2022:

	September 30, 2023					
	1-4 family residential	Multi-family	Commercial	Construction	Consumer	Total
	(Dollars in thousands)					
Three months ended						
Beginning balance	\$ 928	\$ 41	\$ 39	\$ —	\$ 2	\$ 1,010
Charge-offs	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—
Net recoveries (charge-offs)	—	—	—	—	—	—
Provision for (release of) credit losses	56	(2)	(3)	—	—	51
Ending balance	\$ 984	\$ 39	\$ 36	\$ —	\$ 2	\$ 1,061

	September 30, 2023					
	1-4 family residential	Multi-family	Commercial	Construction	Consumer	Total
	(Dollars in thousands)					
Nine months ended						
Beginning balance	\$ 581	\$ 19	\$ 19	\$ —	\$ 5	\$ 624
Cumulative effect of change in accounting principle	335	23	29	—	(3)	384
Charge-offs	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—
Net recoveries (charge-offs)	—	—	—	—	—	—
Provision for (release of) credit losses	68	(3)	(12)	—	—	53
Ending balance	\$ 984	\$ 39	\$ 36	\$ —	\$ 2	\$ 1,061

	September 30, 2022					
	1-4 family residential	Multi-family	Commercial	Construction	Consumer	Total
	(Dollars in thousands)					
Three months ended						
Beginning balance	\$ 713	\$ 26	\$ 26	\$ —	\$ 4	\$ 769
Charge-offs	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—
Net recoveries (charge-offs)	—	—	—	—	—	—
(Release of) provision for loan losses	(79)	(2)	(4)	—	1	(84)
Ending balance	\$ 634	\$ 24	\$ 22	\$ —	\$ 5	\$ 685

	September 30, 2022					
	1-4 family residential	Multi-family	Commercial	Construction	Consumer	Total
	(Dollars in thousands)					
Nine months ended						
Beginning balance	\$ 675	\$ 69	\$ 25	\$ —	\$ 10	\$ 779
Charge-offs	—	—	—	—	—	—
Recoveries	6	—	—	—	—	6
Net recoveries (charge-offs)	6	—	—	—	—	6
(Release of) loan losses	(47)	(45)	(3)	—	(5)	(100)
Ending balance	\$ 634	\$ 24	\$ 22	\$ —	\$ 5	\$ 685

The ACL on loans excludes \$4,000 of allowance for off-balance sheet exposures as of September 30, 2023 recorded within Other Liabilities.

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As of September 30, 2023, collateral dependent loans totaled \$139,000 in the 1-4 family residential loan segment. These loans are collateralized by residential real estate and have no ACL as of September 30, 2023. There were no other collateral dependent loans as of September 30, 2023.

The Bank evaluates collectability based on payment activity and other factors. The Bank uses a graded loan rating system as a means of identifying potential problem loans, as follows:

Pass

Loans in these categories are performing as expected with low to average risk.

Special Mention

Loans in this category are internally designated by management as “watch loans.” These loans are starting to show signs of potential weakness and are closely monitored by management.

Substandard

Loans in this category are internally designated by management as “substandard.” Generally, a loan is considered substandard if it is inadequately protected by the paying capacity of the obligors or the current net worth of the collateral pledged. Substandard loans present a distinct possibility that the Bank will sustain losses if such weaknesses are not corrected.

Doubtful

Loans classified as doubtful have all the weaknesses inherent in those designated as “substandard” with the added characteristic that the weaknesses may make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

On an annual basis, or more often if needed, the Bank formally reviews the ratings on commercial loans. In addition, the Bank performs an independent review of a significant portion of the commercial loan portfolio. Management uses the results of the independent review as part of its annual review process.

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The following tables present the credit risk profile of the Company's loan portfolio based on risk rating category and year of origination as of September 30, 2023 and the risk rating category and class of loan as of December 31, 2022.

As of September 30, 2023							
Term loans amortized cost basis by origination year							
	<u>2023</u>	<u>2022</u>	<u>2021</u>	<u>Prior</u>	<u>Revolving loans amortized cost basis</u>	<u>Revolving loans converted to term loans amortized cost basis</u>	<u>Total</u>
(Dollars in thousands)							
1-4 family residential							
Pass	\$ 8,623	\$ 19,539	\$ 19,824	\$ 48,518	\$ 1,291	\$ —	\$ 97,795
Special Mention	—	—	—	—	—	—	—
Substandard	—	—	—	139	—	—	139
Total 1-4 family residential	<u>8,623</u>	<u>19,539</u>	<u>19,824</u>	<u>48,657</u>	<u>1,291</u>	<u>—</u>	<u>97,934</u>
Current year-to-date gross write-offs	—	—	—	—	—	—	—
Multi-family							
Pass	—	—	241	2,901	—	—	3,142
Special Mention	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—
Total multi-family	<u>—</u>	<u>—</u>	<u>241</u>	<u>2,901</u>	<u>—</u>	<u>—</u>	<u>3,142</u>
Current year-to-date gross write-offs	—	—	—	—	—	—	—
Commercial							
Pass	46	—	101	3,441	150	—	3,738
Special Mention	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—
Total commercial	<u>46</u>	<u>—</u>	<u>101</u>	<u>3,441</u>	<u>150</u>	<u>—</u>	<u>3,738</u>
Current year-to-date gross write-offs	—	—	—	—	—	—	—
Construction							
Pass	1,762	—	—	—	—	—	1,762
Special Mention	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—
Total construction	<u>1,762</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,762</u>
Current year-to-date gross write-offs	—	—	—	—	—	—	—
Consumer							
Pass	129	102	31	3	—	—	265
Special Mention	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—
Total consumer	<u>129</u>	<u>102</u>	<u>31</u>	<u>3</u>	<u>—</u>	<u>—</u>	<u>265</u>
Current year-to-date gross write-offs	—	—	—	—	—	—	—
Total	<u>\$ 10,560</u>	<u>\$ 19,641</u>	<u>\$ 20,197</u>	<u>\$ 55,002</u>	<u>\$ 1,441</u>	<u>\$ —</u>	<u>\$ 106,841</u>
		<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>		<u>Total loans</u>
(Dollars in thousands)							
December 31, 2022							
1-4 family residential		\$ 95,353	\$ 43	\$ 188	\$ —		\$ 95,584
Multi-family		3,237	—	—	—		3,237
Commercial		3,921	—	—	—		3,921
Consumer		249	—	—	—		249
Total		<u>\$ 102,760</u>	<u>\$ 43</u>	<u>\$ 188</u>	<u>\$ —</u>		<u>\$ 102,991</u>

The aging of the Bank's loan portfolio as of September 30, 2023 and December 31, 2022, is as follows:

	<u>31-89 Days Past Due and Accruing</u>	<u>Greater than 90 Days Past Due and Accruing</u>	<u>Non-Accrual</u>	<u>Total Past Due and Non-Accrual</u>	<u>Current</u>	<u>Total Loan Balance</u>
September 30, 2023						
1-4 family residential	\$ —	\$ —	\$ 139	\$ 139	\$ 97,795	\$ 97,934
Multi-family	—	—	—	—	3,142	3,142
Commercial	—	64	—	64	3,674	3,738
Construction	—	—	—	—	1,762	1,762
Consumer	—	—	—	—	265	265
Total	<u>\$ —</u>	<u>\$ 64</u>	<u>\$ 139</u>	<u>\$ 203</u>	<u>\$ 106,638</u>	<u>\$ 106,841</u>
December 31, 2022						
1-4 family residential	\$ 28	\$ —	\$ 154	\$ 182	\$ 95,402	\$ 95,584
Multi-family	—	—	—	—	3,237	3,237
Commercial	—	—	—	—	3,921	3,921
Consumer	—	—	—	—	249	249
Total	<u>\$ 28</u>	<u>\$ —</u>	<u>\$ 154</u>	<u>\$ 182</u>	<u>\$ 102,809</u>	<u>\$ 102,991</u>

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The following table presents the amortized cost basis of loans on nonaccrual status recorded at September 30, 2023 and December 31, 2022.

