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

## FORM 10-Q

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

**For the quarterly period ended September 30, 2021**

**OR**

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

**For the transition period from ____________ to _____________**

**Commission File Number: 0-11487**

# LAKELAND FINANCIAL CORPORATION
**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Indiana** | **35-1559596** |
| (State or Other Jurisdiction of Incorporation or Organization) | (IRS Employer Identification No.) |
| **202 East Center Street, Warsaw , Indiana** | **46580** |
| (Address of principal executive offices) | (Zip Code) |

**(574) 267-6144**
**(Registrant’s Telephone Number, Including Area Code)**

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|---|---|
| Common stock, No par value | LKFN | NASDAQ (Nasdaq Global Select Market) |

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

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐
Smaller reporting company ☐ 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 ☒

Number of shares of common stock outstanding at October 22, 2021: 25,299,178

## TABLE OF CONTENTS

## ITEM 1. FINANCIAL STATEMENTS
## CONSOLIDATED BALANCE SHEETS (in thousands, except share data)

| | September 30, 2021 | December 31, 2020 |
|---|---|---|
| | (Unaudited) | |
| **ASSETS** | | |
| Cash and due from banks | $ 78,523 | $ 74,457 |
| Short-term investments | 478,710 | 175,470 |
| Total cash and cash equivalents | 557,233 | 249,927 |
| | | |
| Securities available-for-sale (carried at fair value) | 1,239,715 | 734,845 |
| Real estate mortgage loans held-for-sale | 7,969 | 11,218 |
| | | |
| Loans, net of allowance for credit losses* of $73,048 and $61,408 | 4,166,405 | 4,587,748 |
| | | |
| Land, premises and equipment, net | 59,998 | 59,298 |
| Bank owned life insurance | 97,224 | 95,227 |
| Federal Reserve and Federal Home Loan Bank stock | 13,772 | 13,772 |
| Accrued interest receivable | 17,780 | 18,761 |
| Goodwill | 4,970 | 4,970 |
| Other assets | 57,850 | 54,669 |
| Total assets | $ 6,222,916 | $ 5,830,435 |
| | | |
| **LIABILITIES** | | |
| Noninterest bearing deposits | $ 1,762,021 | $ 1,538,331 |
| Interest bearing deposits | 3,652,617 | 3,498,474 |
| Total deposits | 5,414,638 | 5,036,805 |
| | | |
| Borrowings | | |
| Federal Home Loan Bank advances | 75,000 | 75,000 |
| Miscellaneous borrowings | 0 | 10,500 |
| Total borrowings | 75,000 | 85,500 |
| | | |
| Accrued interest payable | 2,916 | 5,959 |
| Other liabilities | 47,160 | 44,987 |
| Total liabilities | 5,539,714 | 5,173,251 |
| | | |
| **STOCKHOLDERS' EQUITY** | | |
| Common stock: 90,000,000 shares authorized, no par value | | |
| 25,775,133 shares issued and 25,299,178 outstanding as of September 30, 2021 | | |
| 25,713,408 shares issued and 25,239,748 outstanding as of December 31, 2020 | 119,625 | 114,927 |
| Retained earnings | 567,518 | 529,005 |
| Accumulated other comprehensive income | 10,932 | 27,744 |
| Treasury stock at cost (475,955 shares as of September 30, 2021, 473,660 shares as of December 31, 2020) | (14,962) | (14,581) |
| Total stockholders' equity | 683,113 | 657,095 |
| Noncontrolling interest | 89 | 89 |
| Total equity | 683,202 | 657,184 |
| Total liabilities and equity | $ 6,222,916 | $ 5,830,435 |

* Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF INCOME (unaudited - in thousands, except share and per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2021** | 2020 | **2021** | 2020 |
| **NET INTEREST INCOME** | | | | |
| Interest and fees on loans | | | | |
| Taxable | **$ 43,025** | $ 42,056 | **$ 128,828** | $ 130,759 |
| Tax exempt | **119** | 104 | **324** | 542 |
| Interest and dividends on securities | | | | |
| Taxable | **2,470** | 1,577 | **6,482** | 5,419 |
| Tax exempt | **3,556** | 2,198 | **8,915** | 6,237 |
| Other interest income | **125** | 44 | **348** | 292 |
| Total interest income | **49,295** | 45,979 | **144,897** | 143,249 |
| Interest on deposits | **3,479** | 5,941 | **11,587** | 24,324 |
| Interest on borrowings | | | | |
| Short-term | **0** | 51 | **7** | 458 |
| Long-term | **75** | 74 | **222** | 172 |
| Total interest expense | **3,554** | 6,066 | **11,816** | 24,954 |
| **NET INTEREST INCOME** | **45,741** | 39,913 | **133,081** | 118,295 |
| Provision for credit losses* | **1,300** | 1,750 | **1,077** | 13,850 |
| **NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES** | **44,441** | 38,163 | **132,004** | 104,445 |
| **NONINTEREST INCOME** | | | | |
| Wealth advisory fees | **2,177** | 1,930 | **6,433** | 5,594 |
| Investment brokerage fees | **521** | 421 | **1,560** | 1,148 |
| Service charges on deposit accounts | **2,756** | 2,491 | **7,768** | 7,452 |
| Loan and service fees | **3,005** | 2,637 | **8,823** | 7,470 |
| Merchant card fee income | **838** | 670 | **2,226** | 1,933 |
| Bank owned life insurance income | **640** | 932 | **2,101** | 1,476 |
| Interest rate swap fee income | **180** | 2,143 | **934** | 4,105 |
| Mortgage banking income (loss) | **(32)** | 1,005 | **1,756** | 2,945 |
| Net securities gains | **0** | 314 | **797** | 363 |
| Other income | **1,029** | 572 | **2,613** | 2,575 |
| Total noninterest income | **11,114** | 13,115 | **35,011** | 35,061 |
| **NONINTEREST EXPENSE** | | | | |
| Salaries and employee benefits | **14,230** | 12,706 | **44,377** | 35,696 |
| Net occupancy expense | **1,413** | 1,404 | **4,343** | 4,336 |
| Equipment costs | **1,371** | 1,369 | **4,134** | 4,216 |
| Data processing fees and supplies | **3,169** | 3,025 | **9,692** | 8,736 |
| Corporate and business development | **1,000** | 586 | **3,208** | 2,324 |
| FDIC insurance and other regulatory fees | **748** | 554 | **1,707** | 1,224 |
| Professional fees | **1,342** | 1,306 | **5,058** | 3,506 |
| Other expense | **2,694** | 2,175 | **6,842** | 6,255 |
| Total noninterest expense | **25,967** | 23,125 | **79,361** | 66,293 |
| **INCOME BEFORE INCOME TAX EXPENSE** | **29,588** | 28,153 | **87,654** | 73,213 |
| Income tax expense | **5,469** | 5,377 | **16,204** | 13,468 |
| **NET INCOME** | **$ 24,119** | $ 22,776 | **$ 71,450** | $ 59,745 |
| **BASIC WEIGHTED AVERAGE COMMON SHARES** | **25,479,654** | 25,418,712 | **25,472,185** | 25,484,329 |
| **BASIC EARNINGS PER COMMON SHARE** | **$ 0.95** | $ 0.89 | **$ 2.81** | $ 2.34 |
| **DILUTED WEIGHTED AVERAGE COMMON SHARES** | **25,635,288** | 25,487,302 | **25,608,655** | 25,618,401 |
| **DILUTED EARNINGS PER COMMON SHARE** | **$ 0.94** | $ 0.89 | **$ 2.79** | $ 2.33 |

* Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.
The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited - in thousands)**

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | **2021** | 2020 | **2021** | 2020 |
| Net income | **$ 24,119** | $ 22,776 | **$ 71,450** | $ 59,745 |
| Other comprehensive income (loss) | | | | |
| Change in securities available-for-sale: | | | | |
| Unrealized holding gain (loss) on securities available-for-sale arising during the period | **(14,411)** | 789 | **(20,656)** | 16,848 |
| Reclassification adjustment for gains included in net income | **0** | (314) | **(797)** | (363) |
| Net securities gain (loss) activity during the period | **(14,411)** | 475 | **(21,453)** | 16,485 |
| Tax effect | **3,026** | (101) | **4,505** | (3,462) |
| Net of tax amount | **(11,385)** | 374 | **(16,948)** | 13,023 |
| Defined benefit pension plans: | | | | |
| Amortization of net actuarial loss | **61** | 63 | **181** | 189 |
| Net gain activity during the period | **61** | 63 | **181** | 189 |
| Tax effect | **(15)** | (15) | **(45)** | (47) |
| Net of tax amount | **46** | 48 | **136** | 142 |
| Total other comprehensive income (loss), net of tax | **(11,339)** | 422 | **(16,812)** | 13,165 |
| Comprehensive income | **$ 12,780** | $ 23,198 | **$ 54,638** | $ 72,910 |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (unaudited - in thousands, except share and per share data)

| | Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | | | | | | | |
| | Shares | Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Stockholders' Equity | Noncontrolling Interest | Total Equity |
| Balance at July 1, 2020 | 25,233,280 | $ 113,424 | $ 496,891 | $ 24,802 | $ (14,314) | $ 620,803 | $ 89 | $ 620,892 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 22,776 | | | 22,776 | | 22,776 |
| Other comprehensive income, net of tax | | | | 422 | | 422 | | 422 |
| Cash dividends declared and paid, $0.30 per share | | | (7,626) | | | (7,626) | | (7,626) |
| Treasury shares purchased under deferred directors' plan | (4,709) | 212 | | | (212) | 0 | | 0 |
| Stock activity under equity compensation plans | 7,800 | 0 | | | | 0 | | 0 |
| Stock based compensation expense | | 375 | | | | 375 | | 375 |
| Balance at September 30, 2020 | 25,236,371 | $ 114,011 | $ 512,041 | $ 25,224 | $ (14,526) | $ 636,750 | $ 89 | $ 636,839 |
| | | | | | | | | |
| Balance at July 1, 2021 | **25,289,966** | **$ 117,796** | **$ 552,063** | **$ 22,271** | **$ (14,748)** | **$ 677,382** | **$ 89** | **$ 677,471** |
| Comprehensive income: | | | | | | | | |
| Net income | | | **24,119** | | | **24,119** | | **24,119** |
| Other comprehensive income, net of tax | | | | **(11,339)** | | **(11,339)** | | **(11,339)** |
| Cash dividends declared and paid, $0.34 per share | | | **(8,664)** | | | **(8,664)** | | **(8,664)** |
| Treasury shares purchased under deferred directors' plan | **(3,383)** | **214** | | | **(214)** | **0** | | **0** |
| Treasury shares sold and distributed under deferred directors' plan | **0** | | | | **0** | **0** | | **0** |
| Stock activity under equity compensation plans | **12,595** | **(170)** | | | | **(170)** | | **(170)** |
| Stock based compensation expense | | **1,785** | | | | **1,785** | | **1,785** |
| Balance at September 30, 2021 | **25,299,178** | **$ 119,625** | **$ 567,518** | **$ 10,932** | **$ (14,962)** | **$ 683,113** | **$ 89** | **$ 683,202** |

