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

FORM 10-Q

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

For the quarterly period ended September 30, 2021

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

For the transition period from ________ to ________

NATIONAL BANKSHARES, INC.

(Exact name of registrant as specified in its charter)
Commission File Number 0-15204

Virginia	54-1375874
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Hubbard Street
Blacksburg, Virginia 24062-9002
(Address of principal executive offices)

(540) 951-6300
(Registrant's telephone number, including area code)

(Not applicable)
(Former name, former address and former fiscal year, if changed since last report)

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, par value $1.25 per share	**NKSH**	**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. [x] 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). [x] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 [ ] Accelerated filer [ ] Non-accelerated filer [x] Smaller reporting company [x] Emerging growth company [ ]

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 [x]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Outstanding shares of common stock at November 9, 2021</u>
6,087,758

NATIONAL BANKSHARES, INC.
Form 10-Q
Index

Part I

Item 1. Financial Statements **Financial Information**

National Bankshares, Inc.

Consolidated Balance Sheets

(in thousands, except share and per share data)	(Unaudited) September 30, 2021	December 31, 2020
Assets		
Cash and due from banks	$ **11,728**	$ 13,147
Interest-bearing deposits	**118,863**	120,725
Securities available for sale, at fair value	**641,486**	546,742
Restricted stock, at cost	**845**	1,279
Loans held for sale	**235**	866
Loans:		
Loans, net of unearned income and deferred fees and costs	**797,494**	768,799
Less allowance for loan losses	**(7,698)**	(8,481)
Loans, net	**789,796**	760,318
Premises and equipment, net	**9,823**	10,035
Accrued interest receivable	**5,161**	5,028
Other real estate owned, net	**957**	1,553
Goodwill	**5,848**	5,848
Bank-owned life insurance	**42,108**	36,444
Other assets	**17,181**	17,688
Total assets	$ **1,644,031**	$ 1,519,673
Liabilities and Stockholders' Equity		
Noninterest-bearing demand deposits	$ **328,893**	$ 276,793
Interest-bearing demand deposits	**819,730**	763,293
Savings deposits	**201,656**	167,475
Time deposits	**82,455**	89,582
Total deposits	**1,432,734**	1,297,143
Accrued interest payable	**46**	56
Other liabilities	**20,398**	21,867
Total liabilities	**1,453,178**	1,319,066
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, no par value, 5,000,000 shares authorized; none issued and outstanding	**-**	-
Common stock of $1.25 par value. Authorized 10,000,000 shares; issued and outstanding 6,096,958 at September 30, 2021 and 6,432,020 shares at December 31, 2020	**7,621**	8,040
Retained earnings	**188,693**	189,547
Accumulated other comprehensive income (loss), net	**(5,461)**	3,020
Total stockholders' equity	**190,853**	200,607
Total liabilities and stockholders' equity	$ **1,644,031**	$ 1,519,673

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Income
Three Months Ended September 30, 2021 and 2020
(Unaudited)

(in thousands, except share and per share data)	September 30, 2021	September 30, 2020
Interest Income		
Interest and fees on loans	**$ 9,088**	$ 8,606
Interest on interest-bearing deposits	**56**	17
Interest on securities – taxable	**2,043**	1,572
Interest on securities – nontaxable	**469**	513
Total interest income	**11,656**	10,708
Interest Expense		
Interest on time deposits	**61**	395
Interest on other deposits	**658**	1,025
Total interest expense	**719**	1,420
Net interest income	**10,937**	9,288
Provision for (recovery of) loan losses	**(392)**	154
Net interest income after provision for (recovery of) loan losses	**11,329**	9,134
Noninterest Income		
Service charges on deposit accounts	**548**	471
Other service charges and fees	**50**	37
Credit and debit card fees, net	**460**	339
Trust income	**433**	423
BOLI income	**248**	219
Gain on sale of mortgage loans	**76**	165
Other income	**177**	258
Realized securities gain, net	**-**	14
Total noninterest income	**1,992**	1,926
Noninterest Expense		
Salaries and employee benefits	**3,909**	3,511
Occupancy, furniture and fixtures	**447**	452
Data processing and ATM	**728**	799
FDIC assessment	**120**	87
Net costs of other real estate owned	**11**	18
Franchise taxes	**367**	331
Other operating expenses	**785**	922
Total noninterest expense	**6,367**	6,120
Income before income taxes	**6,954**	4,940
Income tax expense	**1,202**	772
Net Income	**$ 5,752**	$ 4,168
Basic net income per common share	**$ 0.94**	$ 0.64
Fully diluted net income per common share	**$ 0.94**	$ 0.64
Weighted average number of common shares outstanding, basic and diluted	**6,142,538**	6,489,574
Dividends declared per common share	**-**	-

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Comprehensive Income
Three Months Ended September 30, 2021 and 2020
(Unaudited)

(in thousands)	September 30, 2021		September 30, 2020	
Net Income	**$**	**5,752**	$	4,168
Other Comprehensive Income (Loss), Net of Tax				
Unrealized holding gain (loss) on available for sale securities net of tax of ($905) and $601 for the periods ended September 30, 2021 and September 30, 2020, respectively		**(3,403)**		2,256
Reclassification adjustment for gain included in net income, net of tax of ($3) for the period ended September 30, 2020		**-**		(11)
Other comprehensive income (loss), net of tax		**(3,403)**		2,245
Total Comprehensive Income	**$**	**2,349**	$	6,413

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Income
Nine Months Ended September 30, 2021 and 2020
(Unaudited)

(in thousands, except share and per share data)		September 30, 2021		September 30, 2020
Interest Income				
Interest and fees on loans	$	**26,104**	$	25,491
Interest on interest-bearing deposits		**123**		248
Interest on securities – taxable		**5,736**		5,791
Interest on securities – nontaxable		**1,472**		1,316
Total interest income		**33,435**		32,846
Interest Expense				
Interest on time deposits		**223**		1,476
Interest on other deposits		**2,185**		3,338
Total interest expense		**2,408**		4,814
Net interest income		**31,027**		28,032
Provision for (recovery of) loan losses		**(338)**		1,985
Net interest income after provision for (recovery of) loan losses		**31,365**		26,047
Noninterest Income				
Service charges on deposit accounts		**1,488**		1,430
Other service charges and fees		**134**		113
Credit and debit card fees, net		**1,373**		1,031
Trust income		**1,282**		1,244
BOLI income		**664**		659
Gain on sale of mortgage loans		**287**		416
Other income		**1,034**		817
Realized securities gain, net		**5**		96
Total noninterest income		**6,267**		5,806
Noninterest Expense				
Salaries and employee benefits		**11,767**		10,882
Occupancy, furniture and fixtures		**1,378**		1,360
Data processing and ATM		**2,292**		2,396
FDIC assessment		**296**		127
Net costs of other real estate owned		**49**		36
Franchise taxes		**1,059**		1,009
Other operating expenses		**2,509**		2,854
Total noninterest expense		**19,350**		18,664
Income before income taxes		**18,282**		13,189
Income tax expense		**3,151**		2,060
Net Income	**$**	**15,131**	$	11,129
Basic net income per common share	**$**	**2.42**	$	1.71
Fully diluted net income per common share	**$**	**2.42**	$	1.71
Weighted average number of common shares outstanding, basic and diluted		**6,253,796**		6,489,574
Dividends declared per common share	**$**	**0.70**	$	0.67

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Comprehensive Income
Nine Months Ended September 30, 2021 and 2020
(Unaudited)

(in thousands)	September 30, 2021	September 30, 2020
Net Income	**$ 15,131**	$ 11,129
Other Comprehensive Income (Loss), Net of Tax		
Unrealized holding gain (loss) on available for sale securities net of tax of ($2,254) and $3,127 for the periods ended September 30, 2021 and September 30, 2020, respectively	**(8,477)**	11,763
Reclassification adjustment for gain included in net income, net of tax of ($1) and ($20), for the periods ended September 30, 2021 and September 30, 2020, respectively	**(4)**	(76)
Other comprehensive income (loss), net of tax	**(8,481)**	11,687
Total Comprehensive Income	**$ 6,650**	$ 22,816

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)

Three Months Ended September 30, 2021 and 2020

(in thousands except share data)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances at June 30, 2020	$ 8,112	$ 186,733	$ 936	$ 195,781
Net income	-	4,168	-	4,168
Other comprehensive income, net of tax of $598	-	-	2,245	2,245
Balances at September 30, 2020	$ 8,112	$ 190,901	$ 3,181	$ 202,194
Balances at June 30, 2021	$ 7,713	$ 185,580	$ (2,058)	$ 191,235
Net income	-	5,752	-	5,752
Common stock repurchased, 73,100 shares	(92)	(2,639)	-	(2,731)
Other comprehensive loss, net of tax of ($905)	-	-	(3,403)	(3,403)
Balances at September 30, 2021	**$ 7,621**	**$ 188,693**	**$ (5,461)**	**$ 190,853**

See accompanying notes to consolidated financial statements.

Nine Months Ended September 30, 2021 and 2020

(in thousands except per share and share data)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2019	$ 8,112	$ 184,120	$ (8,506)	$ 183,726
Net income	-	11,129	-	11,129
Dividends $0.67 per share	-	(4,348)	-	(4,348)
Other comprehensive income, net of tax of $3,107	-	-	11,687	11,687
Balances at September 30, 2020	$ 8,112	$ 190,901	$ 3,181	$ 202,194
Balances at December 31, 2020	$ 8,040	$ 189,547	$ 3,020	$ 200,607
Net income	-	15,131	-	15,131
Common stock repurchased, 335,062 shares	(419)	(11,666)	-	(12,085)
Dividends $0.70 per share	-	(4,319)	-	(4,319)
Other comprehensive loss, net of tax of ($2,255)	-	-	(8,481)	(8,481)
Balances at September 30, 2021	**$ 7,621**	**$ 188,693**	**$ (5,461)**	**$ 190,853**

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2021 and 2020
(Unaudited)

(in thousands)	September 30, 2021	September 30, 2020
Cash Flows from Operating Activities		
Net income	**$ 15,131**	$ 11,129
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for (recovery of) loan losses	**(338)**	1,985
Depreciation of bank premises and equipment	**484**	529
Amortization of premiums and accretion of discounts, net	**1,266**	1,016
Gain on disposal of fixed assets	**-**	(2)
Gain on sales and calls of securities available for sale, net	**(5)**	(96)
Loss (gain) and write-down on other real estate owned, net	**25**	(13)
Loss on sale of repossessed assets, net	**-**	1
Increase in cash value of bank-owned life insurance	**(664)**	(659)
Origination of mortgage loans held for sale	**(13,320)**	(27,929)
Proceeds from sale of mortgage loans held for sale	**14,238**	25,560
Gain on sale of mortgage loans held for sale	**(287)**	(416)
Net change in:		
Accrued interest receivable	**(133)**	(953)
Other assets	**1,293**	(136)
Accrued interest payable	**(10)**	(58)
Other liabilities	**(1)**	192
Net cash provided by operating activities	**17,679**	10,150
Cash Flows from Investing Activities		
Net change in interest-bearing deposits	**1,862**	8,102
Proceeds from calls, principal payments, sales and maturities of securities available for sale	**46,887**	116,567
Purchase of securities available for sale	**(153,627)**	(154,781)
Net change in restricted stock	**434**	(59)
Purchase of loan participations	**(20,544)**	(4,273)
Collection of loan participations	**3,759**	122
Loan originations and principal collections, net	**(12,661)**	(63,695)
Proceeds from sale of other real estate owned	**621**	72
Proceeds from sale of repossessed assets	**11**	30
Recoveries on loans charged off	**245**	219
Purchase of bank-owned life insurance	**(5,000)**	-
Proceeds from sale and purchases of premises and equipment, net	**(272)**	(1,632)
Net cash used in investing activities	**(138,285)**	(99,328)

(continued)

Cash Flows from Financing Activities		
Net change in time deposits	**(7,127)**	(25,020)
Net change in other deposits	**142,718**	118,849
Common stock repurchased	**(12,085)**	-
Cash dividends paid	**(4,319)**	(4,348)
Net cash provided by financing activities	**119,187**	89,481
Net change in cash and due from banks	**(1,419)**	303
Cash and due from banks at beginning of period	**13,147**	10,290
Cash and due from banks at end of period	**$ 11,728**	$ 10,593
Supplemental Disclosures of Cash Flow Information		
Interest paid on deposits	**$ 2,418**	$ 4,872
Income taxes paid	**2,150**	2,785
Supplemental Disclosure of Noncash Activities		
Loans charged against the allowance for loan losses	**$ 690**	$ 639
Loans transferred to OREO	**50**	-
Loans transferred to repossessed assets	**11**	4
Unrealized gain (loss) on securities available for sale	**(10,736)**	14,794
Lease liabilities arising from obtaining right-of-use assets	**-**	23

See accompanying notes to consolidated financial statements.

National Bankshares, Inc.
Notes to Consolidated Financial Statements
September 30, 2021
(Unaudited)

$ in thousands, except per share data

Note 1: General

The consolidated financial statements of National Bankshares, Inc. (“NBI”) and its wholly-owned subsidiaries, The National Bank of Blacksburg (the “Bank” or “NBB”) and National Bankshares Financial Services, Inc. (“NBFS”) (collectively, the “Company”), conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”) and to general practices within the banking industry. The accompanying interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments consisting of normal recurring adjustments, which are necessary for a fair presentation of the consolidated financial statements, have been included. The results of operations for the three and nine month periods ended September 30, 2021 are not necessarily indicative of results of operations for the full year or any other interim period. The interim period consolidated financial statements and financial information included in this Form 10-Q should be read in conjunction with the notes to the consolidated financial statements included in the Company’s 2020 Form 10-K. The Company posts all reports required to be filed under the Securities Exchange Act of 1934 on its web site at www.nationalbankshares.com.

Reclassifications

Certain amounts reported in prior years have been reclassified to conform to the current year’s presentation. These reclassifications had no effect on the Company’s results of operations, financial position, or net cash flow.

Risks and Uncertainties

Since the beginning of 2020, the COVID-19 pandemic and efforts to reduce its spread have caused significant disruptions in the U.S. economy and negatively impacted financial activity in the Company’s market. The Company’s business is dependent upon the willingness and ability of its employees and customers to conduct banking and other financial transactions. Some measures appear to indicate a positive trajectory, however if the pandemic escalates, the Company could experience a material adverse effect on its business, financial condition, results of operations and cash flows. While it is not possible to know the full extent of the impact COVID-19 will have on the Company’s operations, the Company is disclosing potentially material items of which it is aware.

Financial position and results of operations

During 2020, the pandemic led to declines in two key income categories: interest income and overdraft fee income. Interest income was impacted by modification requests and by a decreased interest rate environment. During the first nine months of 2021, the number of modification requests that reduce interest income vastly decreased, though loan refinance and securities call activity spurred by the low interest rates continue to impact interest income, with reinvestment opportunities at lower rates. If the pandemic’s evolution brings new or worsened economic impacts, these income categories and others may be negatively affected.

Lending operations, accommodations to borrowers and credit risk

The Company has worked with customers directly affected by COVID-19, providing short-term assistance in accordance with the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), the Consolidated Appropriations Act (“CAA”) and regulatory guidelines. Assistance included providing payment extensions, periods of interest only payments to otherwise amortizing loans, and interest rate reductions. Pandemic-related modification requests have greatly subsided and as of September 30, 2021, there were no loans remaining in a temporarily modified state for COVID-19 relief.

If eventual credit losses are identified on loans that received modifications or other loans, accrued interest and fee income would be reversed at the time the loss is identified. If the loans are fully or partially charged off, future requirements for the provision for loan losses will increase. At this time, the Company is unable to project the materiality of such an impact, but recognizes economic declines may affect its borrowers’ ability to repay in future periods. The Company is closely monitoring credit quality and developments related to the pandemic.

The Company provided loans through the Paycheck Protection Program (“PPP”), administered by the Small Business Administration (“SBA”). Loans funded through the program to qualifying borrowers carry the expectation that the SBA will either pay off the loans and forgive the borrower’s debt, or guarantee the loans until the borrower pays off the debt. The loans bear a contractual interest rate of 1%, bolstered by an origination fee to be recognized over the life of the loan. Loans that are forgiven or paid off prior to maturity result in recognition of the outstanding origination fee at the date of forgiveness or payoff. The Company has assisted local businesses through the PPP by providing 1,259 loans totaling $83,023 since the program’s inception in April of 2020. To date, 1,039

PPP loans with original balances totaling $70,228 have been forgiven or paid off. As of September 30, 2021, the Company held $12,086 in PPP loans, net of deferred fees and costs. The company expects that the remaining loans will be forgiven by the SBA in accordance with the terms of the program, and that any remaining balances will be fully guaranteed by the SBA. Should those circumstances change, the Company could be required to establish additional allowance for loan loss through provision for loan loss charged to earnings.

Asset valuation

COVID-19 has not affected the Company's ability, nor is it expected to affect the Company's ability, to account timely for the assets on its balance sheet. However if the impact of the pandemic worsens, valuation procedures in future periods could be negatively affected. While certain valuation assumptions and judgments will change to account for pandemic-related circumstances, such as widening credit spreads, the Company does not anticipate significant changes in methodology used to determine the fair value of assets measured in accordance with U.S. GAAP.

The Company tests goodwill for impairment annually, usually during the fourth quarter using September 30 information, unless facts and circumstances indicate the need for more frequent impairment testing. If the evolution of the pandemic or other adverse events cause a sustained decline in the Company's stock price or the occurrence of what management deems to be a triggering event, under certain circumstances prescribed by U.S. GAAP, the Company will perform goodwill impairment testing as needed, which may be more frequently than annually. In the event that testing indicates that all or a portion of goodwill is impaired, a non-cash charge for the amount of such impairment would be recorded to earnings.

Capital and liquidity

While the Company believes that it has sufficient capital to withstand a potential second economic recession if the pandemic resurges, its reported and regulatory capital ratios could be adversely impacted if credit losses increase.