	<u>September 30, 2023</u>		<u>December 31, 2022</u>
	<u>Nonaccrual with no Allowance for Credit Losses</u>	<u>Nonaccrual</u>	<u>Nonaccrual</u>
	<u>(Dollars in thousands)</u>		
First mortgage loans			
1-4 family residential	\$ 139	\$ 139	\$ 154
Multi-family	—	—	—
Commercial	—	—	—
Construction	—	—	—
Consumer loans	—	—	—
Total loans	<u>\$ 139</u>	<u>\$ 139</u>	<u>\$ 154</u>

The Bank may modify loans to borrowers experiencing financial difficulty by providing modifications to repayment terms; more specifically, modifications to loan interest rates. Management performs an analysis at the time of loan modification. Any reserve required is recorded through a provision to the allowance for credit losses on loans.

As of January 1, 2023, the Company adopted ASU 2022-02, *Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructuring and Vintage Disclosures*, see Note 1. There were no modifications on loans to borrowers experiencing financial difficulty during the three and nine months ended September 30, 2023. There were no new troubled debt restructurings during the three and nine months ended September 30, 2022.

Note 4: Other Real Estate Owned

There was no other real estate owned ("OREO") at September 30, 2023 and December 31, 2022. Additionally, there was no movement in OREO during the three and nine months ended September 30, 2023 and 2022.

There were no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process as of September 30, 2023 and December 31, 2022.

Note 5: Deposits

As of September 30, 2023, for years ended September 30, the scheduled maturities of time deposits are as follows:

For the 12 months ended September 30,	Amount (Dollars in thousands)
2024	\$ 39,535
2025	11,251
2026	4,003
2027	1,764
2028 and beyond	4,008
Total	<u>\$ 60,561</u>

In the normal course of business, deposit accounts are held by directors and executive officers of the Company and the Bank (related parties). The terms for these accounts, including interest rates, fees, and other attributes, are similar to those prevailing for comparable transactions with other customers and do not involve more than the normal level of risk associated with deposit accounts. At September 30, 2023 and December 31, 2022, total deposits held by directors and officers of the Company and the Bank were \$770,000 and \$724,000, respectively.

Note 6: Other Borrowings

During the nine months ended September 30, 2023, the Company borrowed \$5.0 million from the FHLB Chicago at a rate of 4.78% for 24 months, payable on June 20, 2025. The advance is collateralized by loans pledged to the FHLB and is payable at maturity, with a prepayment penalty if repayment is made prior to the maturity date. There were no borrowings made during the three months ended September 30, 2023.

The following table shows the outstanding advances, additional borrowing capacity and total borrowing capacity from the FHLB Chicago at the dates presented.

	September 30, 2023	December 31, 2022
	(Dollars in thousands)	
Outstanding advances	\$ 5,000	\$ —
Additional borrowing capacity	64,336	68,586
Total borrowing capacity	<u>\$ 69,336</u>	<u>\$ 68,586</u>

The eligible borrowings are collateralized by \$89.8 million and \$86.6 million of first mortgage loans under a blanket lien arrangement at September 30, 2023 and December 31, 2022, respectively.

Additionally, at September 30, 2023 and December 31, 2022, we had a \$10.0 million federal funds line of credit with BMO Harris Bank, none of which was drawn at September 30, 2023 and December 31, 2022.

Note 7: Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- | | |
|----------------|---|
| Level 1 | Quoted prices in active markets for identical assets or liabilities |
| Level 2 | 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 for substantially the full term of the assets or liabilities |
| Level 3 | Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities |

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at September 30, 2023 or December 31, 2022.

Available-for-Sale Securities (Recurring)

Where quoted market prices are available in an active market, securities such as U.S. Treasuries, would be classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities would be classified within Level 3 of the hierarchy.

Individually Evaluated Loans (Nonrecurring)

Individually evaluated (formerly, impaired) loans are recorded at fair value on a nonrecurring basis. The fair value of loans is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Individually evaluated loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. Individually evaluated loans that are valued based on the present value of future cash flows are not considered in the fair value hierarchy.

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The following table presents the Bank's assets that are measured at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of September 30, 2023 and December 31, 2022:

	Fair Value Measurements Using			
	Fair Value	Level 1	Level 2	Level 3
(Dollars in thousands)				
September 30, 2023				
Securities Available-for-sale				
U.S. Treasury Notes	\$ 5,866	\$ 5,866	\$ —	\$ —
U.S. government agency obligations	19,848	—	19,848	—
Municipal obligations	18,138	—	18,138	—
Mortgage-backed residential obligations	30,959	—	30,959	—
Collateralized mortgage obligations	34,715	—	34,715	—
Total	\$ 109,526	\$ 5,866	\$ 103,660	\$ —
December 31, 2022				
Securities Available-for-sale				
U.S. Treasury Notes	\$ 7,288	\$ 7,288	\$ —	\$ —
U.S. government agency obligations	21,390	—	21,390	\$ —
Municipal obligations	19,637	—	19,637	—
Mortgage-backed residential obligations	35,738	—	35,738	—
Collateralized mortgage obligations	37,152	—	37,152	—
Total	\$ 121,205	\$ 7,288	\$ 113,917	\$ —

The Bank may be required, from time to time, to measure certain assets and liabilities at fair value on a nonrecurring basis in accordance with accounting principles generally accepted in the United States of America. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. There were no assets measured at fair value on a nonrecurring basis as of September 30, 2023. Assets measured at fair value on a nonrecurring basis and the valuation techniques used to measure nonrecurring Level 3 fair value measurements as of December 31, 2022, were as follows:

	Fair Value			
	Fair Value	Level 1	Level 2	Level 3
(Dollars in thousands)				
December 31, 2022				
Impaired loans	\$ 375	\$ —	\$ —	\$ 375

There were no gains or losses recognized on assets measured on a nonrecurring basis during the three and nine months ended September 30, 2023 and 2022. The numerical range of unobservable inputs for the valuation assumptions used in calculating the amounts disclosed above is not meaningful to this presentation.

Note 8: Fair Value of Financial Instruments

Financial instruments are classified within the fair value hierarchy using the methodologies described in Note 7 – Fair Value Measurements. The following disclosures include financial instruments that are not carried at fair value on the Consolidated Balance Sheets. The calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

Certain financial instruments generally expose the Company to limited credit risk and have no stated maturities or have short-term maturities and carry interest rates that approximate market. The carrying value of these financial instruments assumes to approximate the fair value of these instruments. These instruments include cash and cash equivalents, non-interest bearing deposit accounts, time deposits with other financial institutions, FHLB stock, escrow deposits and accrued interest receivable and payable.

The carrying amounts and estimated fair values by fair value hierarchy of certain financial instruments are as follows:

	Carrying Amount		Level 1		Level 2		Level 3		Estimated Fair Value
(Dollars in thousands)									
September 30, 2023									
Financial assets:									
Loans, net	\$ 106,810	\$	—	\$	—	\$	95,091	\$	95,091
Loans held for sale	177		—		182		—		182
Financial liabilities:									
Interest-bearing deposits	\$ 153,069	\$	—	\$	152,723	\$	—	\$	152,723
Other Borrowings	\$ 5,000	\$	—	\$	4,982	\$	—	\$	4,982
December 31, 2022									
Financial assets:									
Loans, net	\$ 103,359	\$	—	\$	—	\$	94,779	\$	94,779
Financial liabilities:									
Interest-bearing deposits	\$ 165,737	\$	—	\$	165,535	\$	—	\$	165,535

Note 9: Capital Ratios

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

Quantitative measures established by regulatory reporting standards to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, common equity Tier 1 capital to total risk-weighted assets and of Tier I capital to average assets, as such individual components and calculations are defined by related standards.

As of September 30, 2023 the most recent notification from the regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification which management believes have changed the Bank’s category. On November 13, 2019, the federal regulators finalized and adopted a regulatory capital rule establishing a community bank leverage ratio (“CBLR”), which became effective on January 1, 2020. The intent of CBLR is to provide a simple alternative measure of capital adequacy for electing qualifying depository institutions and depository institution holding companies, as directed under the Economic Growth, Relief, and Consumer Protection Act. Under CBLR, if a qualifying depository institution or depository institution holding company elects to use such measure, such institution or holding company will be considered well capitalized if its ratio of Tier 1 capital to average total consolidated assets (i.e., leverage ratio) exceeds 9% subject to a limited two quarter grace period, during which the leverage ratio cannot drop 100 basis points below the then applicable threshold, and will not be required to calculate and report risk-based capital ratios. The Bank elected to begin using CBLR for the first quarter of 2020. Management believes, as of September 30, 2023, that the Bank met all capital adequacy requirements to which it was subject.