| | Nine Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Common Stock | | | | | | | |
| | Shares | Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total Stockholders' Equity | Noncontrolling Interest | Total Equity |
| Balance at January 1, 2020 | 25,444,275 | $ 114,858 | $ 475,247 | $ 12,059 | $ (4,153) | $ 598,011 | $ 89 | $ 598,100 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 59,745 | | | 59,745 | | 59,745 |
| Other comprehensive income, net of tax | | | | 13,165 | | 13,165 | | 13,165 |
| Cash dividends declared and paid, $0.90 per share | | | (22,951) | | | (22,951) | | (22,951) |
| Treasury shares purchased under share repurchase plan | (289,101) | 0 | | | (10,012) | (10,012) | | (10,012) |
| Treasury shares purchased under deferred directors' plan | (10,450) | 480 | | | (480) | 0 | | 0 |
| Treasury shares sold and distributed under deferred directors' plan | 5,748 | (119) | | | 119 | 0 | | 0 |
| Stock activity under equity compensation plans | 85,899 | (2,030) | | | | (2,030) | | (2,030) |
| Stock based compensation expense | | 822 | | | | 822 | | 822 |
| Balance at September 30, 2020 | 25,236,371 | $ 114,011 | $ 512,041 | $ 25,224 | $ (14,526) | $ 636,750 | $ 89 | $ 636,839 |
| | | | | | | | | |
| Balance at January 1, 2021 | **25,239,748** | **$ 114,927** | **$ 529,005** | **$ 27,744** | **$ (14,581)** | **$ 657,095** | **$ 89** | **$ 657,184** |
| Adoption of ASU 2016-13 | | | **(6,951)** | | | **(6,951)** | | **(6,951)** |
| Comprehensive income: | | | | | | | | |
| Net income | | | **71,450** | | | **71,450** | | **71,450** |
| Other comprehensive loss, net of tax | | | | **(16,812)** | | **(16,812)** | | **(16,812)** |
| Cash dividends declared and paid, $1.02 per share | | | **(25,986)** | | | **(25,986)** | | **(25,986)** |
| Treasury shares purchased under deferred directors' plan | **(7,959)** | **496** | | | **(496)** | **0** | | **0** |
| Treasury shares sold and distributed under deferred directors' plan | **5,664** | **(115)** | | | **115** | **0** | | **0** |
| Stock activity under equity compensation plans | **61,725** | **(1,818)** | | | | **(1,818)** | | **(1,818)** |
| Stock based compensation expense | | **6,135** | | | | **6,135** | | **6,135** |
| Balance at September 30, 2021 | **25,299,178** | **$ 119,625** | **$ 567,518** | **$ 10,932** | **$ (14,962)** | **$ 683,113** | **$ 89** | **$ 683,202** |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited - in thousands)

| Nine Months Ended September 30, | 2021 | 2020 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 71,450 | $ 59,745 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation | 4,555 | 4,477 |
| Provision for credit losses* | 1,077 | 13,850 |
| Gain on sale and write down of other real estate owned | (53) | 0 |
| Amortization of loan servicing rights | 1,697 | 563 |
| Net change in loan servicing rights valuation allowance | (197) | 628 |
| Loans originated for sale, including participations | (92,728) | (93,805) |
| Net gain on sales of loans | (3,609) | (3,286) |
| Proceeds from sale of loans, including participations | 98,655 | 90,568 |
| Net (gain) loss on sales of premises and equipment | 4 | 82 |
| Net gain on sales and calls of securities available-for-sale | (797) | (363) |
| Net securities amortization | 3,457 | 3,021 |
| Stock based compensation expense | 6,135 | 822 |
| Earnings on life insurance | (2,101) | (1,476) |
| Gain on life insurance | (404) | (576) |
| Tax benefit of stock award issuances | (266) | (71) |
| Net change: | | |
| Interest receivable and other assets | (2,090) | (3,987) |
| Interest payable and other liabilities | 1,196 | (8,927) |
| Total adjustments | 14,531 | 1,520 |
| Net cash from operating activities | 85,981 | 61,265 |
| Cash flows from investing activities: | | |
| Proceeds from sale of securities available- for-sale | 13,964 | 6,413 |
| Proceeds from maturities, calls and principal paydowns of securities available-for-sale | 102,399 | 69,259 |
| Purchases of securities available-for-sale | (640,364) | (89,934) |
| Purchase of life insurance | (648) | (361) |
| Net (increase) decrease in total loans | 410,323 | (527,886) |
| Proceeds from sales of land, premises and equipment | 6 | 651 |
| Purchases of land, premises and equipment | (5,265) | (5,154) |
| Proceeds from sales of other real estate | 946 | 0 |
| Proceeds from life insurance | 931 | 1,285 |
| Net cash from investing activities | (117,708) | (545,727) |
| Cash flows from financing activities: | | |
| Net increase in total deposits | 377,833 | 634,135 |
| Net increase (decrease) in short-term borrowings | (10,500) | 10,500 |
| Payments on short-term FHLB borrowings | 0 | (170,000) |
| Proceeds from long-term FHLB borrowings | 0 | 75,000 |
| Common dividends paid | (25,973) | (22,938) |
| Preferred dividends paid | (13) | (13) |
| Payments related to equity incentive plans | (1,818) | (2,030) |
| Purchase of treasury stock | (496) | (10,492) |
| Net cash from financing activities | 339,033 | 514,162 |
| Net change in cash and cash equivalents | 307,306 | 29,700 |
| Cash and cash equivalents at beginning of the period | 249,927 | 99,381 |
| Cash and cash equivalents at end of the period | $ 557,233 | $ 129,081 |
| Cash paid during the period for: | | |
| Interest | $ 14,859 | $ 30,255 |
| Income taxes | 20,637 | 14,380 |
| Supplemental non-cash disclosures: | | |
| Loans transferred to other real estate owned | 893 | 35 |
| Securities purchases payable | 4,982 | 7,712 |

* Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

The accompanying notes are an integral part of these consolidated financial statements.

**NOTE 1. BASIS OF PRESENTATION**

This report is filed for Lakeland Financial Corporation (the "Company"), which has two wholly owned subsidiaries, Lake City Bank (the "Bank") and LCB Risk Management, a captive insurance company. Also included in this report are results for the Bank's wholly owned subsidiary, LCB Investments II, Inc. ("LCB Investments"), which manages the Bank's investment portfolio. LCB Investments owns LCB Funding, Inc. ("LCB Funding"), a real estate investment trust. All significant inter-company balances and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and are unaudited. In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2021 are not necessarily indicative of the results that may be expected for any subsequent reporting periods, including the year ending December 31, 2021. The Company's 2020 Annual Report on Form 10-K should be read in conjunction with these statements.

**Adoption of New Accounting Standards**

In June 2016, the FASB issued ASU 2016-13 Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This update, commonly referred to as the current expected credit losses methodology ("CECL"), changes the accounting for credit losses on loans and debt securities. Under the new guidance, the Company's measurement of expected credit losses is based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. For loans, this measurement takes place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model previously required, but still permitted, under GAAP, which delays recognition until it is probable a loss has been incurred. In addition, the guidance modifies the other-than-temporary impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods. This guidance was effective, subject to optional delay discussed below, for the Company for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years.

As previously disclosed, the Company implemented the CECL methodology and ran it concurrently with the historical incurred method. Under a provision provided by the CARES Act, the Company elected to delay the adoption of FASB's new rule covering the CECL standard. On December 27, 2020, then-President Trump signed into law the Consolidated Appropriations Act, 2021. This law extended relief for troubled debt restructurings and provided for further delay of the current expected credit losses adoption under the CARES Act to January 1, 2022, with early adoption permitted. The Company elected to remain on the incurred loan loss methodology for 2020.

The Company adopted ASU 2016-13 during the first quarter of 2021, effective January 1, 2021. Upon adoption, the Company recognized a $9.1 million increase in the allowance for credit losses. This resulted in a one-time cumulative effect adjustment decreasing retained earnings as of January 1, 2021 by $7.0 million, net of deferred taxes of $2.1 million. The Company did not recognize an allowance for credit impairment for available-for-sale securities.

The following table illustrates the impact of adoption of the ASU:

| (dollars in thousands) | January 1, 2021 As Reported Under ASC 326 | January 1, 2021 Pre-ASC 326 Adoption | January 1, 2021 Impact of ASC 326 Adoption |
|---|---|---|---|
| Loans | | | |
| Commercial and industrial loans | $ 32,645 | $ 28,333 | $ 4,312 |
| Commercial real estate and multi-family residential loans | 27,223 | 22,907 | 4,316 |
| Agri-business and agricultural loans | 4,103 | 3,043 | 1,060 |
| Other commercial loans | 1,357 | 416 | 941 |
| Consumer 1-4 family loans | 3,572 | 2,619 | 953 |
| Other consumer loans | 1,300 | 951 | 349 |
| Unallocated | 258 | 3,139 | (2,881) |
| Allowance for credit losses | $ 70,458 | $ 61,408 | $ 9,050 |

The Company's loan segmentation, as disclosed in "Note 3 – Loans", did not change as a result of adopting this ASU.

In December 2018, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new accounting standard. In March 2020, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC published an interim final rule to delay the estimated impact on regulatory capital stemming from the implementation of CECL. The interim final rule maintains the three-year transition option in the previous rule and provides banks the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period (five-year transition option). The Company is not adopting the capital transition relief over the permissible three-year or five-year periods.

In August 2018, the FASB issued ASU 2018-14 "Compensation — Retirement Benefits — Defined Benefit Plans — General (Topic 715-20): Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans." The ASU updated the annual disclosure requirements for employers that sponsor defined benefit pension or other postretirement benefit plans by adding, clarifying and removing certain disclosures. These amendments are effective for fiscal years ending after December 15, 2020, for public business entities, and are to be applied on a retrospective basis to all periods presented. The Company adopted this new accounting standard on January 1, 2021, and the adoption did not have a material impact on its financial statements.

In December 2019, the FASB issued ASU 2019-12 "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes." These amendments remove specific exceptions to the general principles in Topic 740 in GAAP. It eliminates the need for an organization to analyze whether the following apply in a given period: exception to the incremental approach for intraperiod tax allocation; exceptions to accounting for basis differences where there are ownership changes in foreign investments; and exception in interim period income tax accounting for year-to-date losses that exceed anticipated losses. It also improves financial statement preparers' application of income tax-related guidance and simplifies GAAP for: franchise taxes that are partially based on income; transactions with a government that result in a step up in the tax basis of goodwill; separate financial statements of legal entities that are not subject to tax. It also enacts changes in tax laws in interim periods. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company adopted this new accounting standard on January 1, 2021, and the adoption did not have a material impact on its financial statements.

In January 2020, the FASB issued ASU No. 2020-1 *"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."* These amendments, among other things, clarify that a company should consider observable transactions that require a company to either apply or discontinue the equity method of accounting under Topic 323, Investments-Equity Method and Joint Ventures, for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method. The amendments also clarify that, when determining the accounting for certain forward contracts and purchased options a company should not consider, whether upon settlement or exercise, if the underlying securities would be accounted for under the equity method or fair value option. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early application is permitted, including early adoption in an interim period. An entity should apply ASU 2020-1 prospectively at the beginning of the interim period that includes the adoption date. The Company adopted ASU 2020-1 on January 1, 2021 and it did not have a material impact on its financial statements.

In October 2020, the FASB issued ASU No. 2020-8, "*Codification Improvements to Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs*," to clarify 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. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, and early application is not permitted. The Company adopted this new accounting standard on January 1, 2021, and the adoption did not have a material impact on its financial statements.

**Newly Issued But Not Yet Effective Accounting Standards**

On March 12, 2020, the FASB issued Accounting Standards Update (ASU) 2020-4, "Reference Rate Reform ("ASC 848"): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." ASC 848 contains optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The Company has formed a cross-functional project team to lead the transition from LIBOR to a planned adoption of reference rates which could include Secured Overnight Financing Rate ("SOFR"), amongst others. The Company has identified loans that renewed prior to 2021 and obtained updated reference rate language at the time of renewal. Additionally, management is utilizing the timeline guidance published by the Alternative Reference Rates Committee to develop and achieve internal milestones during this transitional period. The Company has adhered to the International Swaps and Derivatives Association 2020 IBOR Fallbacks Protocol that was released on October 23, 2020. The Company will discontinue the use of new LIBOR-based loans no later than December 31, 2021, according to regulatory guidelines, and is operationally preparing for this change during the fourth quarter of 2021. The guidance under ASC-848 will be available for a limited time, generally through December 31, 2022. The Company expects to adopt the LIBOR transition relief allowed under this standard.

In August 2021, the FASB issued ASU 2021-6, "Presentation of Financial Statements (Topic 205), Financial Services - Depository and Lending (Topic 942) and 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*." The guidance is effective upon its addition to the FASB codification. The Company is currently assessing the impact of ASU 2021-6 on its disclosures.

**Reclassifications**

Certain amounts appearing in the consolidated financial statements and notes thereto for prior periods have been reclassified to conform with the current presentation. The reclassifications had no effect on net income or stockholders' equity as previously reported.