The Company maintains access to multiple sources of liquidity. Wholesale funding markets are currently available to the Company. If the uncertainty caused by the COVID-19 pandemic results in volatile or elevated funding costs for an extended period of time and if it becomes necessary for the Company to access wholesale funding, the Company's net interest margin could be adversely affected. Deposits have increased since the beginning of the pandemic, however, if conditions worsen and cause a large number of the Company's deposit customers to withdraw their funds, the Company might become more reliant on volatile or more expensive sources of funding.

<u>Accounting Standards Adopted as of January 1, 2021</u>

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The amendments are expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. This ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. ASU 2019-12 was effective for the Company on January 1, 2021. The adoption of ASU 2019-12 did not have a material impact on the Company's consolidated financial statements.

In January 2020, the FASB issued ASU 2020-01, "Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the Emerging Issues Task Force)." The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2016-01 made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. ASU 2020-01 was effective for the Company on January 1, 2021. The adoption of ASU 2020-01 did not have a material impact on the Company's consolidated financial statements.

In October 2020, the FASB issued ASU 2020-08, "Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable fees and Other Costs." This ASU clarifies that an entity should reevaluate whether a callable debt security is within the scope of ASC paragraph 310-20-35-33 for each reporting period. ASU 2020-08 was effective for the Company on January 1, 2021. The adoption of ASU 2020-08 did not have a material impact on the Company's consolidated financial statements.

In December 2020, the CAA was passed. Under Section 541 of the CAA, Congress extended or modified many of the relief programs first created by the CARES Act, including the PPP loan program and treatment of certain loan modifications related to the COVID-19 pandemic. The Company modified loans in accordance with the CAA and the CARES Act. Further discussion on loan modifications is noted in Management's Discussion and Analysis.

<u>Recent Accounting Pronouncements</u>

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this

ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The FASB has issued multiple updates to ASU 2016-13 as codified in Topic 326, including ASU's 2019-04, 2019-05, 2019-10, 2019-11, 2020-02, and 2020-03. These ASU's have provided for various minor technical corrections and improvements to the codification as well as other transition matters. Smaller reporting companies who file with the U.S. Securities and Exchange Commission (SEC) and all other entities who do not file with the SEC are required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. Management is working to ensure readiness and compliance with the standard and has implemented coding of the loan portfolio to enable appropriate segregation and data integrity, analyzed correlations for forecasting, determined methodologies, and selected a vendor to provide a platform. Management has prepared multiple concurrent models using the Current Expected Credit Losses ("CECL") methodology and will continue to refine assumptions that impact the calculation prior to the effective date.

Effective November 25, 2019, the SEC adopted Staff Accounting Bulletin (SAB) 119. SAB 119 updated portions of SEC interpretative guidance to align with FASB ASC 326, "Financial Instruments – Credit Losses." It covers topics including (1) measuring current expected credit losses; (2) development, governance, and documentation of a systematic methodology; (3) documenting the results of a systematic methodology; and (4) validating a systematic methodology.

In March 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-04 "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. Subsequently, in January 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2021-01 "Reference Rate Reform (Topic 848): Scope." This ASU clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The ASU also amends the expedients and exceptions in Topic 848 to capture the incremental consequences of the scope clarification and to tailor the existing guidance to derivative instruments affected by the discounting transition. An entity may elect to apply ASU No. 2021-01 on contract modifications that change the interest rate used for margining, discounting, or contract price alignment retrospectively as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications from any date within the interim period that includes or is subsequent to January 7, 2021, up to the date that financial statements are available to be issued. An entity may elect to apply ASU No. 2021-01 to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020.The Company has three participation loans that references LIBOR and is working with the primary banks to determine appropriate actions. The Company is assessing ASU 2020-04 and its impact on the Company's transition away from LIBOR for this loan.

In August 2021, the FASB issued ASU 2021-06, "'Presentation of Financial Statements (Topic 205), Financial Services—Depository and Lending (Topic 942), and Financial Services—Investment Companies (Topic 946): Amendments to SEC Paragraphs Pursuant to SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants. This ASU incorporates recent SEC rule changes into the FASB Codification, including SEC Final Rule Releases No. 33-10786, Amendments to Financial Disclosures about Acquired and Disposed Businesses, and No. 33-10835, Update of Statistical Disclosures for Bank and Savings and Loan Registrants". The ASU is effective upon addition to the FASB Codification. The Company does not expect the adoption of ASU 2021-06 to have a material impact on its consolidated financial statements.

Note 2:

Loan Portfolio

The loan portfolio, excluding loans held for sale, was comprised of the following.

	September 30, 2021	December 31, 2020
Real estate construction	**$ 50,883**	$ 42,266
Consumer real estate	**204,880**	181,782
Commercial real estate	**403,840**	393,115
Commercial non real estate	**59,082**	78,771
Public sector and IDA	**48,345**	40,983
Consumer non real estate	**31,576**	33,110
Gross loans	**798,606**	770,027
Less unearned income and deferred fees and costs	**(1,112)**	(1,228)
Loans, net of unearned income and deferred fees and costs	**$ 797,494**	$ 768,799

Note 3: Allowance for Loan Losses, Nonperforming Assets and Impaired Loans

The allowance for loan losses methodology incorporates individual evaluation of impaired loans and collective evaluation of groups of non-impaired loans. The Company performs ongoing analysis of the loan portfolio to determine credit quality and to identify impaired loans. Credit quality is rated based on the loan's payment history, the borrower's current financial situation and value of the underlying collateral.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts will not be collected when due according to the contractual terms of the loan agreement. Impaired loans are those loans that have been modified in a troubled debt restructuring ("TDR") as well as larger, usually non-homogeneous loans that exhibit payment history or financial status that indicate that collection probably will not occur when due according to the loan's terms.

Measurement

Impaired loans are individually evaluated to determine appropriate reserves and are measured at the lower of the invested amount or fair value. Fair value is estimated using the collateral method or the cash flow method. The collateral method is applied to collateral-dependent loans, loans for which foreclosure is imminent and to loans for which the fair value of collateral is a more reliable estimate of fair value. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The cash flow method is applied to loans that are not collateral dependent and for which cash flows may be estimated.

TDRs

TDRs are impaired loans. If the restructuring included forgiveness of a portion of principal or accrued interest, the charge-off is included in the historical charge-off rates applied to the collective evaluation methodology. Restructured loans are individually evaluated for impairment, and the amount of a restructured loan's book value in excess of its fair value is accrued as a specific allocation in the allowance for loan losses. If a TDR loan payment exceeds 90 days past due, it is examined to determine whether the late payment indicates collateral dependency or cash flows below those that were used in the fair value measurement. TDRs, as well as all impaired loans, that are determined to be collateral dependent are charged down to fair value. Deficiencies indicated by impairment measurements for TDRs that are not collateral dependent may be accrued in the allowance for loan losses or charged off if deemed uncollectible.

Please refer to the Company's 2020 Form 10-K, Note 1: Summary of Significant Accounting Policies for additional information on evaluation of impaired loans and associated specific reserves, and policies regarding nonaccruals, past due status and charge-offs.

Collectively-Evaluated Loans

The Company evaluated characteristics in the loan portfolio and determined major segments and smaller classes within each segment. These characteristics include collateral type, repayment sources, and (if applicable) the borrower's business model. Loans within each class are further stratified by risk rating: pass-rated loans, loans rated special mention, and loans rated classified.

Portfolio Segments and Classes

The segments and classes used in determining the allowance for loan losses are as follows.

Real Estate Construction
- Construction, residential
- Construction, other

Consumer Real Estate
- Equity lines
- Residential closed-end first liens
- Residential closed-end junior liens
- Investor-owned residential real estate

Commercial Real Estate
- Multifamily real estate
- Commercial real estate, owner-occupied
- Commercial real estate, other

Commercial Non Real Estate
- Commercial and industrial

Public Sector and IDA
- Public sector and IDA

Consumer Non Real Estate
- Credit cards
- Automobile
- Other consumer loans

Please refer to the Company's 2020 Form 10-K, Note 1: Summary of Significant Accounting Policies for a discussion of risk factors pertinent to each class.

Credit risk is estimated at the class level, by risk rating, by applying historical net charge-off rates and percentages for qualitative factors that influence credit risk.

Historical Loss Rates

The Company's allowance methodology for collectively evaluated loans applies historical loss rates by class to current class balances as part of the process of determining required reserves. The Company averages loss rates for the most recent eight quarters to determine the historical loss rate for each class.

Within each class, loans are risk rated pass, special mention or classified. Loss rates are applied based upon risk rating. Total net charge-offs for the class as a percentage of average class loan balance is applied to pass rated loans and loans rated special mention. Total net charge-offs for the class as a percentage of average classified loans in the class is applied to classified loans. Net charge-offs in both calculations include charge-offs and recoveries of classified and non-classified loans as well as those associated with impaired loans.

Qualitative Factors

In addition to historical loss rates, risk factors pertinent to credit risk for each class are analyzed to estimate reserves for collectively evaluated loans. Factors include changes in national and local economic and business conditions, the nature and volume of classes within the portfolio, loan quality, loan officers' experience, lending policies and the Company's loan review system.

A detailed analysis showing the allowance roll-forward by portfolio segment and related loan balance by segment follows.

Activity in the Allowance for Loan Losses for the Nine Months Ended September 30, 2021

	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2020	$ 503	$ 2,165	$ 3,853	$ 670	$ 339	$ 555	$ 396	$ 8,481
Charge-offs	-	(13)	-	(526)	-	(151)	-	(690)
Recoveries	-	19	86	31	-	109	-	245
Provision for (recovery of) loan losses	(5)	(203)	(776)	743	(27)	(39)	(31)	(338)
Balance, September 30, 2021	**$ 498**	**$ 1,968**	**$ 3,163**	**$ 918**	**$ 312**	**$ 474**	**$ 365**	**$ 7,698**

	Activity in the Allowance for Loan Losses for the Nine Months Ended September 30, 2020							
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2019	$ 400	$ 1,895	$ 2,559	$ 555	$ 478	$ 650	$ 326	$ 6,863
Charge-offs	-	(62)	(15)	(372)	-	(190)	-	(639)
Recoveries	-	18	53	6	-	142	-	219
Provision for (recovery of) loan losses	24	311	1,047	510	53	(5)	45	1,985
Balance, September 30, 2020	$ 424	$ 2,162	$ 3,644	$ 699	$ 531	$ 597	$ 371	$ 8,428

	Activity in the Allowance for Loan Losses for the Year Ended December 31, 2020							
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Balance, December 31, 2019	$ 400	$ 1,895	$ 2,559	$ 555	$ 478	$ 650	$ 326	$ 6,863
Charge-offs	-	(85)	(15)	(372)	-	(248)	-	(720)
Recoveries	-	18	145	9	-	175	-	347
Provision for (recovery of) loan losses	103	337	1,164	478	(139)	(22)	70	1,991
Balance, December 31, 2020	$ 503	$ 2,165	$ 3,853	$ 670	$ 339	$ 555	$ 396	$ 8,481

	Allowance for Loan Losses as of September 30, 2021							
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Collectively evaluated for impairment	**498**	**1,968**	**3,163**	**918**	**312**	**474**	**365**	**7,698**
Total	**$ 498**	**$ 1,968**	**$ 3,163**	**$ 918**	**$ 312**	**$ 474**	**$ 365**	**$ 7,698**

	Allowance for Loan Losses as of December 31, 2020							
	Real Estate Construction	Consumer Real Estate	Commercial Real Estate	Commercial Non Real Estate	Public Sector and IDA	Consumer Non Real Estate	Unallocated	Total
Individually evaluated for impairment	$ -	$ 2	$ -	$ 73	$ -	$ -	$ -	$ 75
Collectively evaluated for impairment	503	2,163	3,853	597	339	555	396	8,406
Total	$ 503	$ 2,165	$ 3,853	$ 670	$ 339	$ 555	$ 396	$ 8,481

	Loans as of September 30, 2021						
	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Total**
Individually evaluated for impairment	**$ -**	**$ 192**	**$ 5,583**	**$ 308**	**$ -**	**$ 1**	**$ 6,084**
Collectively evaluated for impairment	**50,883**	**204,688**	**398,257**	**58,774**	**48,345**	**31,575**	**792,522**
Total	**$ 50,883**	**$ 204,880**	**$ 403,840**	**$ 59,082**	**$ 48,345**	**$ 31,576**	**$ 798,606**

	Loans as of December 31, 2020						
	Real Estate Construction	**Consumer Real Estate**	**Commercial Real Estate**	**Commercial Non Real Estate**	**Public Sector and IDA**	**Consumer Non Real Estate**	**Total**
Individually evaluated for impairment	$ -	$ 194	$ 3,856	$ 851	$ -	$ 2	$ 4,903
Collectively evaluated for impairment	42,266	181,588	389,259	77,920	40,983	33,108	765,124
Total	$ 42,266	$ 181,782	$ 393,115	$ 78,771	$ 40,983	$ 33,110	$ 770,027

A summary of ratios for the allowance for loan losses follows.

	As of and for the		
	Nine Months Ended September 30,		**Year Ended December 31,**
	2021	**2020**	**2020**
Ratio of allowance for loan losses to the end of period loans, net of unearned income and deferred fees and costs[1]	**0.97 %**	1.05%	1.10 %
Ratio of net charge-offs to average loans, net of unearned income and deferred fees and costs[2]	**0.08 %**	0.07%	0.05 %

(1) The ratio of the allowance for loan losses to the end of period loans, net of unearned income and deferred fees and costs at September 30, 2021, December 31, 2020 and September 30, 2020 includes government-guaranteed SBA PPP loans, which do not require an allowance for loan losses. Excluding the PPP loans, the ratio would be 0.98% at September 30, 2021, 1.16% at December 31, 2020 and 1.13% at September 30, 2020.

(2) Net charge-offs are on an annualized basis.

A summary of nonperforming assets follows.

	September 30,		**December 31,**
	2021	**2020**	**2020**
Nonperforming assets:			
Nonaccrual loans	**$ 39**	$ 736	$ 846
Restructured loans in nonaccrual	**3,075**	2,866	2,839
Total nonperforming loans	**3,114**	3,602	3,685
Other real estate owned, net	**957**	1,553	1,553
Total nonperforming assets	**$ 4,071**	$ 5,155	$ 5,238
Ratio of nonperforming assets to loans, net of unearned income and deferred fees and costs, plus other real estate owned	**0.51 %**	0.64%	0.68 %
Ratio of allowance for loan losses to nonperforming loans[1]	**247.21 %**	233.98%	230.15 %

(1) The Company defines nonperforming loans as nonaccrual loans and restructured loans that are nonaccrual. Loans 90 days past due and still accruing and accruing restructured loans are excluded.

A summary of loans past due 90 days or more and impaired loans follows.

	September 30, 2021	September 30, 2020	December 31, 2020
Loans past due 90 days or more and still accruing	**$ 62**	$ 236	$ 17
Ratio of loans past due 90 days or more and still accruing to loans, net of unearned income and deferred fees and costs	**0.01 %**	0.03%	0.00 %
Accruing restructured loans	**$ 3,009**	$ 1,426	$ 1,410
Impaired loans:			
Impaired loans with no valuation allowance	**$ 6,084**	$ 3,939	$ 3,858
Impaired loans with a valuation allowance	**-**	1,056	1,045
Total impaired loans	**$ 6,084**	$ 4,995	$ 4,903
Valuation allowance	**-**	(104)	(75)
Impaired loans, net of allowance	**$ 6,084**	$ 4,891	$ 4,828
Average recorded investment in impaired loans[1]	**$ 6,108**	$ 5,227	$ 5,093
Interest income recognized on impaired loans, after designation as impaired	**$ 175**	$ 49	$ 54
Amount of income recognized on a cash basis	**$ -**	$ -	$ -

[1] Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.

No interest income was recognized on nonaccrual loans for the nine months ended September 30, 2021 or September 30, 2020 or for the year ended December 31, 2020.

A detailed analysis of investment in impaired loans and associated reserves, segregated by loan class follows.

	Impaired Loans as of September 30, 2021				
	Principal Balance	**Total Recorded Investment[1]**	**Recorded Investment[1] for Which There is No Related Allowance**	**Recorded Investment[1] for Which There is a Related Allowance**	**Related Allowance**
Consumer Real Estate[2]					
Investor-owned residential real estate	**$ 192**	**$ 192**	**$ 192**	**$ -**	**$ -**
Commercial Real Estate[2]					
Commercial real estate, owner-occupied	**3,481**	**2,861**	**2,861**	**-**	**-**
Commercial real estate, other	**2,722**	**2,722**	**2,722**	**-**	**-**
Commercial Non Real Estate[2]					
Commercial and industrial	**313**	**308**	**308**	**-**	**-**
Consumer Non Real Estate[2]					
Automobile	**1**	**1**	**1**	**-**	**-**
Total	**$ 6,709**	**$ 6,084**	**$ 6,084**	**$ -**	**$ -**

[1] Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.
[2] Only classes with impaired loans are shown.

	Impaired Loans as of December 31, 2020				
	Principal Balance	Total Recorded Investment[1]	Recorded Investment[1] for Which There is No Related Allowance	Recorded Investment[1] for Which There is a Related Allowance	Related Allowance
Consumer Real Estate[2]					
Investor-owned residential real estate	$ 194	$ 194	$ -	$ 194	$ 2
Commercial Real Estate[2]					
Commercial real estate, owner occupied	3,752	3,202	3,202	-	-
Commercial real estate, other	654	654	654	-	-
Commercial Non-Real Estate[2]					
Commercial and industrial	851	851	-	851	73
Consumer Non-Real Estate[2]					
Automobile	2	2	2	-	-
Total	$ 5,453	$ 4,903	$ 3,858	$ 1,045	$ 75

[1] Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.
[2] Only classes with impaired loans are shown.

The following tables show the average recorded investment and interest income recognized for impaired loans.