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The Bank's actual capital amounts and ratios as of September 30, 2023 and December 31, 2022, are presented below:

	Actual		Minimum Required to be Well-Capitalized (1)	
	Amount	Ratio	Amount	Ratio
(Dollars in thousands)				
As of September 30, 2023				
Tier 1 capital (to Average Assets)	\$ 65,941	25.81%	\$ 22,998	>9%
As of December 31, 2022				
Tier 1 capital (to Average Assets)	\$ 65,634	24.81%	\$ 23,809	>9%

(1) As defined by regulatory agencies. Failure to exceed the leverage ratio thresholds required under CBLR in the future, subject to any applicable grace period, would require the Bank to return to the risk-based capital ratio thresholds previously utilized under the fully phased-in Basel III Capital Rules to determine capital adequacy.

Note 10: Commitments and Contingencies

In the ordinary course of business, the Bank has various commitments and contingent liabilities that are not reflected in the accompanying financial statements. In the opinion of management, the ultimate disposition of these matters is not expected to have a material adverse effect on the financial position of the Bank.

Financial Instruments

The Bank does not engage in the use of interest rate swaps or futures, forwards or option contracts.

At September 30, 2023 and December 31, 2022, unused lines of credit and outstanding commitments to originate loans were as follows:

	September 30, 2023	December 31, 2022
	(Dollars in thousands)	
Unused line of credit	\$ 4,196	\$ 2,872
Commitments to originate loans	2,823	793
Total commitments	\$ 7,019	\$ 3,665

Concentrations of Credit Risk

The Bank generally originates single-family residential loans within its primary lending area which is Waukegan, Illinois and the surrounding area. The Bank's underwriting policies require such loans to be made at approximately 80% loan-to-value, based upon appraised values, unless private mortgage insurance is obtained, or the loan is guaranteed by the government. These loans are secured by the underlying properties.

The Bank maintains its cash in deposit accounts at the Federal Reserve Bank or other institutions, the balances of which may exceed federally insured limits. The Bank has not experienced any losses in such accounts. The Bank believes it is not exposed to any significant credit risk on cash and cash equivalents.

Interest Rate Risk

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, fair values of its financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the overall interest rate risk.

Litigation

Due to the nature of its business activities, the Bank is at times subject to legal action which arises in the normal course of business. In the opinion of management, the ultimate resolution of these matters is not expected to have a material effect on the financial position or results of operations of the Bank.

Note 11: Earnings Per Share

Basic EPS represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common shares (such as stock options) were exercised or converted into additional common shares that should then share in the earnings of the entity. Diluted EPS is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares outstanding for the period, plus the effect of potential dilutive common share equivalents.

Excluded from the earnings per share calculation are anti-dilutive equity awards for the three and nine months ended September 30, 2023, totaling 652,700. There were no securities or other contracts that had a dilutive effect for the three and nine months ended September 30, 2022. Shares held by the Employee Stock Ownership Plan ("ESOP") that have not been allocated to employees in accordance with the terms of the ESOP, referred to as "unallocated ESOP shares", are not deemed outstanding for EPS calculations.

	Three Months Ended September		Nine months ended September 30,	
	2023	2022	2023	2022
	(Income in thousands)		(Income in thousands)	
Net (loss) income applicable to common shares	\$ (232)	\$ 118	\$ (188)	\$ (12)
Average number of common shares outstanding	5,490,825	5,397,959	5,422,851	5,042,050
Less: Average unallocated ESOP shares	397,238	426,029	402,589	397,529
Average number of common shares outstanding used to calculate basic earnings per common share	5,093,587	4,971,930	5,020,262	4,644,521
Earnings (loss) income per common share basic and diluted	\$ (0.05)	\$ 0.02	\$ (0.04)	\$ (0.00)

All unallocated ESOP shares have been excluded from the calculation of basic and diluted EPS.

Note 12: Stock Based Compensation**ESOP**

Employees participate in an Employee Stock Ownership Plan ("ESOP"). The ESOP borrowed funds from the Company to purchase 431,836 shares of stock at \$10 per share. The Bank makes discretionary contributions to the ESOP, as well as paying dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on relative compensation. Participants receive the shares at the end of employment. Dividends on allocated shares increase participants accounts.

There were no contributions to the ESOP during the first nine months of 2023, as the annual loan payment will be made during the fourth quarter. Expense recorded was \$50,000 and \$48,000 for the three months ended September 30, 2023 and 2022, respectively, and \$152,000 and \$151,000 for the nine months ended September 30, 2023 and 2022, respectively, and is recognized over the service period.

Shares held by the ESOP were as follows:

	As of September 30,	
	2023	2022
	(Dollars in thousands)	
Shares allocated	22,009	—
Shares committed for allocation	16,212	12,960
Unallocated	393,615	418,876
Total ESOP shares	431,836	431,836
Fair value of unearned shares as of September 30, 2023 and 2022, respectively	\$ 3,562	\$ 4,532

Fair value of unearned shares is based on a stock price of \$9.05 and \$10.82 as of September 30, 2023 and 2022, respectively.

Equity Incentive Plan

At the Company's annual meeting of stockholders held on May 24, 2023, stockholders approved the NSTS Bancorp, Inc. 2023 Equity Incentive Plan ("2023 Equity Plan"), which provides for the granting of up to 755,714 shares (215,918 shares of restricted stock and 539,796 stock options) of the Company's common stock pursuant to equity awards made under the 2023 Equity Plan.

Stock options granted under the 2023 Equity Plan generally vest in equal annual installments over a service period of five years beginning one year from the date of grant. The vesting of the options accelerates upon death, disability or an involuntary termination at or following a change in control of the Company. Stock options are generally granted at an exercise price equal to the fair value of the Company's common stock on the grant date based on the closing market price of the Company's common stock on the date of grant, and have an expiration period of ten years. In June 2023, the Company granted 465,500 stock options under the 2023 Equity Plan. As of September 30, 2023, the Company has 74,296 stock options available for future grants under the 2023 Equity Plan.

The fair value of stock options granted is estimated utilizing the Black-Scholes option pricing model using the following assumptions: an expected life of 6.5 years, risk-free rate of 3.82%, volatility of 29.0% and a dividend yield of 0.0%. Due to the limited historical information of the Company's stock, management considered the weighted historical volatility of the common stock of the Company and other similar entities for an appropriate period in determining the volatility rate used in the estimation of fair value. The expected life of the stock option was estimated using the simplified method. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The Company recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards. Upon exercise of vested options, management expects to draw on treasury stock as the source for shares. There were no stock options granted during the three months ended September 30, 2023. The weighted average grant date fair value of stock options granted during the nine months ended September 30, 2023 was \$3.56.

The following table presents the stock based compensation expense for the periods presented.

	Three Months Ended September 30,		Nine months ended September 30,	
	2023	2022	2023	2022
	(Dollars in thousands)		(Dollars in thousands)	
Stock option expense	\$ 82	\$ —	\$ 96	\$ —
Restricted stock expense	88	—	102	—
Total stock based compensation expense	\$ 170	\$ —	\$ 198	\$ —

The following is a summary of the Company's stock option activity and related information for the periods presented. There was no stock option activity for the three and nine months ended September 30, 2022.

Stock Option	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at June 30, 2023	465,500	\$ 9.36	10.0
Granted	—	—	—
Forfeited	—	—	—
Outstanding at September 30, 2023	465,500	\$ 9.36	10.0
Exercisable - End of Period	—	—	—

Stock Option	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at December 31, 2022	—	\$ —	—
Granted	465,500	9.36	10.0
Forfeited	—	—	—
Outstanding at September 30, 2023	465,500	\$ 9.36	10.0
Exercisable - End of Period	—	—	—

Expected future expense relating to the non-vested options outstanding as of September 30, 2023 is \$1.6 million over a weighted average period of 4.7 years.

Restricted shares granted under the 2023 Equity Plan generally vest in equal annual installments over a service period of five years beginning one year from the date of grant. The vesting of the awards accelerates upon death, disability or an involuntary termination at or following a change in control of the Company. The product of the number of shares granted and the grant date closing market price of the Company's common stock determines the fair value of restricted shares under the 2023 Equity Plan. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period.