## NOTE 2. SECURITIES

Information related to the amortized cost, fair value and allowance for credit losses of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income is provided in the tables below.

| (dollars in thousands) | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Losses | Allowance for Credit Losses | Fair Value |
|---|---|---|---|---|---|
| **September 30, 2021** | | | | | |
| U.S. Treasury securities | **$ 900** | **$ 0** | **$ 0** | **$ 0** | **$ 900** |
| U.S. government sponsored agencies | **118,681** | **17** | **(2,237)** | **0** | **116,461** |
| Mortgage-backed securities: residential | **430,388** | **5,511** | **(4,066)** | **0** | **431,833** |
| Mortgage-backed securities: commercial | **23,699** | **483** | **0** | **0** | **24,182** |
| State and municipal securities | **650,561** | **20,955** | **(5,177)** | **0** | **666,339** |
| Total | **$ 1,224,229** | **$ 26,966** | **$ (11,480)** | **$ 0** | **$ 1,239,715** |
| | | | | | |
| December 31, 2020 | | | | | |
| U.S. government sponsored agencies | $ 36,492 | $ 56 | $ (61) | $ 0 | $ 36,487 |
| Mortgage-backed securities: residential | 270,231 | 9,289 | (17) | 0 | 279,503 |
| Mortgage-backed securities: commercial | 35,877 | 1,004 | 0 | 0 | 36,881 |
| State and municipal securities | 355,306 | 26,696 | (28) | 0 | 381,974 |
| Total | $ 697,906 | $ 37,045 | $ (106) | $ 0 | $ 734,845 |

Information regarding the fair value and amortized cost of available-for-sale debt securities by maturity as of September 30, 2021 is presented below. Maturity information is based on contractual maturity for all securities other than mortgage-backed securities. Actual maturities of securities may differ from contractual maturities because borrowers may have the right to prepay the obligation without a prepayment penalty.

| (dollars in thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | **$ 4,245** | **$ 4,256** |
| Due after one year through five years | **11,953** | **12,284** |
| Due after five years through ten years | **50,464** | **52,987** |
| Due after ten years | **703,480** | **714,173** |
| | **770,142** | **783,700** |
| Mortgage-backed securities | **454,087** | **456,015** |
| Total debt securities | **$ 1,224,229** | **$ 1,239,715** |

Securities proceeds, gross gains and gross losses are presented below.

| | Three months ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | **2021** | 2020 |
| Sales of securities available-for-sale | | | | |
| Proceeds | **$ 0** | $ 5,265 | **$ 13,964** | $ 6,413 |
| Gross gains | **0** | 314 | **797** | 363 |
| Gross losses | **0** | 0 | **0** | 0 |
| Number of securities | **0** | 12 | **8** | 15 |

In accordance with ASU No. 2017-8, purchase premiums for callable securities are amortized to the earliest call date and premiums on non-callable securities as well as discounts are recognized in interest income using the interest method over the terms of the securities or over the estimated lives of mortgage-backed securities. Gains and losses on sales are based on the amortized cost of the security sold and recorded on the trade date.

Securities with carrying values of $314.7 million and $382.7 million were pledged as of September 30, 2021 and December 31, 2020, respectively, as collateral for borrowings from the Federal Home Loan Bank and Federal Reserve Bank and for other purposes as permitted or required by law.

Information regarding securities with unrealized losses as of September 30, 2021 and December 31, 2020 is presented below. The tables divide the securities between those with unrealized losses for less than twelve months and those with unrealized losses for twelve months or more.

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **September 30, 2021** | | | | | | |
| U.S. government sponsored agencies | **$ 106,441** | **$ 2,237** | **$ 0** | **$ 0** | **$ 106,441** | **$ 2,237** |
| Mortgage-backed securities: residential | **245,919** | **4,066** | **0** | **0** | **245,919** | **4,066** |
| Mortgage-backed securities: commercial | **65** | **0** | **0** | **0** | **65** | **0** |
| State and municipal securities | **276,881** | **5,177** | **0** | **0** | **276,881** | **5,177** |
| Total temporarily impaired | **$ 629,306** | **$ 11,480** | **$ 0** | **$ 0** | **$ 629,306** | **$ 11,480** |
| | | | | | | |
| December 31, 2020 | | | | | | |
| U.S. government sponsored agencies | $ 19,800 | $ 61 | $ 0 | $ 0 | $ 19,800 | $ 61 |
| Mortgage-backed securities: residential | 3 | 0 | 3,112 | 17 | 3,115 | 17 |
| Mortgage-backed securities: commercial | 0 | 0 | 0 | 0 | 0 | 0 |
| State and municipal securities | 6,921 | 28 | 0 | 0 | 6,921 | 28 |
| Total temporarily impaired | $ 26,724 | $ 89 | $ 3,112 | $ 17 | $ 29,836 | $ 106 |

The total number of securities with unrealized losses as of September 30, 2021 and December 31, 2020 is presented below.

| | Less than 12 months | 12 months or more | Total |
|---|---|---|---|
| **September 30, 2021** | | | |
| U.S. government sponsored agencies | **12** | **0** | **12** |
| Mortgage-backed securities: residential | **25** | **0** | **25** |
| Mortgage-backed securities: commercial | **1** | **0** | **1** |
| State and municipal securities | **162** | **0** | **162** |
| Total temporarily impaired | **200** | **0** | **200** |
| | | | |
| December 31, 2020 | | | |
| U.S. government sponsored agencies | 3 | 0 | 3 |
| Mortgage-backed securities: residential | 2 | 1 | 3 |
| Mortgage-backed securities: commercial | 0 | 0 | 0 |
| State and municipal securities | 2 | 0 | 2 |
| Total temporarily impaired | 7 | 1 | 8 |

Available-for-sale debt securities in unrealized loss positions are evaluated for impairment related to credit losses at least quarterly. For available-for sale debt securities in an unrealized loss position, management first assesses whether it intends to sell, or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through the consolidated income statement. For available-for sale debt securities that do not meet the criteria, management evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security and the issuer, among other factors. If this assessment indicates that a credit loss exists, management compares the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis for the security, a credit loss exists and an allowance for credit losses is recorded, limited to the amount that the fair value of the security is less than its amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income, net of applicable taxes. No allowance for credit losses for available-for-sale debt securities was needed at September 30, 2021. Accrued interest receivable on available-for-sale debt securities totaled $6.3 million at September 30, 2021 and is excluded from the estimate of credit losses.

The U.S. government sponsored agencies and mortgage-backed securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major credit rating agencies, and have a long history of no credit losses. Therefore, for those securities, we do not record expected credit losses.

Prior to the adoption of ASC 326, there was no other-than-temporary impairment ("OTTI") recorded during the nine months ended September 30, 2020.

**NOTE 3. LOANS**

| (dollars in thousands) | **September 30, 2021** | | December 31, 2020 | |
|---|---|---|---|---|
| Commercial and industrial loans: | | | | |
| Working capital lines of credit loans | **$ 659,166** | **15.5 %** | $ 626,023 | 13.5 % |
| Non-working capital loans | **782,618** | **18.5** | 1,165,355 | 25.0 |
| Total commercial and industrial loans | **1,441,784** | **34.0** | 1,791,378 | 38.5 |
| | | | | |
| Commercial real estate and multi-family residential loans: | | | | |
| Construction and land development loans | **378,716** | **8.9** | 362,653 | 7.8 |
| Owner occupied loans | **740,836** | **17.4** | 648,019 | 13.9 |
| Nonowner occupied loans | **582,019** | **13.7** | 579,625 | 12.5 |
| Multifamily loans | **252,983** | **6.0** | 304,717 | 6.5 |
| Total commercial real estate and multi-family residential loans | **1,954,554** | **46.0** | 1,895,014 | 40.7 |
| | | | | |
| Agri-business and agricultural loans: | | | | |
| Loans secured by farmland | **152,099** | **3.5** | 195,410 | 4.2 |
| Loans for agricultural production | **171,981** | **4.1** | 234,234 | 5.0 |
| Total agri-business and agricultural loans | **324,080** | **7.6** | 429,644 | 9.2 |
| | | | | |
| Other commercial loans | **83,595** | **2.0** | 94,013 | 2.0 |
| Total commercial loans | **3,804,013** | **89.6** | 4,210,049 | 90.4 |
| | | | | |
| Consumer 1-4 family mortgage loans: | | | | |
| Closed end first mortgage loans | **173,689** | **4.1** | 167,847 | 3.6 |
| Open end and junior lien loans | **161,941** | **3.8** | 163,664 | 3.5 |
| Residential construction and land development loans | **12,542** | **0.3** | 12,007 | 0.3 |
| Total consumer 1-4 family mortgage loans | **348,172** | **8.2** | 343,518 | 7.4 |
| | | | | |
| Other consumer loans | **92,169** | **2.2** | 103,616 | 2.2 |
| Total consumer loans | **440,341** | **10.4** | 447,134 | 9.6 |
| Subtotal | **4,244,354** | **100.0 %** | 4,657,183 | 100.0 % |
| Less: Allowance for credit losses | **(73,048)** | | (61,408) | |
| Net deferred loan fees | **(4,901)** | | (8,027) | |
| Loans, net | **$ 4,166,405** | | $ 4,587,748 | |

The recorded investment in loans does not include accrued interest, which totaled $11.1 million at September 30, 2021.

The Company had $295,000 in residential real estate loans in the process of foreclosure as of September 30, 2021, compared to $19,000 as of December 31, 2020.

**NOTE 4. ALLOWANCE FOR CREDIT LOSSES AND CREDIT QUALITY**

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost. Results for reporting periods beginning after January 1, 2021 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP.

The Company maintains an allowance for credit losses to provide for expected credit losses. Losses are charged against the allowance when management believes that the principal is uncollectable. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance are made for specific loans and for pools of similar types of loans, although the entire allowance is available for any loan that, in management’s judgment, should be charged against the allowance. A provision for credit losses is taken based on management’s ongoing evaluation of the appropriate allowance balance. A formal evaluation of the adequacy of the credit loss allowance is conducted monthly. The ultimate recovery of all loans is susceptible to future market factors beyond the Company’s control.

The level of credit loss provision is influenced by growth in the overall loan portfolio, emerging market risk, emerging concentration risk, commercial loan focus and large credit concentration, new industry lending activity, general economic conditions and historical loss analysis. In addition, management gives consideration to changes in the facts and circumstances of watch list credits, which includes the security position of the borrower, in determining the appropriate level of the credit loss provision. Furthermore, management’s overall view on credit quality is a factor in the determination of the provision.

The determination of the appropriate allowance is inherently subjective, as it requires significant estimates by management. The Company has an established process to determine the adequacy of the allowance for credit losses that generally includes consideration of changes in the nature and volume of the loan portfolio and overall portfolio quality, along with current and forecasted economic conditions that may affect borrowers’ ability to repay. Consideration is not limited to these factors although they represent the most commonly cited factors. To determine the specific allocation levels for individual credits, management considers the current valuation of collateral and the amounts and timing of expected future cash flows as the primary measures. Management also considers trends in adversely classified loans based upon an ongoing review of those credits. With respect to pools of similar loans, an appropriate level of general allowance is determined by portfolio segment using a probability of default-loss given default (“PD/LGD”) model, subject to a floor. A default can be triggered by one of several different asset quality factors, including past due status, nonaccrual status, TDR status or if the loan has had a charge-off. This PD is then combined with a LGD derived from historical charge-off data to construct a default rate. This loss rate is then supplemented with adjustments for reasonable and supportable forecasts of relevant economic indicators, particularly the unemployment rate forecast from the Federal Open Market Committee’s Summary of Economic Projections, and other environmental factors based on the risks present for each portfolio segment. These environmental factors include consideration of the following: levels of, and trends in, delinquencies and nonperforming loans; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedure, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. It is also possible that these factors could include social, political, economic, and terrorist events or activities. All of these factors are susceptible to change, which may be significant. As a result of this detailed process, the allowance results in two forms of allocations, specific and general. These two components represent the total allowance for credit losses deemed adequate to cover probable losses inherent in the loan portfolio.

Commercial loans are subject to a dual standardized grading process administered by the credit administration function. These grade assignments are performed independent of each other and a consensus is reached by credit administration and the loan review officer. Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individual credit that indicate it should be evaluated on an individual basis. Considerations with respect to specific allocations for these individual credits include, but are not limited to, the following: (a) the sufficiency of the customer’s cash flow or net worth to repay the loan; (b) the adequacy of the discounted value of collateral relative to the loan balance; (c) whether the loan has been criticized in a regulatory examination; (d) whether the loan is nonperforming; (e) any other reasons the ultimate collectability of the loan may be in question; or (f) any unique loan characteristics that require special monitoring.