	For the Nine Months Ended September 30, 2021	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Investor-owned residential real estate	**$ 193**	**$ 9**
Commercial Real Estate[2]		
Commercial real estate, owner occupied	**2,866**	**72**
Commercial real estate, other	**2,724**	**83**
Commercial Non Real Estate[2]		
Commercial and industrial	**324**	**11**
Consumer Non Real Estate[2]		
Automobile	**1**	**-**
Total	**$ 6,108**	**$ 175**

	For the Year Ended December 31, 2020	
	Average Recorded Investment[1]	Interest Income Recognized
Consumer Real Estate[2]		
Investor-owned residential real estate	$ 196	$ 13
Commercial Real Estate[2]		
Commercial real estate, owner occupied	3,217	19
Commercial real estate, other	790	-
Commercial Non-Real Estate[2]		
Commercial and industrial	887	22
Consumer Non-Real Estate[2]		
Automobile	3	-
Total	$ 5,093	$ 54

[1] Recorded investment is net of charge-offs and interest paid while a loan is in nonaccrual status.
[2] Only classes with impaired loans are shown.

An analysis of past due and nonaccrual loans follows.

September 30, 2021

	30 – 89 Days Past Due and Accruing	90 or More Days Past Due	90 or More Days Past Due and Accruing	Nonaccruals[2]
Real Estate Construction[1]				
Construction, other	$ 115	$ -	$ -	$ -
Consumer Real Estate[1]				
Equity lines	29	-	-	-
Residential closed-end first liens	489	39	39	-
Investor-owned residential real estate	102	-	-	-
Commercial Real Estate[1]		-	-	-
Commercial real estate, owner-occupied	147	445	-	2,767
Commercial real estate, other	-	-	-	-
Commercial Non Real Estate[1]				
Commercial and industrial	29	318	10	347
Consumer Non Real Estate[1]				
Credit cards	3	1	1	-
Automobile	91	-	-	-
Other consumer loans	218	12	12	-
Total	$ 1,223	$ 815	$ 62	$ 3,114

(1) Only classes with past-due or nonaccrual loans are shown.
(2) Includes current and past due loans in nonaccrual status. Includes impaired loans in nonaccrual status.

December 31, 2020

	30 – 89 Days Past Due and Accruing	90 or More Days Past Due	90 or More Days Past Due and Accruing	Nonaccruals[2]
Consumer Real Estate[1]				
Residential closed-end first liens	$ 365	$ 62	$ -	$ 62
Investor-owned residential real estate	106	-	-	-
Commercial Real Estate[1]				
Commercial real estate, owner occupied	15	571	-	2,941
Commercial real estate, other	-	654	-	654
Commercial Non-Real Estate[1]				
Commercial and industrial	730	27	-	28
Consumer Non-Real Estate[1]				
Credit cards	7	3	3	-
Automobile	144	1	1	-
Other consumer loans	130	13	13	-
Total	$ 1,497	$ 1,331	$ 17	$ 3,685

(1) Only classes with past-due or nonaccrual loans are shown.
(2) Includes current and past due loans in nonaccrual status. Includes impaired loans in nonaccrual status.

The following displays collectively-evaluated loans by credit quality indicator.

September 30, 2021

	Pass[1]	Special Mention[1]	Classified[1]
Real Estate Construction			
Construction, 1-4 family residential	$ 10,498	$ -	$ -
Construction, other	40,385	-	-
Consumer Real Estate			
Equity lines	13,962	-	-
Closed-end first liens	106,806	-	284
Closed-end junior liens	2,773	-	-
Investor-owned residential real estate	80,244	619	-
Commercial Real Estate			
Multifamily residential real estate	106,368	-	-
Commercial real estate owner-occupied	137,965	-	36
Commercial real estate, other	150,131	3,757	-
Commercial Non Real Estate			
Commercial and industrial	58,726	-	48
Public Sector and IDA			
States and political subdivisions	48,345	-	-
Consumer Non Real Estate			
Credit cards	4,270	-	-
Automobile	11,653	-	-
Other consumer	15,528	-	124
Total	$ 787,654	$ 4,376	$ 492

(1) Excludes impaired, if any.

The following displays collectively-evaluated loans by credit quality indicator.

December 31, 2020

	Pass[1]	Special Mention[1]	Classified[1]
Real Estate Construction			
Construction, 1-4 family residential	$ 8,195	$ -	$ -
Construction, other	34,071	-	-
Consumer Real Estate			
Equity lines	13,903	-	-
Residential closed-end first liens	92,241	66	284
Residential closed-end junior liens	3,003	-	-
Investor-owned residential real estate	71,450	641	-
Commercial Real Estate			
Multifamily residential real estate	87,455	265	-
Commercial real estate owner-occupied	146,900	543	140
Commercial real estate, other	147,436	6,520	-
Commercial Non-Real Estate			
Commercial and industrial	77,892	-	28
Public Sector and IDA			
States and political subdivisions	40,983	-	-
Consumer Non-Real Estate			
Credit cards	4,665	-	-
Automobile	12,024	-	6
Other consumer	16,398	-	15
Total	$ 756,616	$ 8,035	$ 473

[1] Excludes impaired, if any.

Determination of risk ratings was completed for the portfolio as of September 30, 2021 and December 31, 2020. For detail on determination of risk ratings, please refer to the Company's 2020 Form 10-K, Note 1: Summary of Significant Accounting Policies and Note 5: Allowance for Loan Losses, Nonperforming Assets and Impaired Loans.

TDRs

Total TDRs amounted to $6,084 at September 30, 2021, $4,249 at December 31, 2020, and $4,292 at September 30, 2020. All of the Company's TDR loans are fully funded and no further increase in credit is available.

TDRs Designated During the Reporting Period

The Company did not designate any loans as TDR during the three months ended September 30, 2021.

During the nine months ended September 30, 2021 the Company designated three loans as a TDR. The restructuring of the commercial real estate owner-occupied loan provided cash flow relief to the borrower by shifting the payment structure from interest-only to amortizing and reducing the interest rate. The restructurings of the two other commercial real estate loans provided cash flow relief by re-amortizing the loans over a longer period and reducing the interest rate. No principal or interest was forgiven. The impairment measurement for all three loans at September 30, 2021 was based upon the collateral method and did not result in a specific allocation.

The following table presents restructurings by class that occurred during the nine month period ended September 30, 2021.

	Restructurings That Occurred During the Nine Months Ended September 30, 2021		
	Number of Contracts	Pre-Modification Outstanding Principal Balance	Post-Modification Outstanding Principal Balance
Commercial Real Estate			
Commercial real estate owner-occupied	**1**	**$ 102**	**$ 102**
Commercial real estate, other	**2**	**2,724**	**2,724**
Total	**3**	**$ 2,826**	**$ 2,826**

The Company did not modify any loans in TDRs during the three or nine month periods ended September 30, 2020.

Defaulted TDRs

The Company analyzed its TDR portfolio for loans that defaulted during the three and nine month periods ended September 30, 2021 and September 30, 2020, and that were modified within 12 months prior to default. The Company designates three circumstances that indicate default: one or more payments that occur more than 90 days past the due date, charge-off, or foreclosure after the date of restructuring.

Of the Company's TDRs at September 30, 2021 and September 30, 2020, none of the defaulted TDRs were modified within 12 months prior to default. All of the defaulted TDRs were in nonaccrual status as of September 30, 2021 and September 30, 2020.

Note 4: Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities available for sale by major security type are as follows.

	September 30, 2021			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Available for Sale:				
U.S. Government agencies and corporations	**$ 220,372**	**$ 3,062**	**$ 3,243**	**$ 220,191**
States and political subdivisions	**196,518**	**4,970**	**2,181**	**199,307**
Mortgage-backed securities	**215,661**	**3,284**	**193**	**218,752**
Corporate debt securities	**3,004**	**259**	**27**	**3,236**
Total securities available for sale	**$ 635,555**	**$ 11,575**	**$ 5,644**	**$ 641,486**

	December 31, 2020			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Values
Available for Sale:				
U.S. Government agencies and corporations	$ 86,859	$ 4,477	$ 173	$ 91,163
States and political subdivisions	196,435	7,778	252	203,961
Mortgage-backed securities	244,780	4,473	78	249,175
Corporate debt securities	2,001	442	-	2,443
Total securities available for sale	$ 530,075	$ 17,170	$ 503	$ 546,742

The amortized cost and fair value of single maturity securities available for sale at September 30, 2021, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities included in these totals are categorized by final maturity.

	September 30, 2021	
	Amortized Cost	Fair Value
Available for Sale:		
Due in one year or less	**$ 1,864**	**$ 1,902**
Due after one year through five years	**8,722**	**8,785**
Due after five years through ten years	**264,217**	**265,751**
Due after ten years	**360,752**	**365,048**
Total securities available for sale	**$ 635,555**	**$ 641,486**

Information pertaining to securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows.

	September 30, 2021			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Temporarily Impaired Securities:				
U.S. Government agencies and corporations	**$ 156,418**	**$ 3,190**	**$ 944**	**$ 53**
States and political subdivisions	**71,912**	**1,868**	**9,026**	**313**
Mortgage-backed securities	**10,229**	**46**	**5,146**	**147**
Corporate debt securities	**976**	**27**	**-**	**-**
Total	**$ 239,535**	**$ 5,131**	**$ 15,116**	**$ 513**

	December 31, 2020			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Temporarily Impaired Securities:				
U.S. Government agencies and corporations	$ 28,798	$ 173	$ -	$ -
States and political subdivisions	32,353	249	635	3
Mortgage-backed securities	8,816	76	4,060	2
Total	$ 69,967	$ 498	$ 4,695	$ 5

The Company has 229 securities with a fair value of $254,651 that are temporarily impaired at September 30, 2021. The total unrealized loss on these securities is $5,644. Of the temporarily impaired securities, 10 securities with a fair value of $15,116 and an unrealized loss of $513 have been in a continuous loss position for twelve months or more. The Company determined that these 10 securities are temporarily impaired at September 30, 2021 for the reasons set out below.

U.S. Government agencies and corporations. The unrealized loss of $53 on US Government agency securities stemmed from one security with a fair value of $944. The unrealized loss was caused by interest rate and market fluctuations. The contractual terms of the investment do not permit the issuers to settle the securities at a price less than the cost basis of the investments. The Company is monitoring bond market trends to develop strategies to address unrealized losses. Because the Company does not intend to sell the investment and it is not likely that the Company will be required to sell the investment before recovery of the amortized cost basis, which may be at maturity, the Company does not consider the investment to be other-than-temporarily impaired.

States and political subdivisions. The unrealized loss of $313 on state and political subdivision securities stemmed from six securities with a fair value of $9,026. The Company reviewed financial statements and cash flows for each of the securities in a continuous loss position for more than 12 months. The Company's analysis determined that the unrealized losses are primarily the result of interest rate and market fluctuations and not associated with impaired financial status. The contractual terms of the investments do not permit the issuer to settle the securities at a price less than the cost basis of each investment. The Company is monitoring bond market trends to develop strategies to address unrealized losses. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of amortized cost basis, which may be at maturity, the Company does not consider the investments to be other-than-temporarily impaired.

Mortgage-backed securities. The unrealized loss of $147 on mortgage-backed securities stemmed from three securities with a fair value of $5,146. The unrealized loss was caused by interest rate and market fluctuations. The contractual terms of the investments do not permit the issuers to settle the securities at a price less than the cost basis of each investment. Because the Company does not intend to sell the investments and it is not likely that the Company will be required to sell the investments before recovery of its amortized cost basis, which may be at maturity, the Company does not consider the investments to be other-than-temporarily impaired.

Restricted Stock.

The Company held restricted stock of $845 as of September 30, 2021 and $1,279 at December 31, 2020. Restricted stock is reported separately from available for sale securities. As a member bank of the Federal Reserve system and the Federal Home Loan Bank of Atlanta ("FHLB"), NBB is required to maintain certain minimum investments in the common stock of those entities. Required levels of investment are based upon NBB's capital, current borrowings, and a percentage of qualifying assets. The correspondents provide calculations that require NBB to purchase or sell stock back to the correspondents. The stock is held by member institutions only and is not actively traded.

Redemption of FHLB stock is subject to certain limitations and conditions. At its discretion, the FHLB may declare dividends on the stock. In addition to dividends, NBB also benefits from its membership with FHLB through eligibility to borrow from the FHLB, using as collateral NBB's capital stock investment in the FHLB and qualifying NBB real estate mortgage loans totaling $596,772 at September 30, 2021. Management reviews for impairment based upon the ultimate recoverability of the cost basis of the FHLB stock, and at September 30, 2021, management did not determine any impairment.

Management regularly monitors the credit quality of the investment portfolio. Changes in ratings are noted and follow-up research on the issuer is undertaken when warranted. Management intends to carefully monitor any changes in bond quality.

Note 5: Defined Benefit Plan

Components of Net Periodic Benefit Cost:

	Pension Benefits Three Months Ended September 30,	
	2021	**2020**
Service cost	**$ 361**	$ 270
Interest cost	**184**	205
Expected return on plan assets	**(555)**	(420)
Amortization of prior service cost	**(3)**	(27)
Recognized net actuarial loss	**208**	177
Net periodic benefit cost	**$ 195**	$ 205

	Pension Benefits Nine Months Ended September 30,	
	2021	**2020**
Service cost	**$ 1,083**	$ 810
Interest cost	**552**	615
Expected return on plan assets	**(1,665)**	(1,260)
Amortization of prior service cost	**(9)**	(81)
Recognized net actuarial loss	**624**	531
Net periodic benefit cost	**$ 585**	$ 615

The service cost component of net periodic benefit cost is included in salaries and employee benefits expense in the consolidated statements of income. All other components are included in other noninterest expense in the consolidated statements of income. For the nine months ended September 30, 2021, the Company did not make a contribution to the defined benefit plan.

Note 6: Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP requires that valuation techniques maximize the use of the observable inputs and minimize the use of the unobservable inputs. U.S. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including:

- quoted prices in active markets for similar assets and liabilities,
- quoted prices for identical or similar assets and liabilities in less active markets,
- inputs other than quoted prices that are observable, and
- model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Accounting guidance for fair value excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Consequently, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company as of September 30, 2021 and December 31, 2020.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring and non-recurring basis in the financial statements:

Financial Instruments Measured at Fair Value on a Recurring Basis

Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). The carrying value of restricted Federal Reserve Bank of Richmond and FHLB stock approximates fair value based upon the redemption provisions of each entity and is therefore excluded from the following tables.

The following tables present the balances of financial assets measured at fair value on a recurring basis as of September 30, 2021 and December 31, 2020.

Description	Balance as of September 30, 2021	Fair Value Measurements at September 30, 2021 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government agencies and corporations	**$ 220,191**	**$ -**	**$ 220,191**	**$ -**
States and political subdivisions	**199,307**	**-**	**199,307**	**-**
Mortgage-backed securities	**218,752**	**-**	**218,752**	**-**
Corporate debt securities	**3,236**	**-**	**3,236**	**-**
Total securities available for sale	**$ 641,486**	**$ -**	**$ 641,486**	**$ -**

Description	Balance as of December 31, 2020	Fair Value Measurements at December 31, 2020 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Government agencies and corporations	$ 91,163	$ -	$ 91,163	$ -
States and political subdivisions	203,961	-	203,961	-
Mortgage-backed securities	249,175	-	249,175	-
Corporate debt securities	2,443	-	2,443	-
Total securities available for sale	$ 546,742	$ -	$ 546,742	$ -

The Company's securities portfolio is valued using Level 2 inputs. The Company relies on a third party vendor to provide market valuations. The inputs used to determine value include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications. The third-party vendor also monitors market indicators, industry activity and economic events as part of the valuation process. Central to the final valuation is the assumption that the indicators used are representative of the fair value of securities held within the Company's portfolio. Level 2 inputs are subject to a certain degree of uncertainty and changes in these assumptions or methodologies in the future, if any, may impact securities fair value, deferred tax assets or liabilities, or expense.

Interest Rate Loan Contracts and Forward Contracts

The Company originates consumer real estate loans which it intends to sell to a correspondent lender. Interest rate lock contracts and forward contracts result from originating loans held for sale and are derivatives reported at fair value. The Company enters interest rate lock commitments with customers who apply for a loan which the Company intends to sell to a correspondent lender. The interest rate lock contract ends when the loan closes or the customer withdraws their application. Fair value of the interest rate lock contracts is based upon the correspondent lender's pricing quotes at the report date. Fair value is adjusted for the estimated probability of the loan closing with the borrower.

At the time the Company enters into an interest rate lock contract with a customer, it also enters into a best efforts forward sales commitment with the correspondent lender. If the loan has been closed and funded, the best efforts commitment converts to a mandatory forward sales commitment. Fair value is based on the gain or loss that would occur if the Company were to pair-off the transaction with the investor at the measurement date. This is a level 3 input. The Company has elected to measure and report best efforts commitments at fair value.

Interest rate lock contracts and forward contracts are valued based on quotes from the correspondent lender at the reporting date. Pricing changes daily and if a loan has not been sold to the correspondent by the next reporting date, the fair value may be different from that reported currently. Changes in fair value measurement impacts net income.

Description	Balance as of September 30, 2021	Fair Value Measurements at September 30, 2021 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate loan contracts	**$ (4)**	**$ -**	**$ -**	**$ (4)**
Forward contracts	**$ 3**	**$ -**	**$ -**	**$ 3**

Description	Balance as of December 31, 2020	Fair Value Measurements at December 31, 2020 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate loan contracts	$ 1	$ -	$ -	$ 1
Forward contracts	$ (11)	$ -	$ -	$ (11)

September 30, 2021	Valuation Technique	Unobservable Input	Range (Weighted Average)
Interest rate loan contracts	Market approach	Pull-through rate	**85.00%(2)**
Forward contracts	Market approach	Pull-through rate	**85.00%(2)**
Interest rate loan contracts	Market approach	Current reference price	**100.37% - 101.13% (100.73%)(1)**
Forward contracts	Market approach	Current reference price	**100.37% - 102.67% (101.21%)(1)**

December 31, 2020	Valuation Technique	Unobservable Input	Range (Weighted Average)
Interest rate loan contracts	Market approach	Pull-through rate	87.02%(2)
Forward contracts	Market approach	Pull-through rate	87.02% (2)
Interest rate loan contracts	Market approach	Current reference price	101.91% - 103.02% (102.55%)(1)
Forward contracts	Market approach	Current reference price	101.91% - 103.19% (102.67%)(1)

(1) Current reference prices were weighted by the relative amount of the loan.
(2) All contracts were valued using the same pull-through rate.