On June 15, 2023, the Company granted to employees, under the 2023 Equity Plan, 187,200 shares of restricted stock with a total grant-date fair value of \$1.8 million. These restricted stock awards vest in equal installments over a five-year period beginning one year from the date of grant. There were no shares of restricted stock granted during the three months ended September 30, 2023. As of September 30, 2023, the Company has 28,718 shares of restricted stock available for future grants under the 2023 Equity Plan.

The following is a summary of the status of the Company's restricted shares as of September 30, 2023 and changes thereto during the periods presented.

Restricted Stock	Shares	Weighted Average Grant Date Fair Value
Outstanding at June 30, 2023	187,200	\$ 9.36
Granted	—	—
Forfeited	—	—
Outstanding at September 30, 2023	187,200	\$ 9.36

Restricted Stock	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2022	—	\$ —
Granted	187,200	9.36
Forfeited	—	—
Outstanding at September 30, 2023	187,200	\$ 9.36

Expected future expense related to the non-vested restricted shares outstanding as of period end is \$1.6 million over a weighted average period of 4.7 years.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section is intended to assist in the understanding of our financial performance through a discussion of our financial condition as of September 30, 2023 and as compared to our financial condition as of December 31, 2022, and our results of operations for the three and nine months ended September 30, 2023 and 2022. This section should be read in conjunction with the unaudited interim consolidated financial statements and notes thereto appearing in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Forward-Looking Statements

This filing contains forward-looking statements, which can be identified by the use of words such as "estimate," "project," "believe," "intend," "anticipate," "plan," "seek," "expect" and words of similar meaning. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market areas, that are different than expected
- changes in the level and direction of loan delinquencies and charge-offs and changes in estimates of the adequacy of the allowance for credit losses;
- inflation and changes in the interest rate environment that reduce our margins and yields, reduce the fair value of financial instruments or reduce the origination levels in our lending business, or increase the level of defaults, losses and prepayments on loans;
- our ability to manage our liquidity and to access cost-effective funding, including significant fluctuations in our deposit accounts;
- major catastrophes such as tornadoes, floods or other natural disasters, the related disruption to local, regional and global economic activity and financial markets, and the impact that any of the foregoing may have on us and our customers and other constituencies;
- further data processing and other technological changes that may be more difficult or expensive than expected;
- success or consummation of new business initiatives may be more difficult or expensive than expected;
- the inability of third-party service providers to perform;
- fluctuations in real estate values and both residential and commercial real estate market conditions;
- demand for loans and deposits in our market area;
- our ability to continue to implement our business strategies;
- competition among depository and other financial institutions;
- adverse changes in the securities markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to manage market risk, credit risk and operational risk in the current economic conditions;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate any assets, liabilities, customers, systems and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- our ability to hire and retain key employees and our reliance on our executive officers; and
- our compensation expense associated with equity allocated or awarded to our employees.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Except as required by applicable law or regulation, we do not undertake, and we specifically disclaim any obligation, to update any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

General

On January 18, 2022, NSTS Bancorp, Inc. (“the Company”) became the holding company for North Shore Trust and Savings (“the Bank”) when North Shore MHC completed its conversion into the stock holding company form of organization. In connection with the conversion, the Company sold 5,290,000 shares of common stock at a price of \$10 per share, for gross proceeds of \$52.9 million. The Company also contributed 107,959 shares of common stock and \$150,000 in cash to North Shore Trust and Savings Charitable Foundation, Inc. Shares of the Company’s common stock began trading on January 19, 2022 on the Nasdaq Capital Market under the trading symbol “NSTS.”

NSTS Bancorp, Inc.

NSTS Bancorp, Inc. is a Delaware corporation which was incorporated in September 2021. As a savings and loan holding company, NSTS Bancorp, Inc. is regulated by the Board of Governors of the Federal Reserve System (“Federal Reserve Board”). The Company’s primary business activities relate to owning all of the outstanding shares of capital stock of the Bank.

The unaudited financial statements and other financial information contained in this Quarterly Report on Form 10-Q should be read in conjunction with NSTS Bancorp, Inc.’s Consolidated Financial Statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2022.

North Shore Trust and Savings

North Shore Trust and Savings, a federally-chartered stock savings institution, was established in 1921 as North Shore Building and Loan, an Illinois-chartered institution. The Bank is a wholly owned subsidiary of NSTS Bancorp, Inc., and operates as a traditional savings institution focused primarily on serving the banking needs of customers in our market area of Lake County, Illinois and adjacent communities. We operate from our headquarters and main banking office in Waukegan, Illinois, as well as two additional full-service branch offices located in Waukegan and Lindenhurst, Illinois, respectively. During the third quarter of 2023, we added additional loan production offices in Aurora and Plainfield, Illinois to complement the existing loan production office in Chicago, Illinois. Our primary business activity is attracting deposits from the general public and using those funds to originate one- to four-family residential mortgage loans and purchase investments. We are subject to comprehensive regulation and examination by the Office of the Comptroller of the Currency (the “OCC”).

Our Business and Franchise

For over 100 years, we have served Lake County, Illinois and the surrounding communities. We have established deep ties to the community and developed customer relationships which have spanned generations. We pride ourselves in matching our products and services to the needs of the community.

Our principal business consists of originating loans for one- to four-family residential properties, multi-family and non-owner occupied commercial real estate loans, and to a lesser extent home equity loans and lines of credit, construction loans, and other consumer loans in the market areas surrounding our branch footprint. We also established a loan production office in the Roscoe Village neighborhood of Chicago, Illinois in 2016 to originate loans outside of our branch network in a more densely populated metropolitan area, which we believe benefits us geographically. To complement the existing offices, during the third quarter of 2023, we established two additional loan production offices in Aurora and Plainfield, Illinois to expand our loan originations within the Chicagoland area. The lending teams operating in the Aurora and Plainfield, Illinois loan production offices originate as Oak Leaf Community Mortgage, a division of North Shore Trust and Savings. We attract retail deposits from the general public in the areas surrounding our main office and branches, offering a wide variety of deposit products. We also invest in investment securities. Our revenues are derived primarily from interest on loans, noninterest income from the sale of one- to four-family residential mortgage loans in the secondary market and interest on investments. Our primary sources of funds are deposits, and principal and interest payments on loans and securities.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated unaudited interim financial statements for the three and nine months ended September 30, 2023 and 2022, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results could differ from these estimates.

Of the significant accounting policies used in the preparation of our consolidated financial statements, we have identified certain items as critical accounting policies based on the associated estimates, assumptions, judgments and complexity. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies*” in our Annual Report on Form 10-K for the year ended December 31, 2022.

Determining the allowance for loan and lease losses has historically been identified as a critical accounting policy. On January 1, 2023, we adopted the new CECL accounting methodology which requires entities to estimate and recognize an allowance for lifetime expected credit losses for loans and other financial assets measured at amortized cost. Previously, an allowance for loan and lease losses was recognized based on probable incurred losses. The accounting estimates relating to the allowance for credit losses is also a “critical accounting policy” as:

- changes in the provision for credit losses can materially affect our financial results;
- estimates relating to the allowance for credit losses require us to project future borrower performance, including cash flows, delinquencies and charge-offs, along with, when applicable, collateral values, based on a reasonable and supportable forecast period utilizing forward-looking economic scenarios in order to estimate probability of default and loss given default;
- the allowance for credit losses is influenced by factors outside of our control such as industry and business trends, geopolitical events and the effects of laws and regulations as well as economic conditions such as trends in housing prices, interest rates, GDP, inflation, energy prices and unemployment; and
- considerable judgment is required to determine whether the models used to generate the allowance for credit losses produce an estimate that is sufficient to encompass the current view of lifetime expected credit losses.

Because our estimates of the allowance for credit losses involve judgment and are influenced by factors outside our control, there is uncertainty inherent in these estimates. Our estimate of lifetime expected credit losses is inherently uncertain because it is highly sensitive to changes in economic conditions and other factors outside of our control. Changes in such estimates could significantly impact our allowance and provision for credit losses. See Note 1 – *Basis of Presentation and Changes in Significant Accounting Policies* in the accompanying notes to the consolidated financial statements included elsewhere in this report for a discussion of our allowance for credit losses.

Overview

This discussion is intended to focus on certain financial information regarding our consolidated company and may not contain all the information that is important to the reader. The purpose of this discussion is to provide the reader with a more thorough understanding of our financial statements. As such, this discussion should be read carefully and in conjunction with the consolidated financial statements and accompanying notes contained elsewhere in this report.