Allocations are also applied to categories of loans considered not to be individually analyzed, but for which the rate of loss is expected to be consistent with or greater than historical averages. Such allocations are based on past loss experience and information about specific borrower situations and estimated collateral values. These general pooled loan allocations are performed for portfolio segments of commercial and industrial; commercial real estate, multi-family, and construction; agri-business and agricultural; other commercial loans; and consumer 1-4 family mortgage and other consumer loans. General allocations of the allowance are determined by a historical loss rate based on the calculation of each pool's probability of default-loss given default, subject to a floor. The length of the historical period for each pool is based on the average life of the pool. The historical loss rates are supplemented with consideration of economic conditions and portfolio trends.

Due to the imprecise nature of estimating the allowance for credit losses, the Company's allowance for credit losses includes an unallocated component. The unallocated component of the allowance for credit losses incorporates the Company's judgmental determination of potential expected losses that may not be fully reflected in other allocations, including factors such as the level of classified credits, economic uncertainties, industry trends impacting specific portfolio segments, broad portfolio quality trends, and trends in the composition of the Company's large commercial loan portfolio and related large dollar exposures to individual borrowers. As a practical expedient, the Company has elected to treat accrued interest the same way it is treated in the incurred loss model, wherein it is stated separately from loan principal balances on the consolidated balance sheet. Additionally, when a loan is placed on non-accrual, interest payments will be reversed through interest income, which is consistent with current practice.

For off balance sheet credit exposures outlined in the ASU at 326-20-30-11, it is the Company's position that nearly all of the unfunded amounts on lines of credit are unconditionally cancellable, and therefore not subject to having a liability set up, which matches the current accounting conclusion in the incurred loss environment.

The following tables present the activity in the allowance for credit losses by portfolio segment for the three-month period ended September 30, 2021:

| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate and Multifamily Residential | Agri-business and Agricultural | Other Commercial | Consumer 1-4 Family Mortgage | Other Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Three Months Ended September 30, 2021** | | | | | | | | |
| Beginning balance, July 1 | $ 33,130 | $ 28,291 | $ 3,930 | $ 1,298 | $ 3,165 | $ 1,393 | $ 506 | $ 71,713 |
| Provision for credit losses | 3,507 | (1,545) | (244) | 89 | (265) | (116) | (126) | 1,300 |
| Loans charged-off | (5) | 0 | 0 | 0 | (13) | (72) | 0 | (90) |
| Recoveries | 44 | 0 | 0 | 0 | 14 | 67 | 0 | 125 |
| Net loans (charged-off) recovered | 39 | 0 | 0 | 0 | 1 | (5) | 0 | 35 |
| Ending balance | $ 36,676 | $ 26,746 | $ 3,686 | $ 1,387 | $ 2,901 | $ 1,272 | $ 380 | $ 73,048 |

The following tables present the activity in the allowance for credit losses by portfolio segment for the nine-month period ended September 30, 2021:

| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate and Multifamily Residential | Agri-business and Agricultural | Other Commercial | Consumer 1-4 Family Mortgage | Other Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Nine Months Ended September 30, 2021** | | | | | | | | |
| Beginning balance, January 1 | $ 28,333 | $ 22,907 | $ 3,043 | $ 416 | $ 2,619 | $ 951 | $ 3,139 | $ 61,408 |
| Impact of adopting ASC 326 | 4,312 | 4,316 | 1,060 | 941 | 953 | 349 | (2,881) | 9,050 |
| Provision for credit losses | 2,780 | (420) | (737) | 30 | (719) | 21 | 122 | 1,077 |
| Loans charged-off | (254) | (71) | 0 | 0 | (51) | (217) | 0 | (593) |
| Recoveries | 1,505 | 14 | 320 | 0 | 99 | 168 | 0 | 2,106 |
| Net loans (charged-off) recovered | 1,251 | (57) | 320 | 0 | 48 | (49) | 0 | 1,513 |
| Ending balance | $ 36,676 | $ 26,746 | $ 3,686 | $ 1,387 | $ 2,901 | $ 1,272 | $ 380 | $ 73,048 |

**Credit Quality Indicators:**

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes commercial loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis for Special Mention, Substandard and Doubtful grade loans and annually on Pass grade loans over $250,000.

The Company uses the following definitions for risk ratings:

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

**Substandard.** Loans classified as Substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans are considered to be "Pass" rated when they are reviewed as part of the previously described process and do not meet the criteria above with the exception of consumer troubled debt restructurings, which are evaluated and listed with Substandard commercial grade loans and consumer nonaccrual loans which are evaluated individually and listed with "Not Rated" loans. Loans listed as Not Rated are consumer loans or commercial loans with consumer characteristics included in groups of homogenous loans which are analyzed for credit quality indicators utilizing delinquency status.

The following table summarizes the risk category of loans by loan segment and origination date as of September 30, 2021:

| (dollars in thousands) | 2021 | 2020 | 2019 | 2018 | 2017 | Prior | Term Total | Revolving | Total |
|---|---|---|---|---|---|---|---|---|---|
| Commercial and industrial loans: | | | | | | | | | |
| Working capital lines of credit loans: | | | | | | | | | |
| Pass | $ 8,755 | $ 6,467 | $ 11,643 | $ 1,646 | $ 834 | $ 82 | $ 29,427 | $ 533,140 | $ 562,567 |
| Special Mention | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 64,240 | 64,240 |
| Substandard | 0 | 0 | 85 | 0 | 0 | 0 | 85 | 32,382 | 32,467 |
| Total | 8,755 | 6,467 | 11,728 | 1,646 | 834 | 82 | 29,512 | 629,762 | 659,274 |
| Non-working capital loans: | | | | | | | | | |
| Pass | 184,286 | 172,825 | 87,892 | 68,814 | 23,713 | 20,548 | 558,078 | 163,413 | 721,491 |
| Special Mention | 17,614 | 0 | 630 | 1,112 | 2,466 | 1,185 | 23,007 | 2,426 | 25,433 |
| Substandard | 4,908 | 7,022 | 1,225 | 4,681 | 5,723 | 512 | 24,071 | 3,208 | 27,279 |
| Not Rated | 1,695 | 1,915 | 920 | 719 | 191 | 22 | 5,462 | 0 | 5,462 |
| Total | 208,503 | 181,762 | 90,667 | 75,326 | 32,093 | 22,267 | 610,618 | 169,047 | 779,665 |
| Commercial real estate and multi-family residential loans: | | | | | | | | | |
| Construction and land development loans: | | | | | | | | | |
| Pass | 13,305 | 40,841 | 4,679 | 30,875 | 0 | 16,870 | 106,570 | 270,801 | 377,371 |
| Owner occupied loans: | | | | | | | | | |
| Pass | 93,789 | 174,606 | 127,573 | 94,853 | 82,439 | 105,570 | 678,830 | 36,226 | 715,056 |
| Special Mention | 6,829 | 0 | 1,809 | 966 | 7,715 | 1,273 | 18,592 | 0 | 18,592 |
| Substandard | 506 | 1,946 | 929 | 2,101 | 707 | 408 | 6,597 | 0 | 6,597 |
| Total | 101,124 | 176,552 | 130,311 | 97,920 | 90,861 | 107,251 | 704,019 | 36,226 | 740,245 |
| Nonowner occupied loans: | | | | | | | | | |
| Pass | 75,760 | 160,552 | 118,333 | 26,642 | 41,494 | 69,129 | 491,910 | 59,107 | 551,017 |
| Special Mention | 11,937 | 349 | 620 | 0 | 0 | 14,341 | 27,247 | 0 | 27,247 |
| Substandard | 0 | 0 | 0 | 3,354 | 0 | 0 | 3,354 | 0 | 3,354 |
| Total | 87,697 | 160,901 | 118,953 | 29,996 | 41,494 | 83,470 | 522,511 | 59,107 | 581,618 |
| Multifamily loans: | | | | | | | | | |
| Pass | 79,260 | 53,500 | 36,784 | 14,372 | 14,688 | 18,696 | 217,300 | 12,997 | 230,297 |
| Special Mention | 0 | 0 | 0 | 0 | 22,252 | 0 | 22,252 | 0 | 22,252 |
| Total | 79,260 | 53,500 | 36,784 | 14,372 | 36,940 | 18,696 | 239,552 | 12,997 | 252,549 |
| Agri-business and agricultural loans: | | | | | | | | | |
| Loans secured by farmland: | | | | | | | | | |
| Pass | 35,548 | 37,854 | 17,533 | 13,327 | 9,841 | 19,776 | 133,879 | 12,345 | 146,224 |
| Special Mention | 0 | 1,985 | 2,336 | 0 | 190 | 30 | 4,541 | 938 | 5,479 |
| Substandard | 212 | 0 | 0 | 0 | 0 | 145 | 357 | 0 | 357 |
| Total | 35,760 | 39,839 | 19,869 | 13,327 | 10,031 | 19,951 | 138,777 | 13,283 | 152,060 |
| Loans for agricultural production: | | | | | | | | | |
| Pass | 27,116 | 27,959 | 4,415 | 11,399 | 1,478 | 4,393 | 76,760 | 76,860 | 153,620 |
| Special Mention | 464 | 8,644 | 1,250 | 0 | 43 | 19 | 10,420 | 8,014 | 18,434 |
| Total | 27,580 | 36,603 | 5,665 | 11,399 | 1,521 | 4,412 | 87,180 | 84,874 | 172,054 |
| Other commercial loans: | | | | | | | | | |
| Pass | 1,488 | 30,130 | 3,541 | 1,328 | 8,897 | 8,772 | 54,156 | 25,162 | 79,318 |
| Special Mention | 0 | 0 | 0 | 0 | 0 | 3,945 | 3,945 | 0 | 3,945 |
| Total | 1,488 | 30,130 | 3,541 | 1,328 | 8,897 | 12,717 | 58,101 | 25,162 | 83,263 |
| Consumer 1-4 family mortgage loans: | | | | | | | | | |
| Closed end first mortgage loans | | | | | | | | | |
| Pass | 13,332 | 17,484 | 5,487 | 6,502 | 3,216 | 2,145 | 48,166 | 2,183 | 50,349 |
| Substandard | 0 | 0 | 0 | 0 | 0 | 1,821 | 1,821 | 0 | 1,821 |
| Not Rated | 35,165 | 28,684 | 10,088 | 7,868 | 9,343 | 29,513 | 120,661 | 562 | 121,223 |
| Total | 48,497 | 46,168 | 15,575 | 14,370 | 12,559 | 33,479 | 170,648 | 2,745 | 173,393 |
| Open end and junior lien loans | | | | | | | | | |
| Pass | 193 | 379 | 162 | 317 | 0 | 0 | 1,051 | 10,733 | 11,784 |
| Substandard | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Not Rated | 17,212 | 6,732 | 6,885 | 4,814 | 2,394 | 1,678 | 39,715 | 112,024 | 151,739 |
| Total | 17,405 | 7,111 | 7,047 | 5,131 | 2,394 | 1,678 | 40,766 | 122,757 | 163,523 |
| Residential construction loans | | | | | | | | | |
| Not Rated | 7,164 | 2,842 | 982 | 140 | 173 | 1,177 | 12,478 | 13 | 12,491 |
| Other consumer loans | | | | | | | | | |
| Pass | 584 | 1,181 | 1,579 | 0 | 1,253 | 0 | 4,597 | 22,084 | 26,681 |
| Substandard | 36 | 0 | 257 | 0 | 0 | 0 | 293 | 0 | 293 |
| Not Rated | 18,262 | 17,058 | 8,678 | 6,945 | 2,531 | 1,418 | 54,892 | 10,081 | 64,973 |
| Total | 18,882 | 18,239 | 10,514 | 6,945 | 3,784 | 1,418 | 59,782 | 32,165 | 91,947 |
| TOTAL | $ 655,420 | $ 800,955 | $ 456,315 | $ 302,775 | $ 241,581 | $ 323,468 | $ 2,780,514 | $ 1,458,939 | $ 4,239,453 |

As of September 30, 2021, $91.9 million in PPP loans were included in the "Pass" category of non-working capital commercial and industrial loans. These loans were included in this risk rating category because they are fully guaranteed by the Small Business Administration (“SBA”).