Financial Instruments Measured at Fair Value on a Non-Recurring Basis

Certain financial instruments are measured at fair value on a nonrecurring basis in accordance with U.S. GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale at September 30, 2021 or December 31, 2020.

Impaired Loans

Impaired loans are measured at fair value on a nonrecurring basis. If an individually evaluated impaired loan's balance exceeds fair value, the excess amount is allocated to the allowance for loan losses. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

The fair value of an impaired loan may be measured using one of three methods. Each method falls within a different level of the fair value hierarchy. The observable market price of a loan is categorized as a Level 1 input. The present value of projected cash flows method results in a Level 3 categorization because the calculation relies on the Company's judgment to determine projected cash flows, which are then discounted at the current rate of the loan, or the rate prior to modification if the loan is a TDR. Loans measured using the fair value of collateral may be categorized in Level 2 or Level 3.

Loans valued using the collateral method may be secured by real estate or business assets including equipment, inventory, and accounts receivable. Real estate collateral secures most loans and valuation is based upon the "as-is" value of independent appraisals or evaluations. Appraisals are used to value loans secured by residential 1-4 family properties with outstanding principal balances greater than $250 and commercial real estate loans with outstanding principal balances greater than $500. Appraisals or real estate evaluations prepared by a third party may be used to value loans with principal balances below these thresholds.

Appraisals of less than 24 months of age, conducted by independent, licensed appraisers using observable market data analyzed through an income or sales valuation approach result in Level 2 categorization. If a current appraisal cannot be obtained prior to a reporting date and an existing appraisal is discounted to obtain an estimated value, or if declines in value are identified after the date of the appraisal, or if an appraisal is discounted for estimated selling costs, or if the appraisal uses unobservable market data, the valuation of real estate collateral is categorized as Level 3. Valuations based on evaluations are categorized as Level 3. The value of business equipment is based upon an outside appraisal (Level 2) if deemed significant, or the net book value on the applicable business' financial statements (Level 3) if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

If a current appraisal uses unobservable data as part of the assessment, the value of the collateral is classified as Level 3.

As of September 30, 2021, fair valuation procedures did not result in any individual allocation for impaired loans. The following table summarizes the Company's impaired loans that were measured at fair value on a nonrecurring basis at December 31, 2020.

			Carrying Value		
Date	**Description**	**Balance**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Assets:				
December 31, 2020	Impaired loans net of valuation allowance	970	-	-	970

The following table presents information about Level 3 Fair Value Measurements at December 31, 2020.

Impaired Loans	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average[(1)])**
December 31, 2020	Present value of cash flows	Discount rate	5.50% –6.50% (5.78%)

(1) Unobservable inputs were weighted by the relative fair value of the impaired loans.

At December 31, 2020, all impaired loans measured at fair value on a nonrecurring basis were measured using the present value of cash flows. The loans are TDRs and the discount rate is the contractual rate that was in effect prior to modification to TDR status. Future changes in cash flow assumptions or if the loans are charged off may result in greater losses than estimated at the reporting dates. An increase in the impairment measurement or a charge-off would increase the provision for loan losses.

Other Real Estate Owned

Certain assets such as other real estate owned ("OREO") are measured at fair value less cost to sell. Valuation of OREO is determined using current appraisals from independent parties, a Level 2 input. If current appraisals cannot be obtained prior to reporting dates, or if declines in value are identified after a recent appraisal is received, appraisal values are discounted, resulting in Level 3 estimates. If the Company markets the property with a realtor, estimated selling costs reduce the fair value, resulting in a valuation based on Level 3 inputs.

The following table summarizes the Company's OREO that was measured at fair value on a nonrecurring basis.

			Carrying Value		
Date	**Description**	**Balance**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
	Assets:				
September 30, 2021	OREO, net of valuation allowance	**$ 957**	**$ -**	**$ -**	**$ 957**
December 31, 2020	OREO, net of valuation allowance	1,553	-	-	1,553

The following tables present information about Level 3 Fair Value Measurements for September 30, 2021 and December 31, 2020.

September 30, 2021	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average[(1)])**
OREO	Discounted appraised value	Selling cost	**6.20%[(3)]**

December 31, 2020	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average[(1)])**
OREO	Discounted appraised value	Selling cost	4.00% – 9.23% (4.54%)[(2)]
OREO	Discounted appraised value	Discount for lack of marketability and age of appraisal	0.00% – 7.66% (0.62%)[(1)]

(1) Discounts were weighted by the relative appraised value of the OREO properties.
(2) The appraised value is discounted by selling costs if the OREO property is listed with a realtor and if appraised value exceeds the list price, less estimated selling costs. Selling costs do not discount appraised value if the Company markets the OREO property independently or if the OREO property is listed with a realtor and the list price less estimated selling costs exceeds appraised value.
(3) As of September 30, 2021, the Company held one OREO property

At September 30, 2021 and December 31, 2020, OREO properties were measured using appraised value, and if applicable, discounted by selling costs, lack of marketability and age of appraisal. Determining the discount to appraisals for selling cost and lack of marketability and age of the appraisal relies on certain key assumptions and judgements.

Discounts for selling costs and in some instances, marketability, result when the Company markets OREO properties via local realtors. The Company works with the realtor to determine the list price, which may be set at appraised value or at a different amount based on the realtor's advice and management's judgement of marketability. Selling costs for improved land generally are estimated at 6% of the list price, and for raw land at 10% of the list price. If the final sale price is different from the list price, the amount of selling costs will also be different from those estimated. Discounts for age may be applied if current appraisals cannot be obtained prior to reporting dates. The most recent appraised value available may be discounted based upon management judgement.

There is uncertainty in determining discounts to appraised value. Future changes to marketability assumptions or updated appraisals may indicate lower fair value, with a corresponding impact to net income.

Fair Value Summary

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2021 and December 31, 2020. For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as noninterest-bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity. Fair values are estimated using the exit price notion.

	September 30, 2021			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Financial Assets:				
Cash and due from banks	$ 11,728	$ 11,728	$ -	$ -
Interest-bearing deposits	118,863	118,863	-	-
Securities	641,486	-	641,486	-
Restricted securities	845	-	845	-
Loans held for sale	235	-	235	-
Loans, net	789,796	-	-	777,049
Accrued interest receivable	5,161	-	5,161	-
Bank-owned life insurance	42,108	-	42,108	-
Forward contracts	3	-	-	3
Financial Liabilities:				
Deposits	$ 1,432,734	$ -	$ 1,350,279	$ 82,626
Accrued interest payable	46	-	46	-
Interest rate loan contracts	4	-	-	4

	December 31, 2020			
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Financial Assets:				
Cash and due from banks	$ 13,147	$ 13,147	$ -	$ -
Interest-bearing deposits	120,725	120,725	-	-
Securities	546,742	-	546,742	-
Restricted securities	1,279	-	1,279	-
Loans held for sale	866	-	866	-
Loans, net	760,318	-	-	752,624
Accrued interest receivable	5,028	-	5,028	-
Bank-owned life insurance	36,444	-	36,444	-
Interest rate loan contracts	1	-	-	1
Financial Liabilities:				
Deposits	$ 1,297,143	$ -	$ 1,207,561	$ 89,681
Accrued interest payable	56	-	56	-
Forward contracts	11	-	-	11

Note 7: Components of Accumulated Other Comprehensive Income (Loss)

The following tables present the components of accumulated other comprehensive income (loss) for the three months ended September 30, 2021 and September 30, 2020.

	Net Unrealized Gain (Loss) on Securities	Adjustments Related to Pension Benefits	Accumulated Other Comprehensive Income (Loss)
Balance at June 30, 2020	**$** 9,518	$ (8,582)	$ 936
Unrealized holding gain on available for sale securities, net of tax of $601	2,256	-	2,256
Reclassification adjustment, net of tax of ($3)	(11)	-	(11)
Balance at September 30, 2020	$ 11,763	$ (8,582)	$ 3,181
Balance at June 30, 2021	$ 8,089	$ (10,147)	$ (2,058)
Unrealized holding loss on available for sale securities net of tax of ($905)	(3,403)	-	(3,403)
Balance at September 30, 2021	**$ 4,686**	**$ (10,147)**	**$ (5,461)**

The following tables present the components of accumulated other comprehensive income (loss) for the nine months ended September 30, 2021 and September 30, 2020.

	Net Unrealized Gain (Loss) on Securities	Adjustments Related to Pension Benefits	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2019	**$** 76	$ (8,582)	$ (8,506)
Unrealized holding gain on available for sale securities, net of tax of $3,127	11,763	-	11,763
Reclassification adjustment, net of tax of ($20)	(76)	-	(76)
Balance at September 30, 2020	$ 11,763	$ (8,582)	$ 3,181
Balance at December 31, 2020	$ 13,167	$ (10,147)	$ 3,020
Unrealized holding loss on available for sale securities net of tax of ($2,254)	(8,477)	-	(8,477)
Reclassification adjustment, net of tax of ($1)	(4)	-	(4)
Balance at September 30, 2021	**$ 4,686**	**$ (10,147)**	**$ (5,461)**

Note 8: Revenue Recognition

Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams such as service charges on deposit accounts, other service charges and fees, credit and debit card fees, trust income, and annuity and insurance commissions are recognized in accordance with ASC Topic 606, "Revenue from Contracts with Customers." Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as financial guarantees, derivatives, and certain credit card fees are outside the scope of the guidance. Noninterest revenue streams within the scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of monthly service fees, overdraft and nonsufficient funds fees, automated teller machine ("ATM") fees, wire transfer fees, and other deposit account related fees. The Company's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Wire transfer fees, overdraft and nonsufficient funds fees and other deposit account related fees are transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Other Service Charges and Fees

Other service charges include safe deposit box rental fees, check ordering charges, and other service charges. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Check ordering charges are transactional based, and therefore the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Credit and Debit Card Fees

Credit and debit card fees are primarily comprised of interchange fee income and merchant services income. Interchange fees are earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. The Company's performance obligation for interchange fee income and merchant services income are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. In compliance with Topic 606, credit and debit card fee income is presented net of associated expense.

Trust Income

Trust income is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives. Estate management fees are based upon the size of the estate. A partial fee is recognized half-way through the estate administration and the remainder of the fee is recognized when remaining assets are distributed and the estate is closed.

Insurance and Investment

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

Investment income consists of recurring revenue streams such as commissions from sales of mutual funds and other investments. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation. The Company also receives periodic service fees (i.e., trailers) from mutual fund companies typically based on a percentage of net asset value. Trailer revenue is recorded over time, usually monthly or quarterly, as net asset value is determined.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and nine months ended September 30, 2021 and September 30, 2020.

	Three Months Ended September 30,	
	2021	**2020**
Noninterest Income		
In-scope of Topic 606:		
Service charges on deposit accounts	**$ 548**	$ 471
Other service charges and fees	**50**	37
Credit and debit card fees, net	**460**	339
Trust income	**433**	423
Insurance and Investment (included within Other Income on the Consolidated Statements of Income)	**99**	143
Noninterest Income (in-scope of Topic 606)	**$ 1,590**	$ 1,413
Noninterest Income (out-of-scope of Topic 606)	**402**	513
Total noninterest income	**$ 1,992**	$ 1,926

	Nine Months Ended September 30,	
	2021	2020
Noninterest Income		
In-scope of Topic 606:		
Service charges on deposit accounts	**$ 1,488**	$ 1,430
Other service charges and fees	**134**	113
Credit and debit card fees, net	**1,373**	1,031
Trust income	**1,282**	1,244
Insurance and Investment (included within Other Income on the Consolidated Statements of Income)	**638**	332
Noninterest Income (in-scope of Topic 606)	**$ 4,915**	$ 4,150
Noninterest Income (out-of-scope of Topic 606)	**1,352**	1,656
Total noninterest income	**$ 6,267**	$ 5,806

Note 9: Leases

The Company's leases are recorded under ASC Topic 842, "Leases". The Company examines its contracts to determine whether they are or contain a lease. A contract with a lease is further examined to determine whether the lease is a short-term, operating or finance lease. As permitted by ASC Topic 842, the Company elected not to capitalize short-term leases, defined by the standard as leases with terms of 12 months or less. The Company also elected the practical expedient not to separate non-lease components from lease components within a single contract.

Right-of-use assets and lease liabilities are recognized for operating and finance leases. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor. Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease.

Lease payments

Lease payments for short-term leases are recognized as lease expense on a straight-line basis over the lease term, or for variable lease payments, in the period in which the obligation was incurred. Payments for leases with terms longer than 12 months are included in the determination of the lease liability. Payments may be fixed for the term of the lease or variable. If the lease agreement provides a known escalator, such as a specified percentage increase per year or a stated increase at a specified time, the variable payment is included in the cash flows used to determine the lease liability. If the variable payment is based upon an unknown escalator, such as the consumer price index at a future date, the increase is not included in the cash flows used to determine the lease liability.

Two of the Company's leases provide known escalators that are included in the determination of the lease liability. One lease has an annual escalator based on the consumer price index-urban ("CPI-U"). The remaining leases do not have variable payments during the term of the lease.

Options to Extend, Residual Value Guarantees, and Restrictions and Covenants

Of the Company's six operating leases, three leases offer the option to extend the lease term. Each of the three leases provides two options of five years each. The Company is reasonably certain it will exercise one option of five years on one lease and has included the additional time and lease payments in the calculation of the lease liability. The lease agreement provides that the lease payment will increase at the exercise date based on the CPI-U. Because the CPI-U at the exercise date is unknown, the increase is not included in the cash flows determining the lease liability. None of the Company's leases provide for residual value guarantees and none provide restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The Company's lease right of use asset is included in other assets and the lease liability is included in other liabilities. The following tables present information about leases:

	September 30, 2021	December 31, 2020
Lease liability	**$ 1,790**	$ 2,016
Right-of-use asset	**$ 1,766**	$ 1,998
Weighted average remaining lease term	**6.21 years**	6.81 years
Weighted average discount rate	**3.05 %**	3.04%

	For the Three Months Ended September 30,	
	2021	2020
Lease Expense		
Operating lease expense	**$ 92**	$ 92
Short-term lease expense	**1**	1
Total lease expense	**$ 93**	$ 93
Cash paid for amounts included in lease liabilities	**$ 91**	$ 90
Right-of-use assets obtained in exchange for operating lease liabilities commencing during the period	**$ -**	$ 23

	For the Nine Months Ended September 30,	
	2021	2020
Lease Expense		
Operating lease expense	**$ 279**	$ 277
Short-term lease expense	**2**	2
Total lease expense	**$ 281**	$ 279
Cash paid for amounts included in lease liabilities	**$ 275**	$ 272
Right-of-use assets obtained in exchange for operating lease liabilities commencing during the period	**$ -**	$ 23

The following table presents a maturity schedule of undiscounted cash flows that contribute to the lease liability:

Undiscounted Cash Flow for the Period	As of September 30, 2021
Twelve months ending September 30, 2022	**$ 356**
Twelve months ending September 30, 2023	**350**
Twelve months ending September 30, 2024	**347**
Twelve months ending September 30, 2025	**263**
Twelve months ending September 30, 2026	**219**
Thereafter	**440**
Total undiscounted cash flows	**$ 1,975**
Less: discount	**(185)**
Lease liability	**$ 1,790**

The contracts in which the Company is lessee are with parties external to the company and not related parties. The Company has a small lease relationship with a director in which the Company is lessor.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
$ in thousands, except share and per share data

The purpose of this discussion and analysis is to provide information about the financial condition and results of operations of the Company. Please refer to the financial statements and other information included in this report as well as the Company's 2020 Annual Report on Form 10-K for an understanding of the following discussion and analysis. References in the following discussion and analysis to "we" or "us" refer to the Company unless the context indicates that the reference is to the Bank.

Cautionary Statement Regarding Forward-Looking Statements

We make forward-looking statements in this Form 10-Q that are subject to significant risks and uncertainties. These forward-looking statements include statements regarding our profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy, and financial and other goals, and are based upon our management's views and assumptions as of the date of this report. The words "believes," "expects," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends," or other similar words or terms are intended to identify forward-looking statements.

These forward-looking statements are based upon or are affected by factors that could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. These factors include, but are not limited to, changes in:

- interest rates,
- general and local economic conditions,
- the legislative/regulatory climate,
- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury, the Office of the Comptroller of the Currency, the Federal Reserve, the Consumer Financial Protection Bureau and the Federal Deposit Insurance Corporation ("FDIC"), and the impact of any policies or programs implemented pursuant to financial reform legislation,
- unanticipated increases in the level of unemployment in the Company's market,
- the quality or composition of the loan and/or investment portfolios,
- demand for loan products,
- deposit flows,
- competition,
- demand for financial services in the Company's market,
- the real estate market in the Company's market,
- laws, regulations and policies impacting financial institutions,
- technological risks and developments, and cyber-threats, attacks or events,
- the Company's technology initiatives,
- steps the Company takes in response to the COVID-19 pandemic, the severity and duration of the pandemic, the uncertainty regarding new variants of COVID-19 that have emerged, the speed and efficacy of vaccine and treatment developments, the impact of loosening or tightening of government restrictions, the pace of recovery as the pandemic subsides and the heightened impact it has on many of the risks described herein,
- performance by the Company's counterparties or vendors,
- applicable accounting principles, policies and guidelines, and
- business disruption and/or impact due to the coronavirus or similar pandemic diseases.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained in this report. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report. This discussion and analysis should be read in conjunction with the description of our "Risk Factors" in Item 1A of the most recently filed Form 10-K.