Our results of operations depend, to a large extent, on net interest income, which is the difference between the income earned on our loan and investment portfolios and interest expense on deposits and borrowings. Our net interest income is largely determined by our net interest spread, which is the difference between the average yield earned on interest-earning assets and the average rate paid on interest-bearing liabilities, and the relative amounts of interest-earning assets and interest-bearing liabilities. Results of operations are also affected by our provisions for credit losses, fee income and other noninterest income and noninterest expense. Noninterest expense principally consists of compensation, office occupancy and equipment expense, data processing, advertising and business promotion and other expenses. We expect that our noninterest expenses will increase as we grow and expand our operations. Our results of operations and financial condition are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, changes in accounting guidance, government policies and actions of regulatory authorities.

Average Balances, Net Interest Income, and Yields Earned and Rates Paid. The following table shows for the periods indicated the total dollar amount of interest from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. All average balances are based on daily balances. The table also reflects the yields on the Company's interest-earning assets and costs of interest-bearing liabilities for the periods shown.

For the Three Months Ended September 30,

	2023			2022		
	Average Outstanding Balance	Interest	Average Yield/Rate	Average Outstanding Balance	Interest	Average Yield/Rate
(Dollars in thousands)						
Interest-earning assets:						
Loans, net	\$ 106,202	\$ 1,079	4.06%	\$ 96,751	\$ 877	3.63%
Federal funds sold and interest-bearing deposits in other banks	11,323	99	3.50%	24,480	111	1.81%
Time deposits with other financial institutions	1,842	21	4.56%	4,243	14	1.32%
Securities available for sale	114,417	733	2.56%	127,644	682	2.14%
FHLB stock	550	7	5.09%	550	4	2.91%
Total interest-earning assets	234,334	\$ 1,939	3.31%	253,668	\$ 1,688	2.66%
Noninterest-earning assets	21,373			20,618		
Total assets	\$ 255,707			\$ 274,286		
Interest-bearing liabilities:						
Interest-bearing demand	\$ 15,661	\$ 3	0.08%	\$ 17,547	\$ 2	0.05%
Money market	35,549	57	0.64%	46,497	24	0.21%
Savings	44,788	17	0.15%	48,489	18	0.15%
Time deposits	57,467	285	1.98%	60,699	148	0.98%
Total interest-bearing deposits	\$ 153,465	\$ 362	0.94%	\$ 173,232	\$ 192	0.44%
Other borrowings(1)	5,000	61	4.88%	—	—	—%
Total interest-bearing liabilities	158,465	\$ 423	1.07%	173,232	\$ 192	0.44%
Noninterest-bearing liabilities	17,438			17,554		
Total liabilities	\$ 175,903			\$ 190,786		
Equity	79,804			83,500		
Total liabilities and equity	\$ 255,707			\$ 274,286		
Net interest income		\$ 1,516			\$ 1,496	
Interest rate spread(2)			2.24%			2.22%
Net interest-earning assets(3)	\$ 75,869			\$ 80,436		
Net interest margin(4)			2.59%			2.36%
Average interest-earning assets to average-interest bearing liabilities	147.88%			146.43%		

For the Nine Months Ended September 30,							
	2023			2022			
	Average Outstanding Balance	Interest	Average Yield/ Rate	Average Outstanding Balance	Interest	Average Yield/ Rate	
	(Dollars in thousands)						
Interest-earning assets:							
Loans, net	\$ 105,084	\$ 3,119	3.96%	\$ 96,726	\$ 2,603	3.59%	
Federal funds sold and interest-bearing deposits in other banks	8,827	210	3.17%	47,288	213	0.60%	
Time deposits with other financial institutions	3,089	75	3.24%	3,810	25	0.87%	
Securities available for sale	118,339	2,225	2.51%	116,683	1,638	1.87%	
FHLB stock	550	16	3.88%	550	11	2.67%	
Total interest-earning assets	235,889	\$ 5,645	3.19%	265,057	\$ 4,490	2.26%	
Noninterest-earning assets	21,227			20,491			
Total assets	\$ 257,116			\$ 285,548			
Interest-bearing liabilities:							
Interest-bearing demand	\$ 17,157	\$ 7	0.05%	\$ 17,492	\$ 7	0.05%	
Money market	38,237	173	0.60%	45,751	69	0.20%	
Savings	46,777	53	0.15%	48,595	55	0.15%	
Time deposits	54,182	612	1.51%	63,261	443	0.93%	
Total interest-bearing deposits	\$ 156,353	\$ 845	0.72%	\$ 175,099	\$ 574	0.44%	
Other borrowings(1)	1,886	68	4.81%	2,601	0	—%	
Total interest-bearing liabilities	158,239	\$ 913	0.77%	177,700	\$ 574	0.43%	
Noninterest-bearing liabilities	11,488			24,993			
Total liabilities	\$ 169,727			\$ 202,693			
Equity	87,389			82,855			
Total liabilities and equity	\$ 257,116			\$ 285,548			
Net interest income		\$ 4,732			\$ 3,916		
Interest rate spread(2)			2.42%			1.83%	
Net interest-earning assets(3)	\$ 77,650			\$ 87,357			
Net interest margin(4)			2.67%			1.97%	
Average interest-earning assets to average- interest bearing liabilities	149.07%			149.16%			

- (1) For the periods ended September 30, 2022, Other borrowings consists of 0% interest rate FHLB advances.
(2) Equals the difference between the yield on average earning-assets and the cost of average interest-bearing liabilities.
(3) Equals total interest-earning assets less total interest-bearing liabilities.
(4) Equals net interest income divided by average interest-earning assets.

COMPARISON OF OPERATING RESULTS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2023 AND 2022

General. For the three months ended September 30, 2023, we had a net loss of \$232,000, compared to net income of \$118,000 for the three months ended September 30, 2022. The decrease in net income is primarily the result of an increase in the interest expense, provision for credit losses and an increase in noninterest expenses. For the nine months ended September 30, 2023, we had a net loss of \$188,000, compared to a net loss of \$12,000 for the nine months ended September 30, 2022. The increase in net loss is primarily the result of a decrease in noninterest income and an increase in noninterest expense. Net interest income after provision for credit losses increased, partially offsetting the increase in net losses.

Net Interest Income. Net interest income remained relatively flat, with an increase of \$20,000 for the three months ended September 30, 2023 compared to the same period ended September 30, 2022. Our interest rate spread increased to 2.24% for the three months ended September 30, 2023 from 2.22% for the same period ended September 30, 2022. Our net interest margin increased to 2.59% for the three months ended September 30, 2023, compared to 2.36% for the three months ended September 30, 2022. Interest earned on earning assets increased \$251,000, to \$1.9 million, with an increased yield on earning assets of 3.31%, or an increase of 65 basis points. The increase is primarily due to an increase in yield on loans, which increased 44 basis points, or \$202,000, during the period compared to the prior year. Additionally, the yield on investment securities increased 43 basis points, or \$51,000, during the quarter ended September 30, 2023 compared to the same period ended September 30, 2022, due to an increase in market rates available at the time of purchase. Average interest-earning assets of \$234.3 million in 2023 decreased \$19.4 million compared to 2022. The decrease in average earning assets was driven by an increase in the unrealized loss on the securities available-for-sale portfolio. The average outstanding balance of loans, net increased to \$106.2 million, an increase of \$9.4 million for the three months ended September 30, 2023.

Net interest income increased \$816,000, to \$4.7 million for the nine months ended September 30, 2023 compared to \$3.9 million for the nine months ended September 30, 2022. Our interest rate spread increased to 2.42% for the nine months ended September 30, 2023 from 1.83% for the same period ended September 30, 2022. Our net interest margin increased to 2.67% for the nine months ended September 30, 2023, compared to 1.97% for the nine months ended September 30, 2022. The increase in interest rate spread and net interest margin was primarily the result of the deployment of funds from the conversion into higher yielding assets, such as securities available-for-sale, offset by rising deposit costs.