**Nonaccrual and Past Due Loans:**

The Company does not record interest on nonaccrual loans until principal is recovered. For all loan classes, a loan is generally placed on nonaccrual status when principal or interest becomes 90 days past due unless it is well secured and in the process of collection, or earlier when concern exists as to the ultimate collectability of principal or interest. Interest accrued but not received is reversed against earnings. Cash interest received on these loans is applied to the principal balance until the principal is recovered or until the loan returns to accrual status. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current, remain current for a prescribed period, and future payments are reasonably assured.

The following table presents the aging of the amortized cost basis in past due loans as of September 30, 2021 by class of loans and loans past due 90 days or more and still accruing by class of loan:

| (dollars in thousands) | Loans Not Past Due | 30-89 Days Past Due | Greater than 89 Days Past Due and Accruing | Total Accruing | Total Nonaccrual | Nonaccrual With No Allowance For Credit Loss | Total |
|---|---|---|---|---|---|---|---|
| Commercial and industrial loans: | | | | | | | |
| Working capital lines of credit loans | $ 659,160 | $ 114 | $ 0 | $ 645,093 | $ 14,181 | $ 1 | $ 659,274 |
| Non-working capital loans | 779,551 | 114 | 0 | 770,709 | 8,956 | 232 | 779,665 |
| Commercial real estate and multi-family residential loans: | | | | | | | |
| Construction and land development loans | 377,371 | 0 | 0 | 377,371 | 0 | 0 | 377,371 |
| Owner occupied loans | 740,245 | 0 | 0 | 736,423 | 3,822 | 986 | 740,245 |
| Nonowner occupied loans | 581,618 | 0 | 0 | 578,260 | 3,358 | 0 | 581,618 |
| Multifamily loans | 252,549 | 0 | 0 | 252,549 | 0 | 0 | 252,549 |
| Agri-business and agricultural loans: | | | | | | | |
| Loans secured by farmland | 152,060 | 0 | 0 | 151,915 | 145 | 0 | 152,060 |
| Loans for agricultural production | 172,054 | 0 | 0 | 172,054 | 0 | 0 | 172,054 |
| Other commercial loans | 83,263 | 0 | 0 | 83,263 | 0 | 0 | 83,263 |
| Consumer 1-4 family mortgage loans: | | | | | | | |
| Closed end first mortgage loans | 172,515 | 860 | 18 | 173,293 | 100 | 56 | 173,393 |
| Open end and junior lien loans | 163,489 | 34 | 0 | 163,425 | 98 | 98 | 163,523 |
| Residential construction loans | 12,491 | 0 | 0 | 12,491 | 0 | 0 | 12,491 |
| Other consumer loans | 91,829 | 118 | 0 | 91,629 | 318 | 0 | 91,947 |
| Total | $ 4,238,195 | $ 1,240 | $ 18 | $ 4,208,475 | $ 30,978 | $ 1,373 | $ 4,239,453 |

As of September 30, 2021 there were no loans 30-89 days past due or greater than 89 days past due on nonaccrual. Additionally, interest income recognized on nonaccrual loans was insignificant during the nine month period ended September 30, 2021.

When management determines that foreclosure is probable, expected credit losses for collateral dependent loans are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate. A loan is considered collateral dependent when the borrower is experiencing financial difficulty and the loan is expected to be repaid substantially through the operation or sale of the collateral. The class of loan represents the primary collateral type associated with the loan. Significant quarter over quarter changes are reflective of changes in nonaccrual status and not necessarily associated with credit quality indicators like appraisal value.

The following table presents the amortized cost basis of collateral dependent loans by class of loan as of September 30, 2021:

| (dollars in thousands) | Real Estate | General Business Assets | Other | Total |
|---|---|---|---|---|
| Commercial and industrial loans: | | | | |
| Working capital lines of credit loans | $ 0 | $ 14,181 | $ 0 | $ 14,181 |
| Non-working capital loans | 1,632 | 13,757 | 229 | 15,618 |
| Commercial real estate and multi-family residential loans: | | | | |
| Owner occupied loans | 1,456 | 1,675 | 1,161 | 4,292 |
| Nonowner occupied loans | 3,358 | 0 | 0 | 3,358 |
| Agri-business and agricultural loans: | | | | |
| Loans secured by farmland | 0 | 145 | 0 | 145 |
| Consumer 1-4 family mortgage loans: | | | | |
| Closed end first mortgage loans | 3,056 | 0 | 0 | 3,056 |
| Other consumer loans | 0 | 0 | 51 | 51 |
| Total | 9,502 | 29,758 | 1,441 | 40,701 |

**Troubled Debt Restructurings:**

Troubled debt restructured loans are included in the totals for individually analyzed loans. The Company has allocated $6.1 million and $5.5 million of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2021 and December 31, 2020, respectively. The Company is not committed to lend additional funds to debtors whose loans have been modified in a troubled debt restructuring.

| (dollars in thousands) | September 30, 2021 | December 31, 2020 |
|---|---|---|
| Accruing troubled debt restructured loans | $ 4,973 | $ 5,237 |
| Nonaccrual troubled debt restructured loans | 6,093 | 6,476 |
| Total troubled debt restructured loans | $ 11,066 | $ 11,713 |

During the three and nine months ended September 30, 2021, no loans were modified as troubled debt restructurings.

During the three months ended September 30, 2020, no loans were modified as troubled debt restructurings.

During the nine months ended September 30, 2020, certain loans were modified as troubled debt restructurings. The modified terms of these loans include one or a combination of the following: inadequate compensation for the terms of the restructure or renewal; a modification of the repayment terms which delays principal repayment for some period; or renewal terms offered to borrowers in financial distress where no additional credit enhancements were obtained at the time of renewal.

The following table presents loans by class modified as new troubled debt restructurings that occurred during the nine months ended September 30, 2020:

| (dollars in thousands) | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Modified Repayment Terms Number of Loans | Modified Repayment Terms Extension Period or Range (in months) |
|---|---|---|---|---|---|
| Troubled Debt Restructurings | | | | | |
| Commercial and industrial loans: | | | | | |
| Working capital lines of credit loans | 1 | $ 250 | $ 315 | 1 | 0 |
| Non-working capital lines of credit loans | 2 | 4,288 | 3,691 | 2 | 0 |
| Commercial real estate and multi-family residential loans: | | | | | |
| Owner occupied loans | 1 | 1,528 | 1,527 | 1 | 0 |
| Total | 4 | $ 6,066 | $ 5,533 | 4 | 0 |

For the nine month period ended September 30, 2020, the troubled debt restructurings described above increased the allowance for credit losses by $2.4 million, and charge-offs of $666,000 were recorded.

As of September 30, 2021, total deferrals attributed to COVID-19 were $22.3 million representing three borrowers. This represented 0.5% of the total loan portfolio. Two were commercial loan borrowers and there was one retail borrower with COVID-19 deferrals. Of the total commercial deferrals attributed to COVID-19, $8.0 million represented a second deferral action and $14.3 million represented a third deferral action. All COVID-19 related loan deferrals remain on accrual status, as each deferral is evaluated individually, and management has determined that all contractual cashflows are collectable at this time. In accordance with Section 4013 of the CARES Act, loan deferrals granted to customers that resulted from the impact of COVID-19 and who were not past due at December 31, 2019 were not considered troubled debt restructurings as of September 30, 2021. This provision was extended to January 1, 2022 under the Consolidated Appropriations Act, 2021. Management continues to monitor these deferrals and has adequately considered these credits in the September 30, 2021 allowance for credit losses balance.

**Allowance for Loan Losses (Prior to January 1, 2021):**

Prior to the adoption of ASC 326 on January 1, 2021 the Company calculated the allowance for loan losses using the incurred losses methodology. The following tables are disclosures related to the allowance for loan losses in prior periods.

The following tables present the activity in the allowance for loan losses by portfolio segment for the three-month period ended September 30, 2020:

| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate and Multfamily Residential | Agri-business and Agricultural | Other Commercial | Consumer 1-4 Family Mortgage | Other Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| Three Months Ended September 30, 2020 | | | | | | | | |
| Beginning balance, July 1 | $ 26,744 | $ 21,063 | $ 3,408 | $ 542 | $ 3,434 | $ 774 | $ 3,054 | $ 59,019 |
| Provision for credit losses | 1,574 | 175 | (314) | 30 | (50) | 237 | 98 | 1,750 |
| Loans charged-off | (6) | 0 | 0 | 0 | (70) | (229) | 0 | (305) |
| Recoveries | 51 | 177 | 3 | 0 | 4 | 48 | 0 | 283 |
| Net loans charged-off | 45 | 177 | 3 | 0 | (66) | (181) | 0 | (22) |
| Ending balance | $ 28,363 | $ 21,415 | $ 3,097 | $ 572 | $ 3,318 | $ 830 | $ 3,152 | $ 60,747 |

The following tables present the activity in the allowance for loan losses by portfolio segment for the nine-month period ended September 30, 2020:

| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate and Multfamily Residential | Agri-business and Agricultural | Other Commercial | Consumer 1-4 Family Mortgage | Other Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| Nine Months Ended September 30, 2020 | | | | | | | | |
| Beginning balance, January 1 | $ 25,789 | $ 15,796 | $ 3,869 | $ 447 | $ 2,086 | $ 345 | $ 2,320 | $ 50,652 |
| Provision for credit losses | 6,264 | 5,312 | (780) | 125 | 1,298 | 799 | 832 | 13,850 |
| Loans charged-off | (4,037) | 0 | 0 | 0 | (83) | (445) | 0 | (4,565) |
| Recoveries | 347 | 307 | 8 | 0 | 17 | 131 | 0 | 810 |
| Net loans charged-off | (3,690) | 307 | 8 | 0 | (66) | (314) | 0 | (3,755) |
| Ending balance | $ 28,363 | $ 21,415 | $ 3,097 | $ 572 | $ 3,318 | $ 830 | $ 3,152 | $ 60,747 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2020:

| (dollars in thousands) | Commercial and Industrial | Commercial Real Estate and Multfamily Residential | Agri-business and Agricultural | Other Commercial | Consumer 1-4 Family Mortgage | Other Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| December 31, 2020 | | | | | | | | |
| Allowance for loan losses: | | | | | | | | |
| Ending allowance balance attributable to loans: | | | | | | | | |
| Individually evaluated for impairment | $ 6,310 | $ 1,377 | $ 84 | $ 0 | $ 270 | $ 0 | $ 0 | $ 8,041 |
| Collectively evaluated for impairment | 22,023 | 21,530 | 2,959 | 416 | 2,349 | 951 | 3,139 | 53,367 |
| Total ending allowance balance | $ 28,333 | $ 22,907 | $ 3,043 | $ 416 | $ 2,619 | $ 951 | $ 3,139 | $ 61,408 |
| | | | | | | | | |
| Loans: | | | | | | | | |
| Loans individually evaluated for impairment | $ 12,533 | $ 5,518 | $ 428 | $ 0 | $ 1,700 | $ 0 | $ 0 | $ 20,179 |
| Loans collectively evaluated for impairment | 1,772,393 | 1,887,054 | 429,234 | 93,912 | 342,999 | 103,385 | 0 | 4,628,977 |
| Total ending loans balance | $ 1,784,926 | $ 1,892,572 | $ 429,662 | $ 93,912 | $ 344,699 | $ 103,385 | $ 0 | $ 4,649,156 |

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2020:

| (dollars in thousands) | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | $ 346 | $ 173 | $ 0 |
| Non-working capital loans | 2,399 | 968 | 0 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 3,002 | 2,930 | 0 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 603 | 283 | 0 |
| Consumer 1-4 family loans: | | | |
| Closed end first mortgage loans | 316 | 236 | 0 |
| Open end and junior lien loans | 5 | 5 | 0 |
| With an allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | 433 | 433 | 255 |
| Non-working capital loans | 11,644 | 10,959 | 6,055 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 2,589 | 2,588 | 1,377 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 145 | 145 | 84 |
| Consumer 1-4 family mortgage loans: | | | |
| Closed end first mortgage loans | 1,457 | 1,459 | 270 |
| Total | $ 22,939 | $ 20,179 | $ 8,041 |