Cybersecurity

The Company considers cybersecurity risk to be one of the greatest risks to its business. We have deployed a multi-faceted approach to limit the risk and impact of unauthorized access to customer accounts and to information relevant to customer accounts. We use digital technology safeguards, internal policies and procedures, and employee training to reduce the exposure of our systems to cyber-intrusions. We do not offer online account openings or loan originations, limit the dollar amount of online banking transfers to other banks, do not permit customers to submit address changes or wire requests through online banking, require a special vetting process for commercial customers who wish to originate ACH transfers, and limit certain functionalities of mobile banking. The Company also requires assurances from key vendors regarding their cybersecurity.

Further, the Company has a program to identify, mitigate and manage its cybersecurity risks. The program includes penetration testing and vulnerability assessment, technological defenses such as antivirus software, patch management, firewall management, email and web protections, an intrusion prevention system, a cybersecurity insurance policy which covers some but not all losses arising from cybersecurity breaches, as well as ongoing employee training. The costs of these measures were $82 for the three months ended September 30, 2021 and $95 for the three months ended September 30, 2020. For the nine months ended September 30, 2021 and September 30, 2020, the expense was $272 and $283 respectively. These costs are included in various categories of noninterest expense.

However, it is not possible to fully eliminate exposure. The potential for financial and reputational losses due to cyber-breaches is increased by the possibility of human error, unknown system susceptibilities, and the rising sophistication of cyber-criminals to attack systems, disable safeguards and gain access to accounts and related information. We maintain insurance for these risks but insurance policies are subject to exceptions, exclusions and terms whose applications have not been widely interpreted in litigation. Accordingly, insurance can provide less than complete protection against the losses that result from cybersecurity breaches and pursuing recovery from insurers can result in significant expense. In addition, some risks such as reputational damage and loss of customer goodwill, which can result from cybersecurity breaches, cannot be insured against.

Response to COVID-19 Pandemic

The COVID-19 pandemic has affected the global economy since the first quarter of 2020. The Company has complied with national, state and local guidelines to help reduce the spread of the virus, including implementing social distancing measures for employees and customers. The Company's business relies on positive relationships with customers. At this time, we feel our customer relationships remain strong and our team remains ready to provide banking services. All forms of customer service are now available without restriction.

The Company has a robust business continuity plan, and partners with vendors whom we believe also have robust business continuity plans. In implementing its business continuity plan to address the COVID-19 pandemic, the Company has not incurred material expenditures and does not anticipate material expenditures. Further, all critical functions are cross-trained as part of our business continuity preparedness. Controls over cash and physical assets have remained in place and internal controls over financial reporting and disclosure have been maintained.

Overview

National Bankshares, Inc. is a financial holding company that was organized in 1986 under the laws of Virginia and is registered under the Bank Holding Company Act of 1956. NBI common stock is listed on the Nasdaq Capital Market and is traded under the symbol "NKSH."

NBI has two wholly-owned subsidiaries, the National Bank of Blacksburg and National Bankshares Financial Services, Inc. NBB is a community bank and does business as National Bank from twenty-five office locations and one loan production office. The Company recently analyzed its branch locations and determined to close one of its Blacksburg, Virginia offices. The office will close on November 19, 2021 and all business will be transferred to nearby locations. NBB is the source of nearly all of the Company's revenue. NBFS does business as National Bankshares Investment Services and National Bankshares Insurance Services. Income from NBFS is not significant at this time, nor is it expected to be so in the near future.

Non-GAAP Financial Measures

This report refers to certain financial measures that are computed under a basis other than U.S. GAAP ("non-GAAP"), including the net interest margin and the noninterest margin.

Return on Average Assets and Return on Average Equity

The return on average assets and return on average equity are measures of profitability. The return on average assets and return on average equity are calculated by annualizing net income and dividing by average year-to-date assets or equity, respectively. When net income includes larger nonrecurring items, the annualization magnifies their effect. In order to reduce distortion within the ratios, the Company adjusts net income for larger non-recurring items prior to annualization, and then nets the items against the annualized net income. The reconciliation of adjusted annualized net income, which is not a measurement under U.S. GAAP, is reflected in the table below.

The following table details the calculation of annualized net income for the return on average assets and the return on average equity:

$ in thousands	Three months ended September 30,	
	2021	2020
Net Income	**$ 5,752**	$ 4,168
Items deemed non-recurring by management:		
Securities gains, net of tax of $3 in 2020	**-**	(11)
Provision recovery, net of tax of $82 in 2021	**(310)**	-
Adjusted net income	**5,442**	4,157
Adjusted net income, annualized	**21,591**	16,538
Items deemed non-recurring by management:		
Add: Securities gains, net of tax of ($3) in 2020	**-**	11
Add: Provision recovery, net of tax of ($82) in 2021	**310**	
Annualized net income for ratio calculation	**$ 21,901**	$ 16,549

$ in thousands	Nine months ended September 30,	
	2021	2020
Net Income	**$ 15,131**	$ 11,129
Items deemed non-recurring by management:		
Partnership income (1), net of tax of $98 in 2021 and $65 in 2020	**(369)**	(244)
Securities gains, net of tax of $1 in 2021 and $20 in 2020	**(4)**	(76)
Provision recovery, net of tax of $71 in 2021	**(267)**	-
Adjusted net income	**14,491**	10,809
Adjusted net income, annualized	**19,374**	14,438
Items deemed non-recurring by management:		
Add: partnership income, net of tax of ($98) in 2021 and ($65) in 2020	**369**	244
Add: Securities gains, net of tax of ($1) in 2021 and ($20) in 2020	**4**	76
Add: Provision recovery, net of tax of ($71) in 2021	**267**	-
Annualized net income for ratio calculation	**$ 20,014**	$ 14,758

(1) During the first quarter of each year, the Company adjusts its basis in partnership interests. During 2021 and 2020, the adjustment resulted in recognition of a gain. During 2021, the Company also received a one-time payout from a partnership interest, recognized in income. Partnership income is removed from income prior to annualization in order to avoid distortion, and added back to income after annualization.

Net Interest Margin

The Company uses the net interest margin to measure profit on interest generating activities, as a percentage of total interest-earning assets. The net interest margin is calculated by dividing annualized taxable equivalent net interest income by total average earning assets. Because a portion of interest income earned by the Company is nontaxable, the tax equivalent net interest income is considered in the calculation of this ratio. Tax equivalent net interest income is calculated by adding the tax benefit realized from interest income that is nontaxable to total interest income then subtracting total interest expense. The tax rate utilized in calculating the tax benefit is 21%. The reconciliation of tax equivalent net interest income, which is not a measurement under U.S. GAAP, to net interest income, is reflected in the table below.

$ in thousands	Three months ended September 30,	
	2021	**2020**
GAAP measures:		
Interest and fees on loans	**$ 9,088**	$ 8,606
Interest on interest-bearing deposits	**56**	17
Interest and dividends on securities - taxable	**2,043**	1,572
Interest on securities - nontaxable	**469**	513
Total interest income	**$ 11,656**	$ 10,708
Interest on deposits	**$ 719**	$ 1,420
Net interest income	**$ 10,937**	$ 9,288
Non-GAAP measures:		
Tax benefit on nontaxable loan income	**$ 84**	$ 119
Tax benefit on nontaxable securities income	**157**	165
Total tax benefit on nontaxable interest income	**$ 241**	$ 284
Total tax equivalent net interest income	**$ 11,178**	$ 9,572
Total tax equivalent net interest income, annualized	**$ 44,348**	$ 38,080

$ in thousands	Nine months ended September 30,	
	2021	**2020**
GAAP measures:		
Interest and fees on loans	**$ 26,104**	$ 25,491
Interest on interest-bearing deposits	**123**	248
Interest and dividends on securities - taxable	**5,736**	5,791
Interest on securities - nontaxable	**1,472**	1,316
Total interest income	**$ 33,435**	$ 32,846
Interest on deposits	**$ 2,408**	$ 4,814
Net interest income	**$ 31,027**	$ 28,032
Non-GAAP measures:		
Tax benefit on nontaxable loan income	**$ 237**	$ 362
Tax benefit on nontaxable securities income	**488**	398
Total tax benefit on nontaxable interest income	**$ 725**	$ 760
Total tax equivalent net interest income	**$ 31,752**	$ 28,792
Total tax equivalent net interest income, annualized	**$ 42,452**	$ 38,459

Efficiency Ratio

The efficiency ratio is computed by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income, excluding certain items management deems unusual or non-recurring. The tax rate used to calculate fully taxable equivalent basis is 21%. This is a non-GAAP financial measure that the Company believes provides investors with important information regarding operational efficiency. The components of the efficiency ratio calculation are summarized in the following table.

$ in thousands	Three months ended September 30,	
	2021	2020
Noninterest expense	$ 6,367	$ 6,120
Taxable-equivalent net interest income	$ 11,178	$ 9,572
Noninterest income	1,992	1,926
Less: realized securities gains	-	(14)
Total income for ratio calculation	$ 13,170	$ 11,484
Efficiency ratio	48.34%	53.29%

$ in thousands	Nine months ended September 30,	
	2021	2020
Noninterest expense	$ 19,350	$ 18,664
Taxable-equivalent net interest income	$ 31,752	$ 28,792
Noninterest income	6,267	5,806
Less: partnership income	(467)	(309)
Less: realized securities gains	(5)	(96)
Total income for ratio calculation	$ 37,547	$ 34,193
Efficiency ratio	51.54%	54.58%

Noninterest Margin

The Company uses the noninterest margin to evaluate net noninterest expense. A lower noninterest margin indicates more effective expense management in relation to noninterest income generation. The noninterest margin is calculated as noninterest expense less noninterest income (excluding realized securities gain/loss, net), annualizing the difference, and dividing by average year-to-date assets. The annualization process excludes significant one-time items to prevent distortion. The reconciliation of adjusted noninterest income and adjusted noninterest expense, which are not measurements under GAAP, is reflected in the table below.

	Three months ended September 30,	
	2021	2020
Noninterest expense under GAAP	$ 6,367	$ 6,120
Noninterest income under GAAP	$ 1,992	$ 1,926
Less: realized securities gains	-	(14)
Noninterest income for ratio calculation, non-GAAP	$ 1,992	$ 1,912
Net noninterest expense, non-GAAP	$ 4,375	$ 4,208
Net noninterest expense, non-GAAP, annualized	$ 17,357	$ 16,741
Average assets	$ 1,662,897	$ 1,430,541
Noninterest margin	1.04%	1.17%

	Nine months ended September 30,	
	2021	2020
Noninterest expense under GAAP	$ 19,350	$ 18,664
Noninterest income under GAAP	$ 6,267	$ 5,806
Less: partnership income [(1)]	(467)	(309)
Less: realized securities gains	(5)	(96)
Noninterest income for ratio calculation, non-GAAP	$ 5,795	$ 5,401
Net noninterest expense, non-GAAP	$ 13,555	$ 13,263
Net noninterest expense, non-GAAP, annualized	$ 18,123	$ 17,716
Add back: partnership income	467	309
Net noninterest expense, non-GAAP, annualized, adjusted	$ 18,590	$ 18,025
Average assets	$ 1,601,711	$ 1,378,921
Noninterest margin	1.16%	1.31%

(1) During the first quarter of each year, the Company adjusts its basis in partnership interests. During 2021 and 2020, the adjustment resulted in recognition of a gain. During 2021, the Company also received a one-time payout from a partnership interest, recognized in income. Partnership income is removed from income prior to annualization in order to avoid distortion, and added back to income after annualization.

Critical Accounting Policies

General

The Company's financial statements are prepared in accordance with U.S. GAAP. The financial information contained within our statements is, to a significant extent, based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. Although the economics of the Company's transactions may not change, the timing of events that would impact the transactions could change.

Presented below is a discussion of accounting policies that are the most important to the portrayal and understanding of the Company's financial condition and results of operations. The Critical Accounting Policies require management's most difficult, subjective, and complex judgments about matters that are inherently uncertain. If conditions occur that differ from our assumptions, depending upon the severity of such differences, the Company's financial condition or results of operations may be materially impacted. The Company evaluates its critical accounting estimates and assumptions on an ongoing basis and updates them as needed.

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable losses inherent in our loan portfolio. The allowance is funded by the provision for loan losses, reduced by charge-offs of loans and increased by recoveries of previously charged-off loans. The determination of the allowance is based on two accounting principles, ASC Topic 450-20 (Contingencies) which requires that losses be accrued when occurrence is probable and the amount of the loss is reasonably estimable, and ASC Topic 310-10 (Receivables) which requires accrual of losses on impaired loans if the recorded investment exceeds fair value. Probable losses are accrued through two calculations, individual evaluation of impaired loans and collective evaluation of the remainder of the portfolio.

Impaired loans

Impaired loans are identified through the Company's credit risk rating process. Nonaccrual loan relationships that meet the Company's balance threshold of $250 are designated impaired. Other loan relationships that meet the Company's balance threshold of $250 and for which the Company does not expect to collect according to the note's contractual terms are also designated impaired. All TDRs are impaired loans.

TDRs

Loan modifications are reviewed to determine whether, at the time of the modification, the borrower is experiencing financial difficulty and whether the Company provided a concession that it would not otherwise consider. With the exception of borrowers affected by COVID-19 who fall under the provisions of the CARES Act and CAA, modified loans that meet this criteria are designated TDRs.

The CARES Act, the CAA and regulatory agencies provided guidance allowing banks to forego TDR designation for COVID-19 related accommodations to loans that met certain criteria. Under the legislation, short-term modifications to loans that were not more than 30 days past due as of December 31, 2019 are not considered for TDR designation. In accordance with the guidance, the Company did not designate TDR status for modifications to loans impacted by the pandemic that met the criteria. Additional tracking mechanisms implemented at the beginning of the pandemic continue to aid the Company in monitoring COVID-19 related modifications.

When the Company grants subsequent modifications to a loan that had received a previous modification, in accordance with accounting guidance, it considers whether the totality of the accommodations along with the evaluation of borrower financial difficulty meet TDR criteria. Loans that received multiple COVID-19 related modifications were evaluated to determine whether the totality of COVID-19 related accommodations exceed the criteria provided by the CARES Act and CAA and/or result in TDR status. The Company performs additional evaluation and documentation for all COVID-19 related modifications to loans over $250.

Individual evaluation

Impaired loans are individually evaluated at each reporting date. If the fair value of an impaired loan is less than the loan's recorded investment, the deficit is accrued to the allowance for loan losses as a specific allocation.

Cash flow method

The cash flow method measures fair value using assumptions specific to each loan, including expected amount and timing of cash flows and discount rate. For TDR loans, the discount rate is the rate immediately prior to the modification that resulted in a TDR.

Collateral method

Fair value under the collateral method is based upon the "as-is" value of independent appraisals or evaluations. Appraisals must conform to the Uniform Standards of Professional Appraisal Practice and are prepared by an independent third-party appraiser who is certified and licensed and who is approved by the Company. Appraisals may incorporate market analysis, comparable sales analysis, cash flow analysis and market data pertinent to the property to determine market value.

Evaluations are prepared by third party providers and reviewed by employees of the Company who are independent of the loan origination, operation, management and collection functions. Evaluations provide a property's market value based on the property's current physical condition and characteristics and the economic market conditions that affect the collateral's market value. Multiple sources of data contribute to the estimate of market value, including physical inspection, independent third-party automated tools, comparable sales analysis and local market information.

Updated appraisals or evaluations are ordered when a loan becomes impaired if the appraisal or evaluation on file is more than 24 months old. Appraisals and evaluations are reviewed for propriety and reasonableness and may be discounted if the Company determines that the value exceeds reasonable levels. If an updated appraisal or evaluation has been ordered but has not been received by a reporting date, the fair value may be based on the most recent available appraisal or evaluation, discounted for age. The appraisal or evaluation value is reduced by selling costs if recovery is expected solely from the sale of collateral.

Charge-off

Estimated losses on collateral-dependent loans, as well as any other impairment loss considered uncollectible, are charged against the allowance for loan losses. Impairment losses that are not considered uncollectible or for loans that are not collateral-dependent are accrued in the allowance. Impaired loans with partial charge-offs are maintained as impaired until the remaining balance is satisfied.

Nonaccrual Status of Impaired Loans

Impaired loans that are not TDRs and for which fair value measurement indicates an impairment loss are designated nonaccrual. A TDR loan that maintains current status for at least six months may accrue interest.

<u>Collectively-evaluated loans</u>

Credit loss on collectively-evaluated loans is estimated by applying to current class balances the class historical charge-off rates and percentages for qualitative factors that affect credit risk. Additional allocations are provided for loans within each class rated special mention or classified and for loans designated high risk.

Risk rating

Risk ratings indicate credit quality and are assigned through the Company's credit review function for larger loans and selective review of loans that fall below credit review thresholds. Loans that do not indicate heightened risk are rated as "pass." All loans secured by real estate and all consumer loans are risk rated "classified" when they become 75 days past due. Commercial loans are rated "special mention" when they appear to have elevated credit risk indicated by possible deterioration in the borrower's financial condition or collateral. Commercial loans not secured by real estate receive a rating of "classified" when they exhibit frequent or persistent delinquency exceeding 75 days or indicate a higher level of weakness in borrower financial condition. Qualitative factor allocations for pass-rated loans increased by 50% for special mention loans and doubled for classified loans.

High risk loans

High risk loans include junior liens, interest only and high loan to value loans. High risk loans within each class are analyzed and allocated additional reserves based on current trends.

Standard allocations

The analysis of certain factors results in standard allocations to all segments and classes. These factors include the risk from changes in lending policies, loan officers' average years of experience, and economic factors including unemployment levels, bankruptcy rates, interest rate environment, and competition/legal/regulatory environments. Qualitative factors incorporate economic data targeted to the Company's market. If market–specific information is not available on a timely basis, regional or national information that historically shows a high degree of correlation to market data may be used.

Also applied to all segments and classes is an economic factor implemented to address COVID-19 uncertainty: national unemployment filings. Due to continuous developments related to the pandemic, current data is valuable in assessing risk. Local unemployment data lags the reporting date but historical analysis determined that local unemployment filings were closely correlated to national unemployment filings.