Average interest-earning assets of \$235.9 million for the nine months ended September 30, 2023 decreased \$29.2 million compared to the same period ended September 30, 2022. The decrease in average earning assets was driven by the refunds issued on the stock oversubscription in the prior year. The average outstanding balance of loans, net increased to \$105.1 million, an increase of \$8.4 million for the nine months ended September 30, 2023. Additionally, the average yield earned on those loans outstanding increased 37 basis points to 3.96% for the nine months ended September 30, 2023, which is the result of new originations made at higher market rates. During the third quarter ended September 30, 2023, the Bank expanded our mortgage lending department by hiring a mortgage lending team, operating as Oak Leaf Community Mortgage, a division of North Shore Trust and Savings. This mortgage lending team offers a variety of different products including higher yielding loans with additional upfront fees. An increase in the average yield earned on loans is expected during the fourth quarter of 2023 and into 2024. Additionally, interest earned on securities available-for-sale increased \$587,000 due to a higher average balance of securities available-for-sale of \$118.3 million and a higher average yield of 2.51%. The increased yield on securities available-for-sale was the result of an overall increase in market rates available at the time of purchase throughout 2022. Management was able to invest the cash received as part of the conversion into these higher yielding assets, resulting in an overall increase in interest income of \$1.2 million.

The cost of interest-bearing deposits increased 50 basis points, to 0.94%, for the three months ended September 30, 2023 compared to the three months ended September 30, 2022. The cost of interest-bearing deposits increased 28 basis points for the nine months ended September 30, 2023 compared to the nine months ended September 30, 2022. The net increase in our funding costs for 2023 was primarily due to an increase in rates offered on money market accounts, which were increased in the fourth quarter of 2022 and the first quarter of 2023 to remain competitive with the local market. Additionally, the Bank offered CD specials during the second and third quarters of 2023 to attract and retain customers.

During 2023, the Bank borrowed \$5.0 million from FHLB Chicago at a rate of 4.78%, resulting in an interest expense of \$61,000 and \$68,000 during the three and nine months ended September 30, 2023, respectively.

Provision for Credit Losses. The allowance for credit losses, including the allowance for credit losses on loans, allowance for credit losses on off-balance sheet liabilities and the allowance for credit losses on available-for-sale securities, is established through a provision for credit losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. On January 1, 2023, we adopted ASU No. 2016-13, *Financial Instruments— Credit Losses (Topic 326)*. As a result of the adoption of this new standard, we recorded a reduction to retained earnings of approximately \$279,000, which was net of the \$110,000 deferred tax asset impact stemming from adoption.

For the three months ended September 30, 2023, a provision for credit losses was recorded based on the current allowance for credit loss ("ACL") assessment. The increase in ACL was not considered part of the ASU 2016-13 adoption, as these changes in the assessment of the ACL occurred after the January 1, 2023 adoption. We recorded a provision for credit losses of \$50,000 during the third quarter of 2023, comprised of \$51,000 in provision of credit losses to loans and a \$1,000 reversal of credit losses related to unfunded commitments. During the nine months ended September 30, 2023, we recorded a provision for credit losses of \$52,000, comprised of \$53,000 in provision for credit losses to loans and a \$1,000 reversal of credit losses related to unfunded commitments. We will continue to assess and evaluate the estimated future credit loss impact of current market conditions in subsequent reporting periods, which will be highly dependent on credit quality, macroeconomic forecasts and conditions, as well as the composition of our loan and available-for-sale securities portfolios.

Noninterest Income. The following table shows the components of noninterest income for the periods presented.

Noninterest income:	Three months ended September 30,		Nine months ended September 30,	
	2023	2022	2023	2022
	(Dollars in thousands)			
Gain on sale of mortgage loans	\$ —	\$ 30	\$ 9	\$ 99
Rental income on office building	16	16	48	37
Service charges on deposits	70	75	203	222
Increase in cash surrender value of BOLI	49	45	141	132
Other	15	19	43	572
Total noninterest income	\$ 150	\$ 185	\$ 444	\$ 1,062

For the three months ended September 30, 2023 compared to the three months ended September 30, 2022, noninterest income decreased \$35,000 as a result of decrease in the gain on sale of mortgage loans. There were no mortgage loans sold during the quarter. For the nine months ended September 30, 2023 compared to the same period ended September 30, 2022, noninterest income decreased \$618,000 as a result of decrease in the gain on sale of mortgage loans and decrease in other noninterest income. The decrease in gain on sale of mortgages was due to a reduction in the number of loans sold primarily due to an overall decrease in total loans originated during the period. Other non-interest income in 2022 included the Employee Retention Credit of \$502,000.

Noninterest Expense. The following table shows the components of noninterest expense for the periods presented.

Noninterest expense:	Three months ended September 30,		Nine months ended September 30,	
	2023	2022	2023	2022
	(Dollars in thousands)			
Salaries and employee benefits	\$ 1,162	\$ 938	\$ 3,095	\$ 2,842
Equipment and occupancy	166	154	499	496
Data processing	159	159	481	461
Professional services	150	141	394	411
Advertising	14	29	65	67
Supervisory fees and assessments	49	33	123	111
Loan expenses	25	16	69	65
Deposit expenses	56	61	163	149
Director fees	56	59	168	172
Other	116	88	353	383
Total noninterest expense	\$ 1,953	\$ 1,678	\$ 5,410	\$ 5,157

Noninterest expense increased \$275,000 for the three months ended September 30, 2023 compared to the same period ended September 30, 2022. The increase in noninterest expense is primarily related to an increase in salaries and employee benefits, which increased \$224,000 during the quarter ended September 30, 2023 compared to the same period ended September 30, 2022, due to the implementation of the 2023 Equity Incentive Plan, which had total expenses of \$170,000 for the quarter ended September 30, 2023.

Noninterest expense increased \$253,000 for the nine months ended September 30, 2023 compared to the same period ended September 30, 2022. The increase is primarily driven by an increase in salaries and employee benefits, deposit expenses and data processing expenses. Salaries and employee benefits increased 8.9% primarily as a result of the introduction of the 2023 Equity Incentive Plan on June 15, 2023, as well as merit increases to employees and health insurance premiums.

During the third quarter ended September 30, 2023, as part of the strategic growth initiatives, the Bank hired a mortgage lending team of 10 individuals, operating as Oak Leaf Community Mortgage, a division of North Shore Trust and Savings. These additional employees joined the Bank between September 11, 2023 and October 2, 2023. Additional expenses related to salaries and benefits for these employees is anticipated in the fourth quarter and into 2024. Deposit expenses increased due to necessary repairs on ATMs during the first quarter of 2023. Data processing expenses increased due to the addition of new employees during the year.

Provision for Income Tax Expense (Benefit). During the three months ended September 30, 2023, the Bank recorded income tax benefit of \$105,000. During the nine months ended September 30, 2023, the Bank recorded income tax benefit of \$98,000, consisting of \$198,000 current tax benefit and \$100,000 change in valuation allowance. Management estimates a taxable net loss for the year ended December 31, 2023 due to non-taxable income, such as income on tax exempt municipal securities and BOLI.

Federal net operating losses as of September 30, 2023 are estimated to be \$4.0 million, of which \$1.3 million is subject to expire in five years, the remainder does not expire. During the quarter ended September 30, 2023, management assessed the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing net operating losses. A significant piece of objective negative evidence evaluated is the cumulative taxable loss incurred over the three-year period ended September 30, 2023. Such objective evidence limits the ability to consider other subjective evidence, such as our projections for future growth. On the basis of this evaluation, as of September 30, 2023, a valuation allowance of \$505,000, against the \$843,000 asset value of the \$4.0 million federal net operating losses has been recorded to recognize only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted, and an additional valuation allowance recorded, if estimates of future taxable income during the carryforward period are reduced or if objective negative evidence in the form of cumulative losses is present and additional weight cannot be given to subjective evidence such as our projections for growth.

COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2023 AND DECEMBER 31, 2022

	<u>At September 30,</u> <u>2023</u>	<u>At December 31,</u> <u>2022</u>
	(Dollars in thousands)	
Selected Consolidated Financial Condition Data:		
Cash and cash equivalents	\$ 10,689	\$ 13,147
Time deposits with other financial institutions	1,742	4,477
Securities available for sale	109,526	121,205
FHLB stock	550	550
Loans, net	106,810	103,359
Total assets	251,786	264,206
Total deposits	165,330	178,714
Other borrowings	5,000	—
Total equity	\$ 77,161	\$ 80,542

Total Assets. Total assets decreased \$12.4 million to \$251.8 million as of September 30, 2023 compared to \$264.2 million at December 31, 2022. The decrease was primarily due to a reduction in securities available for sale, time deposits with other financial institutions and cash and cash equivalents driven by a reduction in deposits.