The following table presents loans individually evaluated for impairment by class of loans as of and for the three-month period ended September 30, 2020:

| (dollars in thousands) | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Income Recognized |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | $ 174 | $ 0 | $ 0 |
| Non-working capital loans | 995 | 5 | 5 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 2,054 | 4 | 4 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 283 | 0 | 0 |
| Consumer 1-4 family loans: | | | |
| Closed end first mortgage loans | 274 | 0 | 0 |
| Open end and junior lien loans | 54 | 0 | 0 |
| Residential construction loans | 8 | 0 | 0 |
| With an allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | 1,546 | 0 | 0 |
| Non-working capital loans | 11,970 | 63 | 63 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 3,994 | 0 | 0 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 146 | 0 | 0 |
| Consumer 1-4 family mortgage loans: | | | |
| Closed end first mortgage loans | 1,520 | 9 | 9 |
| Open end and junior lien loans | 648 | 0 | 0 |
| Residential construction loans | 35 | 0 | 0 |
| Total | $ 23,701 | $ 81 | $ 81 |

The following table presents loans individually evaluated for impairment by class of loans as of and for the nine-month period ended September 30, 2020:

| (dollars in thousands) | Average Recorded Investment | Interest Income Recognized | Cash Basis Interest Income Recognized |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | $ 442 | $ 0 | $ 0 |
| Non-working capital loans | 766 | 16 | 16 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 2,101 | 13 | 13 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 283 | 0 | 0 |
| Consumer 1-4 family loans: | | | |
| Closed end first mortgage loans | 304 | 2 | 2 |
| Open end and junior lien loans | 63 | 0 | 0 |
| Residential construction loans | 3 | 0 | 0 |
| With an allowance recorded: | | | |
| Commercial and industrial loans: | | | |
| Working capital lines of credit loans | 3,001 | 0 | 0 |
| Non-working capital loans | 11,763 | 216 | 216 |
| Commercial real estate and multi-family residential loans: | | | |
| Owner occupied loans | 3,034 | 30 | 30 |
| Agri-business and agricultural loans: | | | |
| Loans secured by farmland | 147 | 0 | 0 |
| Consumer 1-4 family mortgage loans: | | | |
| Closed end first mortgage loans | 1,589 | 28 | 28 |
| Open end and junior lien loans | 642 | 0 | 0 |
| Residential construction loans | 46 | 0 | 0 |
| Total | $ 24,184 | $ 305 | $ 305 |

The following table presents the aging of the recorded investment in past due loans as of December 31, 2020 by class of loans:

| (dollars in thousands) | Loans Not Past Due | 30-89 Days Past Due | Greater than 90 Days Past Due | Nonaccrual | Total Past Due and Nonaccrual | Total |
|---|---|---|---|---|---|---|
| Commercial and industrial loans: | | | | | | |
| Working capital lines of credit loans | $ 625,493 | $ 0 | $ 0 | $ 606 | $ 606 | $ 626,099 |
| Non-working capital loans | 1,153,540 | 0 | 0 | 5,287 | 5,287 | 1,158,827 |
| Commercial real estate and multi-family residential loans: | | | | | | |
| Construction and land development loans | 361,664 | 0 | 0 | 0 | 0 | 361,664 |
| Owner occupied loans | 642,527 | 0 | 0 | 5,047 | 5,047 | 647,574 |
| Nonowner occupied loans | 579,050 | 0 | 0 | 0 | 0 | 579,050 |
| Multifamily loans | 304,284 | 0 | 0 | 0 | 0 | 304,284 |
| Agri-business and agricultural loans: | | | | | | |
| Loans secured by farmland | 194,935 | 0 | 0 | 428 | 428 | 195,363 |
| Loans for agricultural production | 234,191 | 108 | 0 | 0 | 108 | 234,299 |
| Other commercial loans | 93,912 | 0 | 0 | 0 | 0 | 93,912 |
| Consumer 1-4 family mortgage loans: | | | | | | |
| Closed end first mortgage loans | 165,895 | 877 | 116 | 613 | 1,606 | 167,501 |
| Open end and junior lien loans | 165,094 | 137 | 0 | 5 | 142 | 165,236 |
| Residential construction loans | 11,962 | 0 | 0 | 0 | 0 | 11,962 |
| Other consumer loans | 103,240 | 145 | 0 | 0 | 145 | 103,385 |
| Total | $ 4,635,787 | $ 1,267 | $ 116 | $ 11,986 | $ 13,369 | $ 4,649,156 |

As of December 31, 2020, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (dollars in thousands) | Pass | Special Mention | Substandard | Doubtful | Not Rated | Total |
|---|---|---|---|---|---|---|
| Commercial and industrial loans: | | | | | | |
| Working capital lines of credit loans | $ 535,071 | $ 81,095 | $ 9,718 | $ 0 | $ 215 | $ 626,099 |
| Non-working capital loans | 1,111,989 | 26,523 | 14,820 | 0 | 5,495 | 1,158,827 |
| Commercial real estate and multi-family residential loans: | | | | | | |
| Construction and land development loans | 361,664 | 0 | 0 | 0 | 0 | 361,664 |
| Owner occupied loans | 608,845 | 31,355 | 7,374 | 0 | 0 | 647,574 |
| Nonowner occupied loans | 547,790 | 31,260 | 0 | 0 | 0 | 579,050 |
| Multi-family loans | 282,031 | 22,253 | 0 | 0 | 0 | 304,284 |
| Agri-business and agricultural loans: | | | | | | |
| Loans secured by farmland | 183,983 | 10,728 | 652 | 0 | 0 | 195,363 |
| Loans for agricultural production | 185,875 | 48,424 | 0 | 0 | 0 | 234,299 |
| Other commercial loans | 93,912 | 0 | 0 | 0 | 0 | 93,912 |
| Consumer 1-4 family mortgage loans: | | | | | | |
| Closed end first mortgage loans | 40,682 | 0 | 1,695 | 0 | 125,124 | 167,501 |
| Open end and junior lien loans | 8,424 | 0 | 5 | 0 | 156,807 | 165,236 |
| Residential construction loans | 0 | 0 | 0 | 0 | 11,962 | 11,962 |
| Other consumer loans | 36,979 | 253 | 0 | 0 | 66,153 | 103,385 |
| Total | $ 3,997,245 | $ 251,891 | $ 34,264 | $ 0 | $ 365,756 | $ 4,649,156 |

**NOTE 5. BORROWINGS**

For the periods ended September 30, 2021 and December 31, 2020, the Company had an advance outstanding from the Federal Home Loan Bank ("FHLB") in the amount of $75.0 million. The outstanding FHLB advance is a ten-year fixed-rate putable advance with a rate of 0.39% and is due on March 4, 2030. The advance may not be prepaid by the Company without penalty. All FHLB notes require monthly interest payments and are secured by residential real estate loans and securities.

On August 2, 2019 the Company entered into an unsecured revolving credit agreement with another financial institution allowing the Company to borrow up to $30.0 million; this credit agreement was subsequently amended and renewed on July 30, 2021. Funds provided under the agreement may be used to repurchase shares of the Company's common stock under the share repurchase program, which was reauthorized by the Company's board of directors on April 13, 2021. The credit agreement includes a negative pledge agreement whereby the Company agrees not to pledge or otherwise encumber the stock of the Bank. The credit agreement has a one year term which may be amended, extended, modified or renewed. Outstanding borrowings on the credit agreement were $0 and $10.5 million at September 30, 2021 and December 31, 2020, respectively.

**NOTE 6. FAIR VALUE DISCLOSURES**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

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

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

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

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: Securities available-for-sale are valued primarily by a third party pricing service. The fair values of securities available-for-sale are determined on a recurring basis by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or pricing models which utilize significant observable inputs such as matrix pricing. This is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). These models utilize the market approach with standard inputs that include, but are not limited to benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. For certain municipal securities that are not rated and observable inputs about the specific issuer are not available, fair values are estimated using observable data from other municipal securities presumed to be similar or other market data on other non-rated municipal securities (Level 3 inputs).

The Company's Finance Department, which is responsible for all accounting and SEC disclosure compliance, and the Company's Treasury Department, which is responsible for investment portfolio management and asset/liability modeling, are the two areas that determine the Company's valuation policies and procedures. Both of these areas report directly to the Executive Vice President and Chief Financial Officer of the Company. For assets or liabilities that may be considered for Level 3 fair value measurement on a recurring basis, these two departments and the Executive Vice President and Chief Financial Officer determine the appropriate level of the assets or liabilities under consideration. If there are new assets or liabilities that are determined to be Level 3 by this group, the Risk Management Committee of the Company and the Audit Committee of the Board are made aware of such assets at their next scheduled meeting.

Securities pricing is obtained on securities from a third party pricing service and all security prices are tested annually against prices from another third party provider and reviewed with a market value price tolerance variance that varies by sector: municipal securities +/-5%, government mbs/cmo +/-3% and U.S. treasuries +/-1%. If any securities fall outside the tolerance threshold and have a variance of $100,000 or more, a determination of materiality is made for the amount over the threshold. Any security that would have a material threshold difference would be further investigated to determine why the variance exists and if any action is needed concerning the security pricing for that individual security. Changes in market value are reviewed monthly in aggregate by security type and any material changes are reviewed to determine why they exist. At least annually, the pricing methodology of the pricing service is received and reviewed to support the fair value levels used by the Company. A detailed pricing evaluation is requested and reviewed on any security determined to be fair valued using unobservable inputs by the pricing service.

Mortgage banking derivative: The fair values of mortgage banking derivatives are based on observable market data as of the measurement date (Level 2).

Interest rate swap derivatives: Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. The fair value of interest rate swap derivatives is determined by pricing or valuation models using observable market data as of the measurement date (Level 2).

Collateral dependent loans: Collateral dependent loans with specific allocations of the allowance for credit losses generally based on the fair value of the underlying collateral when repayment is expected solely from the collateral. Fair value is determined using several methods. Generally, the fair value of real estate is based on appraisals by qualified third party appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and result in a Level 3 classification of the inputs for determining fair value. In addition, the Company’s management routinely applies internal discount factors to the value of appraisals used in the fair value evaluation of collateral dependent loans. The deductions to the appraisals take into account changing business factors and market conditions, as well as value impairment in cases where the appraisal date predates a likely change in market conditions. Commercial real estate is generally discounted from its appraised value by 0-50% with the higher discounts applied to real estate that is determined to have a thin trading market or to be specialized collateral. In addition to real estate, the Company’s management evaluates other types of collateral as follows: (a) raw and finished inventory is discounted from its cost or book value by 35-65%, depending on the marketability of the goods (b) finished goods are generally discounted by 30-60%, depending on the ease of marketability, cost of transportation or scope of use of the finished good (c) work in process inventory is typically discounted by 50%-100%, depending on the length of manufacturing time, types of components used in the completion process, and the breadth of the user base (d) equipment is valued at a percentage of depreciated book value or recent appraised value, if available, and is typically discounted at 30-70% after various considerations including age and condition of the equipment, marketability, breadth of use, and whether the equipment includes unique components or add-ons; and (e) marketable securities are discounted by 10%-30%, depending on the type of investment, age of valuation report and general market conditions. This methodology is based on a market approach and typically results in a Level 3 classification of the inputs for determining fair value.

Mortgage servicing rights: As of September 30, 2021, the fair value of the Company’s Level 3 servicing assets for residential mortgage loans (“MSRs”) was $2.9 million, carried at amortized cost of $3.4 million less a $518,000 valuation reserve. These residential mortgage loans have a weighted average interest rate of 3.49%, a weighted average maturity of 20 years and are secured by homes generally within the Company’s market area of Northern Indiana and Indianapolis. A third-party valuation is used to estimate fair value by stratifying the portfolios on the basis of certain risk characteristics, including loan type and interest rate. Impairment is estimated based on an income approach. The inputs used include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, late fees and float income. The most significant assumption used to value MSRs is prepayment rate. Prepayment rates are estimated based on published industry consensus prepayment rates. The most significant unobservable assumption is the discount rate. At September 30, 2021, the constant prepayment speed (“PSA”) used was 2.67 and discount rate used was 9.5%. At December 31, 2020, the PSA used was 2.04 and the discount rate used was 9.4%.

Other real estate owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value less costs to sell. Fair values are generally based on third party appraisals of the property and are reviewed by the Company's internal appraisal officer. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable properties used to determine value. Such adjustments are usually significant and result in a Level 3 classification. In addition, the Company's management may apply discount factors to the appraisals to take into account changing business factors and market conditions, as well as value impairment in cases where the appraisal date predates a likely change in market conditions. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Real estate mortgage loans held-for-sale: Real estate mortgage loans held-for-sale are carried at the lower of cost or fair value, as determined by outstanding commitments, from third party investors, and result in a Level 2 classification.