Allocations specific to each class

Factors analyzed for each class, with resultant allocations based upon the level of risk assessed for each class, include the risk from changes in loan review, levels of past due loans, levels of nonaccrual loans, current class balance as a percentage of total loans, loans that received COVID-related modifications that are still in the modification period, and the percentage of high risk loans within the class.

Nonaccrual status

The Company reviews loans with certain risk indicators to determine whether the loans should be placed on nonaccrual status, including loans that exceed 90 days past due, loans rated classified, loans with a non-COVID 19 related modification that provides relief from payments of interest or principle for more than 90 days.

Loans in nonaccrual are reviewed on an individual loan basis to determine whether future payments are reasonably assured. To satisfy this criteria, the Company's evaluation must determine that the underlying cause of the original delinquency or weakness that indicated nonaccrual status has been resolved, such as receipt of new guarantees, increased cash flows that cover the debt service or other resolution. Nonaccrual loans that demonstrate reasonable assurance of future payments and that have made at least six consecutive payments in accordance with repayment terms and timeframes may be returned to accrual status.

Sales, Purchases and Reclassification of Loans

The Company finances mortgages under "best efforts" contracts with mortgage purchasers. The mortgages are designated as held for sale upon initiation. There have been no major reclassifications from portfolio loans to held for sale. Mortgages held for sale are not included in the calculation of the allowance for loan losses.

Occasionally, the Company purchases or sells participations in loans. All participation loans purchased met the Company's normal underwriting standards at the time the participation was entered. Participation loans are included in the appropriate portfolio balances to which the allowance methodology is applied.

Unallocated Surplus

In addition to funding the allowance for loan losses based upon data analysis, the Company has the option to fund an unallocated surplus in excess to the calculated requirement, based upon management judgement. The Company's policy permits an unallocated surplus of between 0% and 5% of the calculated requirement.

Estimation of the allowance for loan losses

The estimation of the allowance involves analysis of internal and external variables, methodologies, assumptions and our judgment and experience. Key judgments used in determining the allowance for loan losses include internal risk rating determinations, market and collateral values, discount rates, loss rates, and our view of current economic conditions. These judgments are inherently subjective and our actual losses could be greater or less than the estimate. Future estimates of the allowance could increase or decrease based on changes in the financial condition of individual borrowers, concentrations of various types of loans, economic conditions or the markets in which collateral may be sold. The estimate of the allowance accrual determines the amount of provision expense and directly affects our financial results.

The estimate of the allowance for September 30, 2021 considered market conditions as of September 30, 2021 where possible, and the most recent available information when data was not available as of September 30, 2021, portfolio conditions and levels of delinquencies at September 30, 2021, and net charge-offs in the eight quarters prior to the quarter ended September 30, 2021. Some of the available economic data lags the reporting date by one to three months. As of September 30, 2021, all loans that received payment extensions or interest only periods related to COVID-19 have returned to their contractual terms. Management used its best judgement and efforts in incorporating possible impacts as of September 30, 2021 in estimating the allowance for loan losses, but if the current economic challenges worsen, the ultimate amount of loss could vary from that estimate. For additional discussion of the allowance, see Note 3 to the consolidated financial statements and “Asset Quality,” and “Provision and Allowance for Loan Losses.”

Goodwill

Goodwill is subject to at least an annual assessment for impairment by applying a fair value based test. The Company contracts with a third party valuation expert to perform impairment testing in the fourth quarter of each year. The Company’s most recent impairment test was performed using data from September 30, 2020. Accounting guidance provides the option of performing preliminary assessment of qualitative factors before performing more substantial testing for impairment. The Company opted not to perform the preliminary assessment. The Company’s goodwill impairment analysis considered three valuation techniques appropriate to the measurement. The first technique uses the Company’s market capitalization as an estimate of fair value; the second technique estimates fair value using current market pricing multiples for companies comparable to the Company; while the third technique uses current market pricing multiples for change-of-control transactions involving companies comparable to the Company. The analysis did not result in an impairment assessment.

Certain key judgments were used in the valuation measurement. Goodwill is held by the Company’s bank subsidiary. The bank subsidiary is 100% owned by the Company, and no market capitalization is available. Because most of the Company’s assets are comprised of the subsidiary bank’s equity, the Company’s market capitalization was used to estimate the Bank’s market capitalization. Other judgments include the assumption that the companies and transactions used as comparables for the second and third technique were appropriate to the estimate of the Company’s fair value, and that the comparable multiples are appropriate indicators of fair value, and compliant with accounting guidance.

Pension Plan

The Company’s actuary determines plan obligations and annual pension plan expense using a number of key assumptions. Key assumptions may include the discount rate, the estimated return on plan assets and the anticipated rate of compensation increases. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated, may impact pension assets, liabilities or expense.

<u>Performance Summary</u>

The following table presents the Company’s key performance ratios for the three and nine months ended September 30, 2021 and September 30, 2020. Income and expense items are annualized for the ratios, except for basic and fully diluted earnings per share.

	Three Months Ended	
	September 30, 2021	**September 30, 2020**
Return on average assets [1]	**1.32 %**	1.16%
Return on average equity [1] [4]	**11.26 %**	8.32%
Basic and fully diluted earnings per share [4]	**$ 0.94**	$ 0.64
Net interest margin [2]	**2.83 %**	2.84%
Noninterest margin [3]	**1.04 %**	1.17%
Efficiency ratio [5]	**48.34 %**	53.29%

The following table presents the Company's key performance ratios for the nine months ended September 30, 2021 and September 30, 2020 and the year ended December 31, 2020. The measures for September 30, 2021 and September 30, 2020 are annualized, except for basic and fully diluted earnings per share.

	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020	Twelve Months Ended December 31, 2020
Return on average assets [1]	**1.25%**	1.07%	1.15%
Return on average equity [1] [4]	**10.36%**	7.61%	8.21%
Basic and fully diluted earnings per share [4]	**$ 2.42**	$ 1.71	$ 2.48
Net interest margin [2]	**2.81%**	2.98%	2.98%
Noninterest margin [3]	**1.16%**	1.31%	1.22%
Efficiency ratio [5]	**51.54%**	54.58%	53.46%

(1) Return on average assets and return on average equity are non-GAAP measures. Components of U.S. GAAP net income that are deemed non-recurring by management are removed prior to annualizing the adjusted net income. The adjusted net income is annualized. Items deemed non-recurring by management are added back to the annualized adjusted net income, and the total is divided by average assets for return on average assets, or divided by average equity for return on average equity. See "Non-GAAP Financial Measures" above.

(2) Net interest margin is a non-GAAP measure. Tax advantaged portions of net interest income are adjusted to their fully-taxable equivalent basis and divided by average earning assets. See "Non-GAAP Financial Measures" above.

(3) Noninterest margin is a non-GAAP measure. Noninterest income is adjusted for items deemed by management to be non-recurring and securities gains and losses. Adjusted noninterest income is subtracted from noninterest expense and the difference is annualized, then non-recurring items are added back and the sum is divided by average year-to-date assets. See "Non-GAAP Financial Measures" above.

(4) During the three months ended September 30, 2021, the Company repurchased 73,100 shares under its publicly announced stock repurchase plan. The repurchase reduced shareholders equity by $2,731 during the third quarter. During the nine months ended September 30, 2021, the Company repurchased 335,062 shares under its publicly announced stock repurchase plan. The repurchase reduced shareholders equity by $12,085 during the first nine months of 2021. See "Non-GAAP Financial Measures" above.

(5) The efficiency ratio is a non-GAAP financial measure that the Company believes provides investors with important information regarding operational efficiency. Such information is not prepared in accordance with GAAP and should not be viewed as a substitute for GAAP. See "Non-GAAP Financial Measures" above.

Growth

NBI's key assets and liabilities and their change from December 31, 2020 are shown in the following table.

	September 30, 2021	December 31, 2020	Percent Change
Interest-bearing deposits	**$ 118,863**	$ 120,725	(1.54) %
Securities and restricted stock	**642,331**	548,021	17.21 %
Loans, net	**789,796**	760,318	3.88 %
Deposits	**1,432,734**	1,297,143	10.45 %
Total assets	**1,644,031**	1,519,673	8.18 %

Asset Quality

Key indicators of the Company's asset quality are presented in the following table.

	September 30, 2021	September 30, 2020	December 31, 2020
Nonperforming loans	**$ 3,114**	$ 3,602	$ 3,685
Loans past due 90 days or more, and still accruing	**62**	236	17
Other real estate owned	**957**	1,553	1,553
Allowance for loan losses to loans net of unearned income and deferred fees and costs	**0.97 %**	1.05%	1.10%
Allowance for loan losses to loans net of unearned income and deferred fees and costs, excluding SBA PPP loans	**0.98 %**	1.13%	1.16%
Net charge-off ratio	**0.08 %**	0.07%	0.05%
Ratio of nonperforming assets to loans, net of unearned income and deferred fees and costs, plus other real estate owned	**0.51 %**	0.64%	0.68%
Ratio of allowance for loan losses to nonperforming loans	**247.21 %**	233.98%	230.15%

The Company's risk analysis at September 30, 2021 determined an allowance for loan losses of $7,698 or 0.97% of loans net of unearned income and deferred fees and costs. Included in loans net of unearned income and deferred fees and costs are $12,086 in Paycheck Protection Program loans. Because PPP loans are guaranteed by the U.S. Small Business Administration, they are not included in the calculation for the allowance for loan losses. If the PPP loans are removed from loans net of unearned income and deferred fees and costs, the allowance ratio is 0.98%. The allowance at December 31, 2020 was $8,481 or 1.10% of loans net of unearned income and deferred fees and costs. Excluding PPP loans, the ratio of the allowance to loans net of unearned income and deferred fees and costs at December 31, 2020 was 1.16%.

The determination of the appropriate level for the allowance for loan losses resulted in a recovery of $338 for the nine months ended September 30, 2021, compared with a provision of $1,985 for the nine month period ended September 30, 2020. To determine the appropriate level of the allowance for loan losses, the Company considers credit risk for certain loans designated as impaired and for non-impaired ("collectively evaluated") loans.

Individually Evaluated Impaired Loans

Individually evaluated impaired loans at September 30, 2021 were $6,084 gross and $6,086 net of unearned income and deferred fees and costs. There were no specific allocations to the allowance for loan losses. At December 31, 2020, individually evaluated impaired loans totaled $4,903 gross and $4,905 net of unearned income and deferred fees and costs, with specific allocations to the allowance for loan losses totaling $75. The specific allocation is determined based on criteria particular to each impaired loan.

The impact of the COVID-19 pandemic continues to present uncertainty and may lead to additional loans designated as impaired in future quarters. Cash flow assumptions associated with impaired loans measured under the cash flow method may be impacted if borrowers are further distressed by the economic impacts of the pandemic, resulting in lower measurements and higher funding requirements for the allowance for loan losses. Real estate activity in the Company's market over the most recent 12 months has been robust. However if the real estate market changes, collateral values for impaired loans measured under the collateral method could decline and may result in charge-offs.

Collectively Evaluated Loans

Collectively evaluated loans totaled $792,522 gross and $791,409 net of unearned income and deferred fees and costs, with an allowance of $7,698 or 0.97% of collectively-evaluated loans net of unearned income and deferred fees and costs at September 30, 2021. Excluding PPP loans, the collectively evaluated allowance ratio was 0.98% at September 30, 2021. At December 31, 2020, collectively evaluated loans totaled $765,124 gross and $763,894 net of unearned income and deferred fees and costs, with an allowance of $8,406 or 1.10%. Excluding PPP loans, the collectively evaluated allowance ratio was 1.16% at December 31, 2020.

Collectively evaluated loans are divided into classes based upon risk characteristics. In order to calculate the allowance for collectively evaluated loans, the Company applies to each loan class a historical net charge-off rate for the class, adjusted for qualitative factors that influence credit risk. Qualitative factors evaluated for impact to credit risk include economic measures, asset quality indicators, loan characteristics, and changes to internal Company policies and changes in management.

Net Charge-Offs

Increases in the net charge-off rate increase the required allowance for collectively-evaluated loans, while decreases in the net charge-off rate decrease the required allowance for collectively-evaluated loans. Charge-off rates are calculated and applied on a class level.

On a portfolio level, net charge-offs were $445 for the nine months ended September 30, 2021, or 0.08% (annualized) of average loans. Net charge-offs for the nine months ended September 30, 2020 were $420 or 0.07% (annualized) of average loans, while net charge-offs for the 12 months ended December 31, 2020 were $373 or 0.05% of average loans. The 8-quarter average historical loss rate was 0.06% as of September 30, 2021, 0.07% as of December 31, 2020 and 0.08% as of September 30, 2020.

Economic Factors

Economic factors influence credit risk and impact the allowance for loan loss. The Company considers economic indicators within its market area, including: unemployment, business and personal bankruptcy filings, the residential vacancy rate and the inventory of new and existing homes.

The Company sources economic data pertinent to its market from the most recently available publications. However, some economic indicators lag the report date by one to three months. In periods of low volatility, lagging indicators are accepted as reasonably representative of current conditions. The COVID-19 pandemic has introduced significant uncertainty which results in the need for greater timeliness in information.

At the beginning of the pandemic, the Company implemented a qualitative factor for national unemployment filings to represent current economic data. Unemployment filings for the Company's market area is not available on a timely basis, however national data is available on a timely basis and historical analysis shows a strong correlation between national and local unemployment filings. National unemployment claims escalated sharply beginning in the latter half of March 2020. Weekly claims peaked at the beginning of April 2020 and have fallen since, but for the nine months ended September 30, 2021, are almost three times pre-pandemic levels. The Company assessed this as a significant impact to credit risk at September 30, 2021, but lower than at December 31, 2020.

The Company continues to monitor the most recently available economic indicators for its market and their effect on credit risk. As of September 30, 2021, the unemployment rate for the Company's market area was measured as of August 31, 2021 and decreased from the measurement available at December 31, 2020, decreasing the allocation to the allowance for loan losses.

Business and personal bankruptcy filing data was available as of June 2021. Higher bankruptcy filings indicate heightened credit risk and increase the allowance for loan losses, while lower bankruptcy filings have a beneficial impact on credit risk. Compared with data available at December 31, 2020, business bankruptcies and personal bankruptcies were slightly lower and resulted in a slightly lower allocation.

Residential vacancy rates and housing inventory impact the Company's residential construction customers and the consumer real estate market. Higher levels increase credit risk. The residential vacancy rate at September 30, 2021 was measured as of the second quarter of 2021 and while still lower than normal levels, worsened slightly from the data incorporated into the December 31, 2020 calculation, resulting in a higher allocation. Housing inventory data was available as of September 30, 2021. Levels are historically low and similar to those at December 31, 2020.

Asset Quality Indicators

Asset quality indicators, including past due levels, nonaccrual levels and internal risk ratings, are evaluated at the class level. Loans past due and loans designated nonaccrual indicate heightened credit risk. Increases in past due and nonaccrual loans increase the required level of the allowance for loan losses and decreases in past due and nonaccrual loans reduce the required level of the allowance for loan losses.

Accruing loans past due 30-89 days were 0.15% of total loans net of unearned income and deferred fees and costs at September 30, 2021, a decrease from 0.19% at December 31, 2020. Accruing loans past due 90 days or more were 0.01% of total loans, net of unearned income and deferred fees and costs at September 30, 2021 compared to 0.00% at December 31, 2020. Nonaccrual loans at September 30, 2021 were 0.39% of total loans net of unearned income and deferred fees and costs, lower than 0.48% at December 31, 2020.

Loans rated special mention and classified (together, "criticized assets") indicate heightened credit risk. Higher levels of criticized assets increase the required level of the allowance for collectively-evaluated loans, while lower levels of criticized assets reduce the required level of the allowance for collectively-evaluated loans. Collectively evaluated loans rated special mention were $4,376 at September 30, 2021, lower than $8,035 at December 31, 2020. Collectively evaluated loans rated classified were $492 at September 30, 2021 and $473 at December 31, 2020.

The Company provided COVID-19 related accommodations to qualifying borrowers. The Company followed its normal risk rating practices and in keeping with the regulatory guidance, did not automatically downgrade the risk rating on loans that received COVID-19 accommodations.

Other Factors

The Company considers other factors that impact credit risk, including the interest rate environment, the competitive, legal and regulatory environments, changes in lending policies and loan review, changes in management, and high risk loans, as well as a factor to measure the risk from loans that received a COVID-19 modification and then received a subsequent COVID-19 modification.

The interest rate environment impacts variable rate loans. If interest rates increase, the payment on variable rate loans increases, which may increase credit risk. The interest rate environment is at a low level as of September 30, 2021, unchanged from the level at December 31, 2020. The low level of interest rates indicates no additional credit risk.

The competitive, legal and regulatory environments were evaluated for changes that would impact credit risk. Higher competition for loans increases credit risk, while lower competition decreases credit risk. Competition remained at similar levels to those at December 31, 2020. The legal and regulatory environments remain in a similar posture to that at December 31, 2020.

Lending policies, loan review procedures and management's experience influence credit risk. Since December 31, 2020, there have been no changes that affect credit risk to the Company's lending policies or loan review procedures, or changes in management's experience.

Levels of high risk loans are considered in the determination of the level of the allowance for loan loss. A decrease in the level of high risk loans within a class decreases the required allocation for the loan class, and an increase in the level of high risk loans within a class increases the required allocation for the loan class. Total high risk loans decreased $13,228 or 11.69% from the level at December 31, 2020, resulting in a decreased allocation.

In light of COVID-19 related modifications, the Company considers the impact to credit risk of certain loans granted COVID-19 related modifications. The loans captured in the analysis were granted COVID-19 related modifications subsequent to initial COVID-19 related modifications that remained in their modification period at the reporting date and were flagged by credit review procedures for additional monitoring. As of September 30, 2021, there were no loans that met this criteria and no allocation was taken.

Unallocated Surplus

The unallocated surplus at September 30, 2021 is $365 or 5.0% in excess of the calculated requirement. The unallocated surplus at December 31, 2020 was $396 or 4.9% in excess of the calculated requirement. The surplus provides some mitigation of the uncertainty surrounding the impact of COVID-19.