Cash and cash equivalents. Cash and cash equivalents decreased \$2.5 million to \$10.7 million as of September 30, 2023 from \$13.1 million at December 31, 2022. The reduction in cash was the result of a reduction in deposit balances during the nine months ended September 30, 2023. The reduction in cash due to deposit outflows was partially offset due to the Bank borrowing \$5.0 million from the FHLB Chicago during the second quarter of 2023, as well as principal and interest payments received on the securities available for sale portfolio. Management continues to actively monitor our liquidity position on a daily basis and maintain levels of liquid assets deemed adequate.

Time deposits with other financial institutions. Time deposits with other financial institutions decreased \$2.8 million to \$1.7 million as of September 30, 2023, compared to \$4.5 million at December 31, 2022. The decrease is due to maturities within the portfolio. Management has redeployed the maturing time deposits to higher yielding loan originations.

Securities Available for Sale. Securities available-for-sale decreased to \$109.5 million as of September 30, 2023, compared to \$121.2 million at December 31, 2022. There were no purchases or sales of securities available-for-sale during the nine months ended September 30, 2023. During the nine months ended September 30, 2023, the Bank received principal and interest payments of \$6.5 million, had calls and maturities of \$2.1 million, had net premium amortization and discount accretion of \$412,000 and had an increase in the unrealized loss on the portfolio of \$2.7 million.

As of September 30, 2023, the securities available for sale portfolio included an unrealized loss position of \$18.2 million, or 14.3% of the total book value of the portfolio. Management monitors the portfolio for credit losses and believes that the decline in value does not presently represent realized losses and is due to market volatility and increased market interest rates. While the Bank does not currently intend to sell securities in a loss position, management may consider the opportunity to reposition the investment securities portfolio in the future.

Loans, net. Our loans, net, increased by \$3.5 million to \$106.8 million at September 30, 2023 compared to \$103.3 million at December 31, 2022. The Bank originated \$12.6 million in loans to be held in the portfolio during the nine months ended September 30, 2023. Additionally, during the nine months ended September 30, 2023, loan principal payments and paydowns totaled \$8.7 million.

During the three months ended September 30, 2023, the Bank expanded the residential mortgage lending department with the hire of the Oak Leaf Community Mortgage team. The team consists of two senior mortgage loan originators and an additional support staff of eight. Oak Leaf Community Mortgage focuses on 1-4 family residential lending within the expanded Chicagoland area.

As of January 1, 2023, the Bank adopted ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. The Company recorded a reduction to retained earnings of approximately \$278,000 upon adoption of ASU 2016-13. The transition adjustment included an increase to the allowance for credit losses on loans of \$384,000 and an increase to the allowance for credit losses on off-balance sheet credit exposure of \$5,000. The transition adjustment included a corresponding increase in deferred tax assets. As of September 30, 2023, the allowance for credit losses (“ACL”) which includes the allowance for credit losses on loans, and the allowance for credit losses on off-balance sheet exposures, totaled \$1.1 million, an increase of \$53,000 from the date of adoption. As of September 30, 2023, there were two loans rated substandard or watch which were individually assessed, totaling \$139,000, of which none had specific reserves. Additionally, the Bank individually assessed the residential construction loan, noting no specific reserve was required as of September 30, 2023.

Deposits. Total deposits decreased \$13.4 million to \$165.3 million at September 30, 2023 compared to \$178.7 million at December 31, 2022, representing a decrease of 7.5%. During the nine months ended September 30, 2023, the deposits decreased as a result of various large customers moving money to higher yielding accounts outside the Bank. The decrease in deposits was primarily out of the money market and savings accounts. During the third quarter ended September 30, 2023, time deposits increased \$6.4 million to \$60.6 million as of September 30, 2023 compared to \$54.2 million as of June 30, 2023, as a result of special CD offers. Approximately \$4.7 million of the increase represents money coming into the bank, as opposed to money transferring between accounts within the bank. Management continues to actively monitor the deposit balances and interest rates offered to maintain an adequate level of liquidity.

Other borrowings. During the nine months ended September 30, 2023, the Bank borrowed \$5.0 million from the FHLB Chicago with a term of 24 months at 4.78%.

Total Equity. Total equity decreased \$3.4 million to \$77.2 million at September 30, 2023 primarily due to an increase in the unrealized loss position on the securities available-for-sale portfolio and the repurchase of outstanding shares. The increase in the unrealized loss position of \$1.9 million is due to changes in market interest rates. Additionally, during the nine months ended September 30, 2023, the Bank began repurchasing outstanding shares as part of the Board approved share repurchase program. As of September 30, 2023, the Bank has repurchased 152,681 shares, for a total value of \$1.4 million.

Asset Quality

The following table sets forth certain information with respect to our nonperforming assets. The decrease in non-accrual loans from December 31, 2022 to September 30, 2023 was the result of payments made on the non-accrual loans.

	<u>At September 30,</u> <u>2023</u>	<u>At December 31,</u> <u>2022</u>
	(Dollars in thousands)	
Nonaccrual loans	\$ 139	\$ 154
Loans 90+ days past due and accruing	64	—
Total non-performing loans	203	154
Other real estate owned, net	—	—
Total non-performing assets	\$ 203	\$ 154
Asset Quality Ratios: (1)		
Non-accrual loans as a percent of total loans outstanding	0.13%	0.15%
Non-performing assets as a percent of total assets	0.08%	0.06%
Allowance for credit losses on loans as a percent of total loans outstanding	0.99%	0.61%
Allowance for credit losses on loans as a percent of non-performing loans(2)	522.66%	405.19%
Net charge-offs (recoveries) to average loans receivable	—%	(0.08)%

(1) Asset quality ratios and capital ratios are end of period ratios, except for net charge-offs to average loans receivable.

(2) Non-performing loans consist of non-accrual loans and loans that are 90 or more days past due and still accruing.

The allowance for credit losses on loans as a percentage of total loans as of September 30, 2023 was 0.99%. The allowance for loan losses as a percentage of total loans at December 31, 2022 was 0.61%. The increase is due to the adoption of ASU 2016-13, *Financial Instruments— Credit Losses (Topic 326)*.

Liquidity and Capital Resources

The Bank maintains levels of liquid assets deemed adequate by management. We adjust our liquidity levels to fund deposit outflows, repay our borrowings, and to fund loan commitments. We also adjust liquidity, as appropriate, to meet asset and liability management objectives.

Liquidity describes our ability to meet the financial obligations that arise in the ordinary course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of our customers and to fund current and planned expenditures. Our primary sources of funds are deposits, principal and interest payments on loans and securities, and proceeds from maturities of securities. We also have the ability to borrow from the FHLB of Chicago and a \$10.0 million unsecured Fed Funds line of credit with BMO Harris Bank. At September 30, 2023, we had one outstanding advance from the FHLB of Chicago totaling \$5.0 million and had the capacity to borrow approximately \$64.3 million additional from the FHLB of Chicago. Additionally, we had no outstanding balance under our \$10.0 million federal funds line of credit with BMO Harris Bank.

While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions, and competition. Our most liquid assets are cash and short-term investments. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period.

Our cash flows are comprised of three primary classifications: cash flows from operating activities, investing activities, and financing activities. Net cash provided by operating activities was \$363,000 and \$3.4 million for the nine months ended September 30, 2023 and 2022, respectively. Net cash provided by (used in) investing activities, which consists primarily of net change in loans receivable and net change in investment securities, was \$7.4 million and \$(44.4) million for the nine months ended September 30, 2023 and 2022, respectively, with the decrease in cash used during 2023 driven by the absence of purchases of securities held in the available for sale portfolio. Net cash used in financing activities, consisting primarily of the activity in deposit accounts, receipt of FHLB advance in 2023 and proceeds from the issuance of common stock in 2022, was \$10.2 million and \$62.5 million for the nine months ended September 30, 2023 and 2022, respectively.

We are committed to maintaining a strong liquidity position. We monitor our liquidity position on a daily basis. We anticipate that we will have sufficient funds to meet our current funding commitments. Time deposits that are scheduled to mature in less than one year from September 30, 2023, totaled \$39.5 million. Based on our deposit retention experience and current pricing strategy, and notwithstanding recent deposit outflows during the first nine months of 2023, we anticipate that a significant portion of maturing time deposits will be retained. However, if a substantial portion of these deposits is not retained, we may utilize FHLB of Chicago advances or raise interest rates on deposits to attract new accounts, which may result in higher levels of interest expense.