The tables below presents the balances of assets measured at fair value on a recurring basis:

| | **September 30, 2021** | | | |
|---|---|---|---|---|
| | **Fair Value Measurements Using** | | | **Assets at Fair Value** |
| (dollars in thousands) | **Level 1** | **Level 2** | **Level 3** | |
| Assets: | | | | |
| U.S. Treasury securities | **$ 900** | **$ 0** | **$ 0** | **$ 900** |
| U.S. government sponsored agency securities | **0** | **116,461** | **0** | **116,461** |
| Mortgage-backed securities: residential | **0** | **431,833** | **0** | **431,833** |
| Mortgage-backed securities: commercial | **0** | **24,182** | **0** | **24,182** |
| State and municipal securities | **0** | **666,199** | **140** | **666,339** |
| Total Securities | **900** | **1,238,675** | **140** | **1,239,715** |
| Mortgage banking derivative | **0** | **719** | **0** | **719** |
| Interest rate swap derivative | **0** | **15,426** | **0** | **15,426** |
| Total assets | **$ 900** | **$ 1,254,820** | **$ 140** | **$ 1,255,860** |
| | | | | |
| Liabilities: | | | | |
| Mortgage banking derivative | $ 0 | **$ 1** | **$ 0** | **$ 1** |
| Interest rate swap derivative | **0** | **15,447** | **0** | **15,447** |
| Total liabilities | **$ 0** | **$ 15,448** | **$ 0** | **$ 15,448** |

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets at Fair Value |
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | |
| U.S. government sponsored agency securities | $ 0 | $ 36,487 | $ 0 | $ 36,487 |
| Mortgage-backed securities: residential | 0 | 279,503 | 0 | 279,503 |
| Mortgage-backed securities: commercial | 0 | 36,881 | 0 | 36,881 |
| State and municipal securities | 0 | 381,834 | 140 | 381,974 |
| Total Securities | 0 | 734,705 | 140 | 734,845 |
| Mortgage banking derivative | 0 | 1,182 | 0 | 1,182 |
| Interest rate swap derivative | 0 | 21,764 | 0 | 21,764 |
| Total assets | $ 0 | $ 757,651 | $ 140 | $ 757,791 |
| | | | | |
| Liabilities: | | | | |
| Mortgage banking derivative | $ 0 | $ 111 | $ 0 | $ 111 |
| Interest rate swap derivative | 0 | 21,794 | 0 | 21,794 |
| Total liabilities | $ 0 | $ 21,905 | $ 0 | $ 21,905 |

The fair value of Level 3 available-for-sale securities was immaterial and thus did not require additional recurring fair value disclosure.

The tables below presents the balances of assets measured at fair value on a nonrecurring basis:

| | September 30, 2021 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets at Fair Value |
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | |
| Assets | | | | |
| Collateral dependent loans: | | | | |
| Commercial and industrial loans: | | | | |
| Working capital lines of credit loans | $ 0 | $ 0 | $ 9,982 | $ 9,982 |
| Non-working capital loans | 0 | 0 | 7,525 | 7,525 |
| Commercial real estate and multi-family residential loans: | | | | |
| Owner occupied loans | 0 | 0 | 652 | 652 |
| Nonowner occupied loans | 0 | 0 | 3,131 | 3,131 |
| Agri-business and agricultural loans: | | | | |
| Loans secured by farmland | 0 | 0 | 43 | 43 |
| Total collateral dependent loans | 0 | 0 | 21,333 | 21,333 |
| Other real estate owned | 0 | 0 | 0 | 0 |
| Total assets | $ 0 | $ 0 | $ 21,333 | $ 21,333 |

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Fair Value Measurements Using | | | Assets at Fair Value |
| (dollars in thousands) | Level 1 | Level 2 | Level 3 | |
| Assets | | | | |
| Collateral dependent loans: | | | | |
| Commercial and industrial loans: | | | | |
| Working capital lines of credit loans | $ 0 | $ 0 | $ 178 | $ 178 |
| Non-working capital loans | 0 | 0 | 4,904 | 4,904 |
| Commercial real estate and multi-family residential loans: | | | | |
| Owner occupied loans | 0 | 0 | 1,211 | 1,211 |
| Agri-business and agricultural loans: | | | | |
| Loans secured by farmland | 0 | 0 | 61 | 61 |
| Consumer 1-4 family mortgage loans: | | | | |
| Closed end first mortgage loans | 0 | 0 | 411 | 411 |
| Total collateral dependent loans | 0 | 0 | 6,765 | 6,765 |
| Other real estate owned | 0 | 0 | 0 | 0 |
| Total assets | $ 0 | $ 0 | $ 6,765 | $ 6,765 |

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at September 30, 2021:

| (dollars in thousands) | Fair Value | Valuation Methodology | Unobservable Inputs | Average | Range of Inputs |
|---|---|---|---|---|---|
| Collateral dependent loans: | | | | | |
| Commercial and industrial | **$ 17,507** | **Collateral based measurements** | **Discount to reflect current market conditions and ultimate collectability** | **58 %** | **25%-99%** |
| Collateral dependent loans: | | | | | |
| Commercial real estate | **3,783** | **Collateral based measurements** | **Discount to reflect current market conditions and ultimate collectability** | **38 %** | **7%-99%** |
| Collateral dependent loans: | | | | | |
| Agribusiness and agricultural | **43** | **Collateral based measurements** | **Discount to reflect current market conditions and ultimate collectability** | **70 %** | **N/A** |

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at December 31, 2020:

| (dollars in thousands) | Fair Value | Valuation Methodology | Unobservable Inputs | Average | Range of Inputs |
|---|---|---|---|---|---|
| Collateral dependent loans: | | | | | |
| Commercial and industrial | $ 5,082 | Collateral basedmeasurements | Discount to reflect current market conditions and ultimate collectability | 55 % | 16%-100% |
| Collateral dependent loans: | | | | | |
| Commercial real estate | 1,211 | Collateral basedmeasurements | Discount to reflect current market conditions and ultimate collectability | 53 % | 21%-74% |
| Collateral dependent loans: | | | | | |
| Agribusiness and agricultural | 61 | Collateral basedmeasurements | Discount to reflect current market conditions and ultimate collectability | 58 % | N/A |
| Collateral dependent loans: | | | | | |
| Consumer 1-4 family mortgage | 411 | Collateral basedmeasurements | Discount to reflect current market conditions and ultimate collectability | 11 % | 10%-15% |

The following tables contain the estimated fair values and the related carrying values of the Company’s financial instruments. Items which are not financial instruments are not included.

| | September 30, 2021 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| (dollars in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | | |
| Cash and cash equivalents | $ 557,233 | $ 555,522 | $ 1,711 | $ 0 | $ 557,233 |
| Securities available-for-sale | 1,239,715 | 900 | 1,238,675 | 140 | 1,239,715 |
| Real estate mortgages held-for-sale | 7,969 | 0 | 8,133 | 0 | 8,133 |
| Loans, net | 4,166,405 | 0 | 0 | 4,101,098 | 4,101,098 |
| Mortgage banking derivative | 719 | 0 | 719 | 0 | 719 |
| Interest rate swap derivative | 15,426 | 0 | 15,426 | 0 | 15,426 |
| Federal Reserve and Federal Home Loan Bank Stock | 13,772 | N/A | N/A | N/A | N/A |
| Accrued interest receivable | 17,780 | 0 | 6,710 | 11,070 | 17,780 |
| Financial Liabilities: | | | | | |
| Certificates of deposit | (864,902) | 0 | (869,759) | 0 | (869,759) |
| All other deposits | (4,549,736) | (4,549,736) | 0 | 0 | (4,549,736) |
| Federal Home Loan Bank advances | (75,000) | 0 | (66,596) | 0 | (66,596) |
| Mortgage banking derivative | (1) | 0 | (1) | 0 | (1) |
| Interest rate swap derivative | (15,447) | 0 | (15,447) | 0 | (15,447) |
| Standby letters of credit | (334) | 0 | 0 | (334) | (334) |
| Accrued interest payable | (2,916) | (72) | (2,844) | 0 | (2,916) |

| | December 31, 2020 | | | | |
|---|---|---|---|---|---|
| | | Estimated Fair Value | | | |
| (dollars in thousands) | Carrying Value | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | | |
| Cash and cash equivalents | $ 249,927 | $ 247,228 | $ 2,699 | $ 0 | $ 249,927 |
| Securities available-for-sale | 734,845 | 0 | 734,705 | 140 | 734,845 |
| Real estate mortgages held-for-sale | 11,218 | 0 | 11,651 | 0 | 11,651 |
| Loans, net | 4,587,748 | 0 | 0 | 4,532,639 | 4,532,639 |
| Mortgage banking derivative | 1,182 | 0 | 1,182 | 0 | 1,182 |
| Interest rate swap derivative | 21,764 | 0 | 21,764 | 0 | 21,764 |
| Federal Reserve and Federal Home Loan Bank Stock | 13,772 | N/A | N/A | N/A | N/A |
| Accrued interest receivable | 18,761 | 0 | 3,801 | 14,960 | 18,761 |
| Financial Liabilities: | | | | | |
| Certificates of deposit | (1,024,819) | 0 | (1,033,095) | 0 | (1,033,095) |
| All other deposits | (4,011,986) | (4,011,986) | 0 | 0 | (4,011,986) |
| Miscellaneous borrowings | (10,500) | 0 | (10,500) | 0 | (10,500) |
| Federal Home Loan Bank advances | (75,000) | 0 | (68,967) | 0 | (68,967) |
| Mortgage banking derivative | (111) | 0 | (111) | 0 | (111) |
| Interest rate swap derivative | (21,794) | 0 | (21,794) | 0 | (21,794) |
| Standby letters of credit | (686) | 0 | 0 | (686) | (686) |
| Accrued interest payable | (5,959) | (66) | (5,893) | 0 | (5,959) |

## NOTE 7. OFFSETTING ASSETS AND LIABILITIES

The following tables summarize gross and net information about financial instruments and derivative instruments that are offset in the statement of financial position or that are subject to an enforceable master netting arrangement at September 30, 2021 and December 31, 2020.

| | September 30, 2021 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Gross Amounts Not Offset in the Statement of Financial Position | | |
| (dollars in thousands) | Gross Amounts of Recognized Assets/Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts presented in the Statement of Financial Position | Financial Instruments | Cash Collateral Position | Net Amount |
| **Assets** | | | | | | |
| Interest Rate Swap Derivatives | **$ 15,426** | **$ 0** | **$ 15,426** | **$ 0** | **$ (1,270)** | **$ 14,156** |
| Total Assets | **$ 15,426** | **$ 0** | **$ 15,426** | **$ 0** | **$ (1,270)** | **$ 14,156** |
| **Liabilities** | | | | | | |
| Interest Rate Swap Derivatives | **$ 15,447** | **$ 0** | **$ 15,447** | **$ 0** | **$ (9,980)** | **$ 5,467** |
| Total Liabilities | **$ 15,447** | **$ 0** | **$ 15,447** | **$ 0** | **$ (9,980)** | **$ 5,467** |

| | December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Gross Amounts Not Offset in the Statement of Financial Position | | |
| (dollars in thousands) | Gross Amounts of Recognized Assets/Liabilities | Gross Amounts Offset in the Statement of Financial Position | Net Amounts presented in the Statement of Financial Position | Financial Instruments | Cash Collateral Position | Net Amount |
| Assets | | | | | | |
| Interest Rate Swap Derivatives | $ 21,764 | $ 0 | $ 21,764 | $ 0 | $ 0 | $ 21,764 |
| Total Assets | $ 21,764 | $ 0 | $ 21,764 | $ 0 | $ 0 | $ 21,764 |
| Liabilities | | | | | | |
| Interest Rate Swap Derivatives | $ 21,794 | $ 0 | $ 21,794 | $ 0 | $ (21,370) | $ 424 |
| Total Liabilities | $ 21,794 | $ 0 | $ 21,794 | $ 0 | $ (21,370) | $ 424 |

If an event of default occurs causing an early termination of an interest rate swap derivative, any early termination amount payable to one party by the other party may be reduced by set-off against any other amount payable by the one party to the other party. If a default in performance of any obligation of a repurchase agreement occurs, each party will set-off property held in respect of transactions against obligations owing in respect of any other transactions.