Conclusion

The calculation of the appropriate level for the allowance for loan losses incorporates analysis of multiple factors and requires management's prudent and informed judgment. The most recently available data showed improvements that decreased the required level of the allowance for loan losses at September 30, 2021 from December 31, 2020 including loans considered high risk, business and personal bankruptcy filings, the unemployment rate and certain loans with COVID-19 related modifications. Other indicators, including accruing loans past due 90 days or more, residential vacancy and classified loans, showed worsening from levels at December 31, 2020 and increased the required level of the allowance for loan losses. Continued high national unemployment filings contributed to the allowance for loan losses, though lower than at December 30, 2020. The Company also increased its unallocated surplus to 5.0% to mitigate some of the uncertainty caused by the pandemic. Based on analysis of historical indicators, asset quality and economic factors, management believes the level of allowance for loan losses is reasonable for the credit risk in the loan portfolio as of September 30, 2021.

Please refer to Note 3: Allowance for Loan Losses, Nonperforming Assets and Impaired Loans for further information on collectively evaluated loans, individually evaluated impaired loans and the unallocated portion of the allowance for loan losses.

Other Real Estate Owned

The following table discloses the OREO in physical possession and in process at each reporting date:

Other Real Estate Owned[(1)]	**September 30, 2021**		**September 30, 2020**		**December 31, 2020**	
Real estate construction	**$**	**957**	$	1,443	$	1,443
Consumer real estate		**-**		110		110
Total other real estate owned	**$**	**957**	$	1,553	$	1,553
Loans in process of foreclosure	**$**	**124**	$	651	$	1,344

(1) Net of valuation allowance.

OREO decreased $596 when the balance at September 30, 2021 is compared with the balance at December 31, 2020 and September 30, 2020. As of September 30, 2021, loans in in various stages of foreclosure totaled $124 and were secured by residential real estate. Loans currently in process of foreclosure may impact OREO in future quarters. It is not possible to accurately predict the future total of OREO because property sold at foreclosure may be acquired by third parties and OREO properties are regularly marketed and sold.

The Company continues to monitor risk levels within the loan portfolio, including any effect on collateral values from the COVID-19 pandemic. As of September 30, 2021, the effect of the COVID-19 pandemic has not impacted real estate values in the Company's market and has not impacted current OREO values.

Modifications and TDRs

In the ordinary course of business the Company modifies loan terms on a case-by-case basis, including consumer and commercial loans, for a variety of reasons. Modifications may include rate reductions, payment extensions of varying lengths of time, a change in amortization term or method or other arrangements. Payment extensions allow borrowers temporary payment relief and result in extending the original contractual maturity by the number of months for which the extension was granted. The Company may grant payment extensions to borrowers who have demonstrated a willingness and ability to repay their loan but who are experiencing consequences of a specific unforeseen temporary hardship. If the temporary event is not expected to impact a borrower's ability to repay the debt, and if the Company expects to collect all amounts due including interest accrued at the contractual interest rate for the extension period at contractual maturity, the modification is not designated a TDR.

Modifications to consumer loans generally involve short-term payment extensions to accommodate specific, temporary circumstances. Modifications to commercial loans may include, but are not limited to, changes in interest rate, maturity, amortization and financial covenants. If the modified terms are consistent with competitive market conditions and representative of terms the borrower could otherwise obtain in the open market, the modified loan is not categorized as a TDR.

The Company codes modifications to assist in identifying TDRs. When the COVID-19 pandemic began, the Company added coding to identify modifications to borrowers experiencing COVID-19 related hardship.

Modifications Made for Competitive Purposes

During the nine months ended September 30, 2021, the Company provided 659 modifications for competitive reasons to loans totaling $72,327. The modifications were not TDRs and were not related to COVID-19. For the nine months ended September 30, 2020, the Company provided non-TDR modifications for competitive reasons to 798 loans totaling $128,821. For the twelve months ended December 31, 2020, the Company provided non-TDR modifications for competitive reasons to 1,047 loans totaling $152,681.

Modifications Related to COVID-19

The COVID-19 pandemic negatively impacted a significant number of the Company's borrowers, and may adversely impact some borrowers for the foreseeable future. Since the pandemic began in March 2020, the Company provided modifications related to COVID-19 financial difficulty, including payment extensions and interest only periods. The CARES Act, the CAA and regulatory guidance specify criteria that, if met, provide an election not to designate the loans as TDRs. The TDRs designated during the nine months ended September 30, 2021 resulted from COVID-19 related modifications that did not meet the legal and regulatory criteria to avoid designation as TDR. All of the Company's other COVID-19 related modifications met the criteria and were not designated TDR. The Company followed its normal risk rating and nonaccrual designation procedures and did not automatically downgrade or designate as nonaccrual if the loan was modified for COVID-19 related difficulty.

The following tables provide information regarding COVID-19 related modifications for the three and nine months ended September 30, 2021 and September 30, 2020, and the 12 months ended December 31, 2020.

	Three Months Ended September 30,			
	2021		2020	
Modifications To Borrowers Impacted by the COVID-19 Pandemic	**Number**	**Amount (in thousands)**	**Number**	**Amount (in thousands)**
Payment extensions[(1)]	**3**	**$ 89**	59	$ 31,347
Interest-only period for amortizing loans[(1)]	**-**	**-**	5	9,172
Total	**3**	**$ 89**	64	$ 40,519

Modifications To Borrowers Impacted by the COVID-19 Pandemic	Nine Months Ended September 30, 2021 Number	2021 Amount (in thousands)	2020 Number	2020 Amount (in thousands)
Payment extensions(1)	**37**	**$ 16,426**	319	$ 94,982
Interest-only period for amortizing loans(1)	**8**	**22,135**	37	64,806
Rate reductions(2)	**-**	**-**	5	442
Total	**45**	**$ 38,561**	361	$ 160,230

Modifications To Borrowers Impacted by the COVID-19 Pandemic	Twelve Months Ended December 31, 2020 Number	Amount (in thousands)
Payment extensions (1)	350	$ 121,676
Interest-only period for amortizing loans (1)	31	59,982
Rate reductions (2)	5	442
Maturity date extension	2	729
Total	388	$ 182,829

(1) Payment extensions and interest-only periods are governed by agreements that specify expiration dates.
(2) Rate reductions were granted to qualifying loans and are permanent for the remaining term of the loan. Rate reductions were provided to alleviate COVID-19 hardship and also to remain competitive in the current low interest rate environment.

All COVID-19 related modifications for payment extensions and interest-only periods have returned to contractual terms as of September 30, 2021.

Methodology

A loan that received multiple modifications as part of one request, for instance, a rate reduction and a payment extension, is presented only under one modification category. A loan that was modified pursuant to a first request and then was modified subsequently pursuant to a separate request is included for each of the requests. For example, a loan that received a payment extension under a first request and a rate reduction under a second request is counted in the rate reduction category and again in the payment extension category.

TDRs

The Company's TDRs were $6,084 at September 30, 2021, an increase from $4,249 at December 31, 2020. Accruing TDR loans amounted to $3,009 at September 30, 2021 and $1,410 at December 31, 2020. The following tables present the past due status of TDRs as of the dates indicated.

	TDR Status as of September 30, 2021				
		Accruing			
	Total TDR Loans	**Current**	**30-89 Days Past Due**	**90+ Days Past Due**	**Nonaccrual**
Consumer real estate	**$ 192**	**$ 192**	**$ -**	**$ -**	**$ -**
Commercial real estate	**5,583**	**2,816**	**-**	**-**	**2,767**
Commercial non-real estate	**308**	**-**	**-**	**-**	**308**
Consumer non-real estate	**1**	**1**	**-**	**-**	**-**
Total TDR Loans	**$ 6,084**	**$ 3,009**	**$ -**	**$ -**	**$ 3,075**

	TDR Status as of December 31, 2020				
		Accruing			
	Total TDR Loans	Current	30-89 Days Past Due	90+ Days Past Due	Nonaccrual
Consumer real estate	$ 194	$ 194	$ -	$ -	$ -
Commercial real estate	3,202	-	363	-	2,839
Commercial non-real estate	851	188	663	-	-
Consumer non-real estate	2	1	-	1	-
Total TDR Loans	$ 4,249	$ 383	$ 1,026	$ 1	$ 2,839

Please refer to Note 3: Allowance for Loan Losses, Nonperforming Assets and Impaired Loans for information on TDRs.

Net Interest Income

The net interest income analysis for the three and nine months ended September 30, 2021 and 2020 follows:

	Three Months Ended					
	September 30, 2021			September 30, 2020		
	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate
Interest-earning assets:						
Loans [(1)(2)(3)(5)(6)]	**$ 798,807**	**$ 9,172**	**4.56 %**	$ 800,168	$ 8,725	4.34 %
Taxable securities [(7)(8)]	**540,854**	**2,043**	**1.50 %**	400,204	1,572	1.56 %
Nontaxable securities [(2)(7)]	**79,097**	**626**	**3.14 %**	75,482	678	3.57 %
Interest-bearing deposits	**145,759**	**56**	**0.15 %**	64,981	17	0.10 %
Total interest-earning assets	**$ 1,564,517**	**$ 11,897**	**3.02 %**	$ 1,340,835	$ 10,992	3.26 %
Interest-bearing liabilities:						
Interest-bearing demand deposits	**$ 839,477**	**$ 617**	**0.29 %**	$ 674,646	$ 917	0.54 %
Savings deposits	**195,767**	**41**	**0.08 %**	162,012	108	0.27 %
Time deposits	**86,379**	**61**	**0.28 %**	109,024	395	1.44 %
Total interest-bearing liabilities	**$ 1,121,623**	**$ 719**	**0.25 %**	$ 945,682	$ 1,420	0.60 %
Net interest income and interest rate spread		**$ 11,178**	**2.77 %**		$ 9,572	2.66 %
Net yield on average interest-earning assets			**2.83 %**			2.84 %

	Nine Months Ended					
	September 30, 2021			September 30, 2020		
	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Average Yield/ Rate
Interest-earning assets:						
Loans [(1)(2)(4)(5)(6)]	**$ 786,613**	**$ 26,341**	**4.48 %**	$ 765,726	$ 25,853	4.51 %
Taxable securities [(7)(8)]	**505,134**	**5,736**	**1.52 %**	395,713	5,791	1.95 %
Nontaxable securities [(2)(7)]	**80,596**	**1,960**	**3.25 %**	56,859	1,714	4.03 %
Interest-bearing deposits	**136,391**	**123**	**0.12 %**	74,296	248	0.45 %
Total interest-earning assets	**$ 1,508,734**	**$ 34,160**	**3.03 %**	$ 1,292,594	$ 33,606	3.47 %
Interest-bearing liabilities:						
Interest-bearing demand deposits	**$ 799,593**	**$ 2,053**	**0.34 %**	$ 652,869	$ 2,990	0.61 %
Savings deposits	**186,720**	**132**	**0.09 %**	155,542	348	0.30 %
Time deposits	**88,009**	**223**	**0.34 %**	118,611	1,476	1.66 %
Total interest-bearing liabilities	**$ 1,074,322**	**$ 2,408**	**0.30 %**	$ 927,022	$ 4,814	0.69 %
Net interest income and interest rate spread		**$ 31,752**	**2.73 %**		$ 28,792	2.78 %
Net yield on average interest-earning assets			**2.81 %**			2.98 %

(1) Loans are net of unearned income and deferred fees and costs.
(2) Interest on nontaxable loans and securities is computed on a fully taxable equivalent basis using a Federal income tax rate of 21%.
(3) For the three months ended September 30, 2021, interest income includes loan fees of $911, of which $882 was related to the PPP loans. For the three months ended September 30, 2020, interest income includes loan fees of $323, of which $285 was related to the PPP loans.
(4) For the nine months ended September 30, 2021, interest income includes loan fees of $1,855 of which $1,776 was related to the PPP loans. For the nine months ended September 30, 2020, interest income includes loan fees of $595, of which $509 was related to PPP loans.
(5) Nonaccrual loans are included in average balances for yield computations.
(6) Includes loans held for sale.
(7) Daily averages are shown at amortized cost.
(8) Includes restricted stock.

The net interest margin for the three and nine month periods ended September 30, 2021 declined when compared with the comparable periods of 2020. The decline is due to high levels of loan re-finance activity, spurred by the Federal Reserve rate cuts in March 2020. Also impacted by the Federal Reserve rate cuts were investment opportunities in the bond market. Replacing matured and called securities and investing excess liquidity from customer deposits resulted in lower yields for taxable and nontaxable securities. Further, uncertainty surrounding the length of time that customer deposits, bolstered by federal stimulus aid, will remain with the Bank resulted in a higher balance in interest-bearing deposits, which provides the lowest yielding investment opportunity. The Company reacted to the Federal Reserve rate cuts by reducing offering rates on deposits. The Company’s yield on earning assets and cost of funds are largely dependent on the interest rate environment.

Fees and interest income from PPP loans helped increase the net interest margin. For the three months ended September 30, 2021, PPP loans increased average loans by $20,913, and provided $55 in interest and $882 in fee recognition. For the three months ended September 30, 2020, PPP loans increased average loans by $58,036, and provided $146 in interest and $285 in fee recognition. If PPP loans are excluded, the net interest margin for the three months ended September 30, 2021 would have been 2.60% and the net interest margin for the three months ended September 30, 2020 would have been 2.72%.

For the nine months ended September 30, 2021, PPP loans increased average loans by $32,294 and provided $253 in interest and $1,776 in fee recognition. For the nine months ended September 30, 2020, PPP loans increased average loans by $32,560 and provided $263 in interest and $509 in fee recognition. If PPP loans are excluded, the net interest margin for the nine months ended September 30, 2021 would have been 2.64% and the net interest margin for the nine months ended September 30, 2020 would have been 2.91%.

Net deferred fees that will be recognized over the life of the PPP loans at September 30, 2021 were $709.

Provision and Allowance for Loan Losses

The recovery for loan losses was $392 and $338 for the three and nine month periods ended September 30, 2021, respectively, compared with provision expense of $154 and $1,985 for the three and nine month periods ended September 30, 2020, respectively.

To reflect the impact of the pandemic, beginning with the March 31, 2020 calculation of the allowance for loan loss, the Company added a qualitative factor for national unemployment filings. During 2020, national unemployment filings increased dramatically from pre-pandemic levels and was the source of most of the provision taken for the nine months ended September 30, 2020. During the nine months ended September 30, 2021, unemployment filings have declined substantially. Combined with improvements in other qualitative factors, the required allowance for loan losses declined, resulting in a recovery for the three and nine months ended September 30, 2021. The provision for loan losses is the result of a detailed analysis to estimate an adequate allowance for loan losses. See "Asset Quality" for additional information.

Noninterest Income

	Three Months Ended		
	September 30, 2021	**September 30, 2020**	**Percent Change**
Service charges on deposits	**$ 548**	$ 471	**16.35 %**
Other service charges and fees	**50**	37	**35.14 %**
Credit and debit card fees, net	**460**	339	**35.69 %**
Trust fees	**433**	423	**2.36 %**
BOLI income	**248**	219	**13.24 %**
Gain on sale of mortgage loans	**76**	165	**(53.94) %**
Other income	**177**	258	**(31.40) %**
Realized securities gain, net	**-**	14	**(100.00) %**

	Nine Months Ended		
	September 30, 2021	**September 30, 2020**	**Percent Change**
Service charges on deposits	**$ 1,488**	$ 1,430	**4.06 %**
Other service charges and fees	**134**	113	**18.58 %**
Credit and debit card fees, net	**1,373**	1,031	**33.17 %**
Trust fees	**1,282**	1,244	**3.05 %**
BOLI income	**664**	659	**0.76 %**
Gain on sale of mortgage loans	**287**	416	**(31.01) %**
Other income	**1,034**	817	**26.56 %**
Realized securities gain, net	**5**	96	**(94.79) %**

Service charges on deposit accounts increased $77 when the three month periods ended September 30, 2021 and September 30, 2020 are compared, and increased $58 when the nine month periods ended September 30, 2021 and September 30, 2020 are compared. Higher income on account service charges for demand deposit accounts and savings accounts and higher income from ATM fees contributed to the increases when the three and nine month periods are compared. The three month period ended September 30, 2021 also benefitted from increased NSF and overdraft fee income.

Other service charges and fees increased $13 and $21 for the three and nine month periods ended September 30, 2021 compared with the same periods ended September 30, 2020. Other service charges include charges for official checks, income from the sale of checks to customers, safe deposit box rent, fees for letters of credit and the income earned from commissions on the sale of credit life, accident and health insurance.

Credit and debit card fees are presented net of interchange expense. Credit and debit card fees increased $121 and $342 for the three and nine month periods ended September 30, 2021 when compared with the same periods last year. Credit and debit card fees are based on volume and other factors.

Income from trust fees increased $10 and $38 for the three and nine month periods ended September 30, 2021 when compared with the same periods ended September 30, 2020. Trust income varies depending on the total assets held in trust accounts, the type of accounts under management and financial market conditions.

BOLI income increased $29 and $5 when the three and nine month periods ended September 30, 2021 and September 30, 2020 are compared. The Company purchased an additional $5 million in BOLI investments during June 2021.

Gain on sale of mortgage loans decreased $89 and $129 when the three and nine month periods ended September 30, 2021 and

September 30, 2020 are compared. During 2020, Federal Reserve rate cuts spurred a high level of real estate refinance and purchase financing activity, resulting in higher income. This activity is beginning to normalize in 2021.

Other income includes revenue from investment and insurance sales, adjustments to partnership bases and other miscellaneous components. These areas fluctuate with market conditions and competitive factors. Other income decreased $81 for the three month periods ended September 30, 2021 when compared with the same period ended September 30, 2020, primarily due to lower commissions on investment sales and lower income recognized on derivatives associated with the secondary mortgage market. When the nine month periods are compared, other income increased $217, primarily due to increased commissions on securities sales, dividends, a one-time commission and a one-time bonus payment.