As of September 30, 2023, the Bank was well capitalized under the regulatory framework for prompt corrective action. During the year ended December 31, 2020, the Bank elected to begin using the CBLR. Under CBLR, if a qualifying depository institution or depository institution holding company elects to use such measure, such institution or holding company will be considered well capitalized if its ratio of Tier 1 capital to average total consolidated assets (i.e., leverage ratio) exceeds 9%, subject to a limited two quarter grace period, during which the leverage ratio cannot go 100 basis points below the then applicable threshold, and will not be required to calculate and report risk-based capital ratios. North Shore Trust and Savings' Tier 1 capital to Average Assets was 25.81% and 24.81% at September 30, 2023 and December 31, 2022, respectively.

Off-Balance Sheet Arrangements. At September 30, 2023, we had \$2.8 million of outstanding commitments to originate loans. Our total letters and lines of credit and unused lines of credit totaled \$4.2 million at September 30, 2023.

Commitments. The following table summarizes our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and undisbursed construction loans at September 30, 2023.

	Total Amounts Committed at September 30, 2023	Amount of Commitment Expiration – Per Period			
		To 1 Year	1-3 Years	4-5 Years	After 5 Years
		(Dollars in thousands)			
Unused line of credit	\$ 4,196	\$ 509	\$ 937	\$ 332	\$ 2,418
Commitments to originate loans	2,823	2,823	—	—	—
Total commitments	\$ 7,019	\$ 3,332	\$ 937	\$ 332	\$ 2,418

Contractual Cash Obligations. The following table summarizes our contractual cash obligations at September 30, 2023.

	Total at September 30, 2023	Payments Due By Period			
		To 1 Year	1-3 Years	4-5 Years	After 5 Years
		(Dollars in thousands)			
Time deposits	\$ 60,561	\$ 39,535	\$ 15,254	\$ 5,772	\$ —
FHLB advances	5,000	—	5,000	—	—
Total contractual obligations	\$ 65,561	\$ 39,535	\$ 20,254	\$ 5,772	\$ —

Impact of Inflation and Changing Prices

The consolidated financial statements and the accompanying notes presented elsewhere in this document have been prepared in accordance with U.S. GAAP, which generally requires the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. Unlike most industrial companies, virtually all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Changes in Accounting Principles

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*,” also known as Current Expected Credit Losses, or CECL. ASU 2016-13 was issued to provide financial statement users with more useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date to enhance the decision making process. The CECL model utilizes a lifetime “expected credit loss” measurement objective for the recognition of credit losses for loans, held-to-maturity securities, and other receivables at the time the financial asset is originated or acquired. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. For available for-sale securities where fair value is less than cost, credit-related impairment, if any, will be recognized in an allowance for credit losses and adjusted each period for changes in expected credit risk. This model replaces the multiple existing impairment models, which generally require that a loss be incurred before it is recognized.

We adopted ASU 2016-13 using the current expected credit loss (“CECL”) methodology for financial assets measured at amortized cost, effective January 1, 2023. Results for the periods beginning after January 1, 2023 are presented under ASU 2016-13, while prior period amounts are reported in accordance with the previously applicable accounting standards. The Company recorded a reduction to retained earnings of approximately \$279,000 upon adoption of ASU 2016-13. The transition adjustment included an increase to the allowance for credit losses on loans of \$384,000 and an increase to the allowance for credit losses on off-balance sheet credit exposure of \$5,000. The transition adjustment included a corresponding increase in deferred tax assets.

The following table illustrates the impact of ASU 2016-13 adoption:

	Allowance for credit losses as reported under ASU 2016-13	Allowance pre-ASU 2016-13 Adoption	Impact on Allowance of ASU 2016-13 Adoption
	(Dollars in thousands)		
Assets:			
First mortgage loans			
1-4 family residential	\$ 916	\$ 581	\$ 335
Multi-family	42	19	23
Commercial	48	19	29
Consumer loans	2	5	(3)
Allowance for credit losses for all loans	<u>\$ 1,008</u>	<u>\$ 624</u>	<u>\$ 384</u>
Liabilities:			
Allowance for credit losses on off-balance sheet exposures	<u>\$ 5</u>	<u>\$ —</u>	<u>\$ 5</u>

In March 2022, FASB issued ASU 2022-02, *Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*. The amendments in this update eliminate the accounting guidance and related disclosures for TDRs by creditors in Subtopic 310-40, *Receivables—Troubled Debt Restructurings by Creditors*, while enhancing disclosure requirements for certain loan refinancings and restructurings by creditors when a borrower is experiencing financial difficulty and requiring an entity to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20, *Financial Instruments—Credit Losses—Measured at Amortized Cost*. The amendments in this update are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years and are applied prospectively, except with respect to the recognition and measurement of TDRs, where an entity has the option to apply a modified retrospective transition method. Early adoption of the amendments in this update is permitted. An entity may elect to early adopt the amendments regarding TDRs and related disclosure enhancements separately from the amendments related to vintage disclosures.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required for smaller reporting companies.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to provide assurance that the information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the principal executive officer and principal financial officer concluded that, as of September 30, 2023, our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and is accumulated and communicated to the Company's management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2023, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

We are not presently involved in any legal proceedings of a material nature. From time to time, we are subject to various legal actions arising in the normal course of our business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 1A. RISK FACTORS

Not required for smaller reporting companies.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**Issuer Purchases of Equity Securities**

The following table reports information regarding repurchases of our common stock during the quarter ended September 30, 2023, and the stock repurchase plans approved by our Board of Directors.

Period	(a) Total number of Shares Purchased (1)	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased As part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet to be Purchased Under the Plans or Programs (1)
July 1 - July 31, 2023	13,589	\$ 9.19	13,589	182,014
August 1 - August 31, 2023	13,865	9.01	13,865	168,149
September 1 - September 30, 2023	50,932	8.97	50,932	117,217
Total	78,386	\$ 9.01	78,386	117,217

(1) On March 29, 2023, the Company adopted a program to repurchase up to 269,898 shares, or 5%, of its then outstanding common stock. The original program expired on September 29, 2023 and was extended with a new expiration date of September 30, 2024, unless terminated earlier; 117,217 shares remain available to be repurchased under the program as of September 30, 2023.

As of October 30, 2023, the Company has repurchased all of the shares remaining available to be repurchased pursuant to the terms of the existing stock repurchase program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 31.1 [Certification pursuant to Rule 13a-14\(a\) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Steven G. Lear, President and Chief Executive Officer.](#)
- 31.2 [Certification pursuant to Rule 13a-14\(a\) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, of Carissa H. Schoolcraft, Chief Financial Officer.](#)
- 32.1 [Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Stephen G. Lear, President and Chief Executive Officer, and Carissa H. Schoolcraft, Chief Financial Officer*.](#)
- 101.INS Inline XBRL Instance Document (the Instance Document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
- 101.SCH Inline XBRL Taxonomy Extension Schema Document
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document
- 104 Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

*The certification attached as Exhibit 32.1 to this quarterly report on Form 10-Q is “furnished” to the Securities and Exchange Commission pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed “filed” by the Registrant for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

**Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Stephen G. Lear, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of NSTS Bancorp, Inc. (the "Registrant"):
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: November 13, 2023

/s/ Stephen G. Lear

Stephen G. Lear
President and Chief Executive Officer
(Principal Executive Officer)

**Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Carissa H. Schoolcraft, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of NSTS Bancorp, Inc. (the "Registrant"):
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: November 13, 2023

/s/ Carissa H. Schoolcraft

Carissa H. Schoolcraft
Chief Financial Officer
(Principal Financial and Accounting Officer)

**Certification of Principal Executive Officer and Principal Financial Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

Stephen G. Lear, Chief Executive Officer of NSTS Bancorp, Inc. (the “Company”) and Carissa H. Schoolcraft, Chief Financial Officer of the Company, each hereby certifies in his or her capacity as an officer of the Company that he or she has reviewed the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2023 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), and that to the best of his or her knowledge:

- 1.The Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2.The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 13, 2023

By: /s/ Stephen G. Lear
Stephen G. Lear
President Chief Executive Officer
(Principal Executive Officer)

Dated: November 13, 2023

By: /s/ Carissa H. Schoolcraft
Carissa H. Schoolcraft
Chief Financial Officer
(Principal Financial and Accounting Officer)