The Company did not have a gain or loss on securities during the three months ended September 30, 2021, and realized a gain on securities of $5 during the nine months ended September 30, 2021. During 2020, the Company realized a gain of $14 for the three months ended September 30, 2020 and $96 during the nine month period ended September 30, 2020.

Noninterest Expense

	Three Months Ended		
	September 30, 2021	**September 30, 2020**	**Percent Change**
Salaries and employee benefits	**$ 3,909**	$ 3,511	**11.34 %**
Occupancy, furniture and fixtures	**447**	452	**(1.11)%**
Data processing and ATM	**728**	799	**(8.89)%**
FDIC assessment	**120**	87	**37.93 %**
Net costs of other real estate owned	**11**	18	**(38.89)%**
Franchise taxes	**367**	331	**10.88 %**
Other operating expenses	**785**	922	**(14.86)%**

	Nine Months Ended		
	September 30, 2021	**September 30, 2020**	**Percent Change**
Salaries and employee benefits	**$ 11,767**	$ 10,882	**8.13 %**
Occupancy, furniture and fixtures	**1,378**	1,360	**1.32 %**
Data processing and ATM	**2,292**	2,396	**(4.34)%**
FDIC assessment	**296**	127	**133.07 %**
Net costs of other real estate owned	**49**	36	**36.11 %**
Franchise taxes	**1,059**	1,009	**4.96 %**
Other operating expenses	**2,509**	2,854	**(12.09)%**

Total noninterest expense increased $247 or 4.04% when the three month periods ended September 30, 2021 and September 30, 2020 are compared, and increased $686 or 3.68% when the nine month period ended September 30, 2021 is compared with the same period of 2020.

Salaries and employee benefits increased $398 when the three month periods ended September 30, 2021 and September 30, 2020 are compared and increased $885 when the nine month period ended September 30, 2021 is compared with the same period in 2020. This expense category includes employee salaries, payroll taxes, insurance and fringe benefits, ESOP contribution accruals, the service component of net periodic pension cost, and salary continuation expenses. The service component of net periodic pension cost increased $156 and $404 when the three and nine month periods ended September 30, 2021 and September 30, 2020 are compared.

Federal Deposit Insurance Corporation ("FDIC") assessment expense increased $33 and $169 when the three and nine month periods ended September 30, 2021 are compared with the same periods of 2020. The FDIC assessment is accrued based on a method provided by the FDIC. The calculation is based on average assets divided by average tangible equity and incorporates risk-based factors to determine the amount of the assessment. During the third quarter of 2019, the FDIC notified the Bank that it was eligible to use small bank assessment credits. The credits fully offset the Bank's September 30, 2019, December 31, 2019 and March 31, 2020 assessment payments, and partially offset the June 30, 2020 assessment.

Net costs of OREO decreased $7 when the three month period ended September 30, 2021 and September 30, 2020 are compared, and increased $13 when the nine month period ended September 30, 2021 is compared with the same periods in 2020. The cost of OREO includes maintenance costs as well as valuation write-downs and gains and losses on the sale of properties. The expense varies with the number of properties, the maintenance required and changes in the real estate market. OREO properties are accounted for at fair value less cost to sell upon foreclosure and are thereafter periodically appraised to determine market value. Declines in market value are recognized through valuation expense.

Franchise tax expense increased $36 when the three month periods ended September 30, 2021 and September 30, 2020 are compared. Franchise tax expense increased $50 when the nine month periods ended September 30, 2021 and September 30, 2020 are compared. Franchise tax is primarily based on capital levels of the subsidiary bank, and is also affected by investment levels in securities issued by U.S. government agencies.

The category of other operating expenses includes noninterest expense items such as professional services, stationery and supplies, telephone costs, postage, charitable donations, losses and other expenses. Other operating expense decreased $137 and $345 when the three and nine month periods ended September 30, 2021 are compared with the same periods ended September 30, 2020. The decrease in other operating expense stemmed primarily from a lower non-service pension cost and cost control measures.

Income Tax

Income tax expense was $1,202 for the three months ended September 30, 2021 and $772 for the same period of 2020. For the nine months ended September 30, 2021 and 2020, income tax expense was $3,151 and $2,060 respectively. The Company's federal statutory tax rate is 21%. The Company's effective tax rate was 17.29% and 17.24% for the three and nine month periods ended September 30, 2021, compared with 15.63% and 15.62% for the three and nine month periods ended September 30, 2020.

Balance Sheet

Year-to-date daily averages for the major balance sheet categories are as follows:

Assets	**September 30, 2021**	**December 31, 2020**	**Percent Change**
Interest-bearing deposits	**$ 136,391**	$ 81,639	**67.07 %**
Securities available for sale and restricted stock	**594,322**	474,934	**25.14 %**
Loans, net	**777,649**	760,641	**2.24 %**
Total assets	**1,601,711**	1,403,671	**14.11 %**
Liabilities and stockholders' equity			
Noninterest-bearing demand deposits	**$ 313,911**	$ 248,392	**26.38 %**
Interest-bearing demand deposits	**799,593**	669,383	**19.45 %**
Savings deposits	**186,720**	158,334	**17.93 %**
Time deposits	**88,009**	112,463	**(21.74)%**
Stockholders' equity	**193,184**	195,768	**(1.32)%**

Securities

Securities at September 30, 2021 increased compared with December 31, 2020, in both ending balance and year-to-date average balance. Securities growth stems from investment of excess liquidity provided by increased deposit balances. Securities available for sale are measured at fair value on a recurring basis. Market conditions at September 30, 2021 are reflected in the presentation of securities available for sale. While we do not expect significant changes in future judgements or methodologies used to determine the fair value of the securities portfolio, market volatility associated with the COVID-19 pandemic, or any future national or global concern, will impact the value of securities. Management regularly monitors the quality of the securities portfolio and closely follows the uncertainty in the economy and the volatility of financial markets. The value of individual securities will be written down if the decline in fair value is considered to be other than temporary based upon the totality of circumstances. See Note 4: Securities for additional information.

Loans

	September 30, 2021	December 31, 2020	Percent Change
Real estate construction loans	**$ 50,883**	$ 42,266	**20.39 %**
Consumer real estate loans	**204,880**	181,782	**12.71 %**
Commercial real estate loans	**403,840**	393,115	**2.73 %**
Commercial non real estate loans	**59,082**	78,771	**(25.00)%**
Public sector and IDA	**48,345**	40,983	**17.96 %**
Consumer non real estate	**31,576**	33,110	**(4.63)%**
Less: unearned income and deferred fees and costs	**(1,112)**	(1,228)	**(9.45)%**
Loans, net of unearned income and deferred fees and costs	**$ 797,494**	$ 768,799	**3.73 %**

The Company's loans, net of unearned income and deferred fees and costs, increased $28,695 or 3.73% from $768,799 at December 31, 2020 to $797,494 at September 30, 2021. Real estate construction, consumer real estate, commercial real estate and public sector and IDA loans increased from December 31, 2020. Included in commercial non real estate loans are PPP loans of $12,795 at September 30, 2021 and $36,903 at December 31, 2020. Excluding PPP loans, commercial non real estate loans increased $4,419.

Deposits

	September 30, 2021	December 31, 2020	Percent Change
Noninterest-bearing demand deposits	**$ 328,893**	$ 276,793	**18.82 %**
Interest-bearing demand deposits	**819,730**	763,293	**7.39 %**
Saving deposits	**201,656**	167,475	**20.41 %**
Time deposits	**82,455**	89,582	**(7.96)%**
Total deposits	**$ 1,432,734**	$ 1,297,143	**10.45 %**

Total deposits increased $135,591 or 10.45% from $1,297,143 at December 31, 2020 to $1,432,734 at September 30, 2021. The increase is due in large part to government stimulus funds received by municipal depositors and other depositors. The Company's deposits do not include any brokered deposits.

Liquidity

Liquidity measures the Company's ability to meet its financial commitments at a reasonable cost. Demands on the Company's liquidity include funding additional loan demand and accepting withdrawals of existing deposits. The Company has diverse liquidity sources, including customer and purchased deposits, customer repayments of loan principal and interest, sales, calls and maturities of securities, Federal Reserve discount window borrowing, short-term borrowing, and FHLB advances. At September 30, 2021, the Bank did not have discount window borrowings, short-term borrowings, or FHLB advances. To assure that short-term borrowing is readily available, the Company tests accessibility annually.

The Company considers its security portfolio for typical liquidity needs, within accounting, legal and strategic parameters. Portions of the securities portfolio are pledged to meet state requirements for public funds deposits. Discount window borrowings also require pledged securities. Increased/decreased liquidity from public funds deposits or discount window borrowings results in increased/decreased liquidity from pledging requirements. The Company monitors public funds pledging requirements and unpledged available-for-sale securities accessible for liquidity needs.

Regulatory capital levels at the subsidiary bank determine the Bank's ability to use purchased deposits and the Federal Reserve discount window. At September 30, 2021, the Bank is considered well capitalized and does not have any restrictions on purchased deposits or borrowing ability at the Federal Reserve discount window.

The Company monitors factors that may increase its liquidity needs. Some of these factors include deposit trends, large depositor activity, maturing deposit promotions, interest rate sensitivity, maturity and repricing timing gaps between assets and liabilities, the level of unfunded loan commitments, loan growth and share repurchase activity within the Company's own stock. At September 30, 2021, the Company's liquidity is sufficient to meet projected trends in these areas.

To monitor and estimate liquidity levels, the Company performs stress testing under varying assumptions on credit sensitive liabilities and the sources and amounts of balance sheet and external liquidity available to replace outflows. The Company's Contingency Funding Plan sets forth avenues for rectifying liquidity shortfalls. At September 30, 2021, the analysis indicated adequate liquidity under the tested scenarios.

The Company utilizes several other strategies to maintain sufficient liquidity. Loan and deposit growth are managed to keep the loan to deposit ratio within the Company's own target range of 65% to 75%. At September 30, 2021, the loan to deposit ratio was 55.66%. The investment strategy takes into consideration the term of the investment, and securities in the available for sale portfolio are laddered based upon projected funding needs.

The Company's liquidity position was strong prior to the COVID-19 pandemic and has increased due to government stimulus payments received by depositors. The Company continues to monitor liquidity as the impact of the pandemic evolves.

Capital Resources

Total stockholders' equity at September 30, 2021 was $190,853, a decrease of $9,754 or 4.86%, from the $200,607 at December 31, 2020. Shareholders' equity was impacted by payment of $4,319 in dividends and $12,085 in share repurchases. The Company repurchased 335,062 shares under a program approved by the Company's Board of Directors on May 13, 2020 for up to 1,000,000 shares. On May 12, 2021, the Board of Directors approved the repurchase of up to 1,000,000 additional shares of the Company's common stock. The authorization began June 1, 2021 and expires May 31, 2022.

The Company's subsidiary bank is subject to various capital requirements administered by banking agencies. Risk based capital ratios for the Bank are shown in the following tables.

	NBB	Regulatory Capital Minimum Ratios	Regulatory Capital Minimum Ratios with Capital Conservation Buffer
Common Equity Tier I Capital Ratio	**19.06**%	4.50%	7.00%
Tier I Capital Ratio	**19.06**%	6.00%	8.50%
Total Capital Ratio	**19.86**%	8.00%	10.50%
Leverage Ratio	**11.86**%	4.00%	4.00%

Risk-based capital ratios are calculated in compliance with FDIC rules based on Basel III capital requirements. Banks are subject to an additional capital conservation buffer in order to make capital distributions or discretionary bonus payments. The Bank's ratios are well above the required minimums and the capital conservation buffer at September 30, 2021.

Off-Balance Sheet Arrangements

In the normal course of business, NBB extends lines of credit and letters of credit to its customers. Depending on their needs, customers may draw upon lines of credit at any time in any amount up to a pre-approved limit. Standby letters of credit are issued for two purposes. Financial letters of credit guarantee payments to facilitate customer purchases. Performance letters of credit guarantee payment if the customer fails to complete a specific obligation.

Historically, the full approved amount of letters and lines of credit has not been drawn at any one time. The Company has developed plans to meet a sudden and substantial funding demand. These plans include accessing a line of credit with a correspondent bank, borrowing from the FHLB, selling available for sale investments or loans and raising additional deposits.

The Company sells mortgages on the secondary market. Our agreement with the purchaser provides for strict underwriting and documentation requirements. Violation of the representations and warranties of the agreement would entitle the purchaser to recourse provisions. The Company has determined that its risk in this area is not significant because of a low volume of secondary market mortgage loans and high underwriting standards. The Company estimates a potential loss reserve for recourse provisions that is not material as of September 30, 2021. To date, no recourse provisions have been invoked. If funds were needed, the Company would access the same sources as noted above for funding lines and letters of credit.

There were no material changes in off-balance sheet arrangements during the nine months ended September 30, 2021, except for normal seasonal fluctuations in the total of mortgage loan commitments.

Contractual Obligations

The Company had no finance lease or purchase obligations and no long-term debt at September 30, 2021.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company considers interest rate risk to be a significant market risk and has systems in place to measure the exposure of net interest income to adverse movement in interest rates. Interest rate shock analyses provide management with an indication of potential economic loss due to future rate changes. There have not been any changes which would significantly alter the results disclosed as of December 31, 2020 in the Company's 2020 Form 10-K.

Item 4. Controls and Procedures

The Company's management evaluated, with the participation of the Company's principal executive officer and principal financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective as of September 30, 2021 to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified by the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the three months ended September 30, 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Because of the inherent limitations in all control systems, the Company believes that no system of controls, no matter how well designed and operated, can provide absolute assurance that all control issues have been detected.

Part II

Other Information

Item 1. Legal Proceedings

There are no pending or threatened legal proceedings to which the Company or any of its subsidiaries is a party or to which the property of the Company or any of its subsidiaries is subject that, in the opinion of management, may materially impact the financial condition of the Company.

Item 1A. Risk Factors

Please refer to the "Risk Factors" previously disclosed in Item 1A of our 2020 Annual Report on Form 10-K and the factors discussed under "Cautionary Statement Regarding Forward-Looking Statements" in Part I. Item 2 of this Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Issuer

Share repurchase activity during the nine months ended September 30, 2021 was as follows:

Period	Total Number of Shares Purchased(1)		Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(1)	Number of Shares that May Yet Be Purchased Under the Program(1)
July 1, 2021 – July 31, 2021	-		-	-	1,000,000
August 1, 2021 – August 31, 2021	45,100		37.51	45,100	954,900
September 1, 2021 – September 30, 2021	28,000		37.10	28,000	926,900
Total during third quarter 2021	73,100	$	37.35	73,100	

(1) In May 2021, the Company announced the Board of Directors had authorized a 1,000,000 share repurchase program. The authorization began June 1, 2021 and expires May 31, 2022. The Company's share repurchase program does not obligate it to acquire any specific number of shares.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Index of Exhibits

Exhibit No.	Description	
3(i)	Amended and Restated Articles of Incorporation of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3.1 of the Form 8-K for filed on March 16, 2006)
3(ii)	Amended and Restated Bylaws of National Bankshares, Inc.	(incorporated herein by reference to Exhibit 3(ii) of the Form 8-K filed on April 14, 2021)
4	Specimen copy of certificate for National Bankshares, Inc. common stock	(incorporated herein by reference to Exhibit 4(a) of the Annual Report on Form 10-K for fiscal year ended December 31, 1993)
+31(i)	Section 302 Certification of Chief Executive Officer	Filed herewith
+31(ii)	Section 302 Certification of Chief Financial Officer	Filed herewith
+32(i)	18 U.S.C. Section 1350 Certification of Chief Executive Officer	Filed herewith
+32(ii)	18 U.S.C. Section 1350 Certification of Chief Financial Officer	Filed herewith
+101	The following materials from National Bankshares, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2021 are formatted in iXBRL (Inline Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets at September 30, 2021 and December 31, 2020; (ii) Consolidated Statements of Income for the three and nine month periods ended September 30, 2021 and 2020; (iii) Consolidated Statements of Comprehensive Income for the three and nine month periods ended September 30, 2021 and 2020; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three and nine months ended September 30, 2021 and 2020; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2021 and 2020; and (vi) Notes to Consolidated Financial Statements.	Filed herewith
104	Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)	Filed herewith

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL BANKSHARES, INC.

Date: November 10, 2021

/s/ F. Brad Denardo
F. Brad Denardo
Chairman, President and
Chief Executive Officer
(Principal Executive Officer)

Date: November 10, 2021

/s/ David K. Skeens
David K. Skeens
Treasurer and
Chief Financial Officer
(Principal Financial Officer)
(Principal Accounting Officer)

Exhibit 31(i)

CERTIFICATIONS

I, F. Brad Denardo, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;

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(s) 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 of 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(s) 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 the 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.

Date: November 10, 2021

/s/ F. Brad Denardo

F. Brad Denardo
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31(ii)

CERTIFICATIONS

I, David K. Skeens, certify that:

1. I have reviewed this quarterly report on Form 10-Q of National Bankshares, Inc.;

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(s) 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 of 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(s) 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 the 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.

Date: November 10, 2021

/s/ David K. Skeens

David K. Skeens
Treasurer and
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32 (i)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2021, I, F. Brad Denardo, Chairman, President and Chief Executive Officer (Principal Executive Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2021, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2021, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ F. Brad Denardo
F. Brad Denardo
Chairman, President and Chief Executive Officer
(Principal Executive Officer)
November 10, 2021

Exhibit 32 (ii)

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Form 10-Q of National Bankshares, Inc. for the quarter ended September 30, 2021, I, David K. Skeens, Treasurer and Chief Financial Officer (Principal Financial Officer) of National Bankshares, Inc., hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge and belief, that:

(1) such Form 10-Q for the quarter ended September 30, 2021, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in such Form 10-Q for the quarter ended September 30, 2021, fairly presents, in all material respects, the financial condition and results of operations of National Bankshares, Inc.

/s/ David K. Skeens
David K. Skeens
Treasurer and
Chief Financial Officer
(Principal Financial Officer)
November 10, 2021