## NOTE 8. EARNINGS PER SHARE

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period, which includes shares held in treasury on behalf of participants in the Company’s Directors Fee Deferral Plan, and share repurchases. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock based awards and warrants, none of which were antidilutive.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2021** | 2020 | **2021** | 2020 |
| Weighted average shares outstanding for basic earnings per common share | **25,479,654** | 25,418,712 | **25,472,185** | 25,484,329 |
| Dilutive effect of stock based awards and warrants | **155,634** | 68,590 | **136,470** | 134,072 |
| Weighted average shares outstanding for diluted earnings per common share | **25,635,288** | 25,487,302 | **25,608,655** | 25,618,401 |
| | | | | |
| Basic earnings per common share | **$ 0.95** | $ 0.89 | **$ 2.81** | $ 2.34 |
| Diluted earnings per common share | **$ 0.94** | $ 0.89 | **$ 2.79** | $ 2.33 |

Table of Contents

## NOTE 9. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables summarize the changes within each classification of accumulated other comprehensive income for the three months ended September 30, 2021 and 2020, all shown net of tax:

| (dollars in thousands) | **Unrealized Gains and Losses on Available-for-Sales Securities** | **Defined Benefit Pension Items** | **Total** |
|---|---|---|---|
| Balance at July 1, 2021 | **$ 23,619** | **$ (1,348)** | **$ 22,271** |
| Other comprehensive income before reclassification | **(11,385)** | **0** | **(11,385)** |
| Amounts reclassified from accumulated other comprehensive income | **0** | **46** | **46** |
| Net current period other comprehensive income (loss) | **(11,385)** | **46** | **(11,339)** |
| Balance at September 30, 2021 | **$ 12,234** | **$ (1,302)** | **$ 10,932** |

| (dollars in thousands) | Unrealized Gains and Losses on Available-for-Sales Securities | Defined Benefit Pension Items | Total |
|---|---|---|---|
| Balance at July 1, 2020 | $ 26,256 | $ (1,454) | $ 24,802 |
| Other comprehensive income before reclassification | 622 | 0 | 622 |
| Amounts reclassified from accumulated other comprehensive income | (248) | 48 | (200) |
| Net current period other comprehensive income | 374 | 48 | 422 |
| Balance at September 30, 2020 | $ 26,630 | $ (1,406) | $ 25,224 |

The following tables summarize the changes within each classification of accumulated other comprehensive income for the nine months ended September 30, 2021 and 2020, all shown net of tax:

| (dollars in thousands) | **Unrealized Gains and Losses on Available-for-Sales Securities** | **Defined Benefit Pension Items** | **Total** |
|---|---|---|---|
| Balance at January 1, 2021 | **$ 29,182** | **$ (1,438)** | **$ 27,744** |
| Other comprehensive loss before reclassification | **(16,318)** | **0** | **(16,318)** |
| Amounts reclassified from accumulated other comprehensive income | **(630)** | **136** | **(494)** |
| Net current period other comprehensive income (loss) | **(16,948)** | **136** | **(16,812)** |
| Balance at September 30, 2021 | **$ 12,234** | **$ (1,302)** | **$ 10,932** |

| (dollars in thousands) | Unrealized Gains and Losses on Available-for-Sales Securities | Defined Benefit Pension Items | Total |
|---|---|---|---|
| Balance at January 1, 2020 | $ 13,607 | $ (1,548) | $ 12,059 |
| Other comprehensive income before reclassification | 13,310 | 0 | 13,310 |
| Amounts reclassified from accumulated other comprehensive income | (287) | 142 | (145) |
| Net current period other comprehensive income | 13,023 | 142 | 13,165 |
| Balance at September 30, 2020 | $ 26,630 | $ (1,406) | $ 25,224 |

Reclassifications out of accumulated comprehensive income for the three months ended September 30, 2021 are as follows:

| **Details about Accumulated Other Comprehensive Income Components** | **Amount Reclassified From Accumulated Other Comprehensive Income** | | **Affected Line Item in the Statement Where Net Income is Presented** |
|---|---|---|---|
| (dollars in thousands) | | | |
| Realized gains and losses on available-for-sale securities | **$** | **0** | Net securities gains |
| Tax effect | | **0** | Income tax expense |
| | | **0** | Net of tax |
| Amortization of defined benefit pension items | | **(61)** | Other expense |
| Tax effect | | **15** | Income tax expense |
| | | **(46)** | Net of tax |
| Total reclassifications for the period | **$** | **(46)** | Net income |

Reclassifications out of accumulated comprehensive income for the three months ended September 30, 2020 are as follows:

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified From Accumulated Other Comprehensive Income | | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|---|
| (dollars in thousands) | | | |
| Realized gains and losses on available-for-sale securities | $ | 314 | Net securities gains |
| Tax effect | | (66) | Income tax expense |
| | | 248 | Net of tax |
| Amortization of defined benefit pension items | | (63) | Other expense |
| Tax effect | | 15 | Income tax expense |
| | | (48) | Net of tax |
| Total reclassifications for the period | $ | 200 | Net income |

Reclassifications out of accumulated comprehensive income for the nine months ended September 30, 2021 are as follows:

| **Details about Accumulated Other Comprehensive Income Components** | **Amount Reclassified From Accumulated Other Comprehensive Income** | | **Affected Line Item in the Statement Where Net Income is Presented** |
|---|---|---|---|
| (dollars in thousands) | | | |
| Realized gains and losses on available-for-sale securities | **$** | **797** | Net securities gains |
| Tax effect | | **(167)** | Income tax expense |
| | | **630** | Net of tax |
| Amortization of defined benefit pension items | | **(181)** | Other expense |
| Tax effect | | **45** | Income tax expense |
| | | **(136)** | Net of tax |
| Total reclassifications for the period | **$** | **494** | Net income |

Reclassifications out of accumulated comprehensive income for the nine months ended September 30, 2020 are as follows:

| Details about Accumulated Other Comprehensive Income Components | Amount Reclassified From Accumulated Other Comprehensive Income | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|
| (dollars in thousands) | | |
| Realized gains and losses on available-for-sale securities | $ 363 | Net securities gains |
| Tax effect | (76) | Income tax expense |
| | 287 | Net of tax |
| Amortization of defined benefit pension items | (189) ` | Other expense |
| Tax effect | 47 | Income tax expense |
| | (142) | Net of tax |
| Total reclassifications for the period | $ 145 | Net income |

**NOTE 10. LEASES**

The Company leases certain office facilities under long-term operating lease agreements. The leases expire at various dates through 2029 and some include renewal options. Many of these leases require the payment of property taxes, insurance premiums, maintenance, utilities and other costs. In many cases, rentals are subject to increase in relation to a cost-of-living index. The Company accounts for lease and non-lease components together as a single lease component. The Company determines if an arrangement is a lease at inception. Operating leases are recorded as a right-of-use ("ROU") lease assets and are included in other assets on the consolidated balance sheet. The Company's corresponding lease obligations are included in other liabilities on the consolidated balance sheet. ROU lease assets represent the Company's right to use an underlying asset for the lease term and lease obligations represent the Company's obligation to make lease payments arising from the lease. Operating ROU lease assets and obligations are recognized at the commencement date based on the present value of lease payments over the lease term. As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The ROU lease asset also includes any lease payments made and excludes lease incentives. The Company's lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option.

Lease expense for lease payments is recognized on a straight-line basis over the lease term. Short-term leases are leases having a term of twelve months or less. The Company recognizes short-term leases on a straight-line basis and does not record a related lease asset or liability for such leases, as allowed as practical expedient of the standard.

The following is a maturity analysis of the operating lease liabilities as of September 30, 2021:

| **Years ending December 31, (in thousands)** | **Operating lease Obligation** |
|---|---|
| 2021 | $ 147 |
| 2022 | 595 |
| 2023 | 606 |
| 2024 | 622 |
| 2025 | 640 |
| 2026 and thereafter | 2,233 |
| Total undiscounted lease payments | 4,843 |
| Less imputed interest | (508) |
| Lease liability | $ 4,335 |
| Right-of-use asset | $ 4,335 |

| | Three months ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2021** | 2020 | **2021** | 2020 |
| **Lease cost** | | | | |
| Operating lease cost | $ 133 | $ 141 | $ 403 | $ 402 |
| Short-term lease cost | 6 | 6 | 18 | 18 |
| Total lease cost | $ 139 | $ 147 | $ 421 | $ 420 |
| | | | | |
| **Other information** | | | | |
| Operating cash outflows from operating leases | | | $ 403 | $ 402 |
| Weighted-average remaining lease term - operating leases | 8.1 years | 9.1 years | 8.1 years | 9.1 years |
| Weighted average discount rate - operating leases | 2.8 % | 2.8 % | 2.8 % | 2.8 % |

**NOTE 11. CONTINGENCIES**

Lakeland Financial Corporation and its subsidiaries are defendants in various legal proceedings arising in the normal course of business. In the opinion of management, based on present information including advice of legal counsel, the ultimate resolution of these proceedings is not expected to have a material effect on the Company's consolidated financial position or results of operations.

## ITEM 2 - MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OVERVIEW

Net income in the first nine months of 2021 was $71.5 million, which increased $11.7 million, or 19.6%, from $59.7 million for the comparable period of 2020. Diluted income per common share was $2.79 in the first nine months of 2021, up 19.7% from $2.33 in the comparable period of 2020. The increase in net income for 2021 was primarily due to growth in net interest income of $14.8 million and a decrease in provision expense of $12.8 million, offset by an increase in noninterest expense of $13.1 million. The elevated provision in 2020 was driven primarily by the economic impact of COVID-19 on the Company's loan customers using the incurred loan loss methodology. Pretax pre-provision earnings in the first nine months of 2021 were $88.7 million, an increase of $1.7 million, or 1.9%, compared to $87.1 million for the comparable period. Pretax pre-provision earnings is a non-GAAP measure calculated by adding net interest income to noninterest income and subtracting noninterest expense.

Annualized return on average total equity was 14.29% in the first nine months of 2021 versus 12.96% in the comparable period of 2020. Annualized return on average total assets was 1.57% in the first nine months of 2021 versus 1.50% for the comparable period of 2020. The Company's average equity to average assets ratio was 11.01% in the first nine months of 2021 versus 11.59% in the comparable period of 2020.

Net income in the third quarter of 2021 was $24.1 million, up $1.3 million, or 5.9%, from $22.8 million for the comparable period of 2020. Diluted earnings per common share was $0.94 in the third quarter of 2021, up 5.6% from $0.89 in the comparable period of 2020. The increase was primarily due to a $5.8 million increase in net interest income for the quarter. Additionally, the Company recording a provision for credit losses of $1.3 million for the third quarter of 2021, a decrease of $450,000, compared to provision expense of $1.8 million for the third quarter of 2020. These increases were offset by a $2.0 million, or 15.3%, decrease in noninterest income and a $2.8 million, or 12.3%, increase in noninterest expense. Pretax pre-provision earnings in the third quarter of 2021 were $30.9 million, an increase of $985,000, or 3.3%, compared to $29.9 million for the comparable period of 2020.

Annualized return on average total equity was 13.90% in the third quarter of 2021 versus 14.36% in the comparable period of 2020. Annualized return on average total assets was 1.56% in the third quarter of 2021 versus 1.64% in the comparable period of 2020. The average equity to average assets ratio was 11.19% in the third quarter of 2021 versus 11.43% in the comparable period of 2020.

Total assets were $6.223 billion as of September 30, 2021 versus $5.830 billion as of December 31, 2020, an increase of $392.5 million, or 6.7%. This increase was primarily due to a $504.9 million increase in securities available-for-sale and a $307.3 million increase in cash and cash equivalents, offset by a decrease in net loans of $421.3 million. The outstanding balance of Paycheck Protection Program (PPP) loans at September 30, 2021, was $91.9 million versus $412.0 million at December 31, 2020. The Paycheck Protection Program has strengthened the Company’s borrowers’ balance sheets and improved their operating performance. It has further provided a valuable cash injection for all clients who participated in the program. Since the start of the pandemic, loan line utilization has declined from 48% as of March 31, 2020 to 41% as of September 30, 2021, thereby decreasing loans outstanding. Line utilization was 42% as of December 31, 2020.

Balance sheet growth was primarily funded through growth in deposits during 2021, which was driven by the deposit of PPP loan proceeds into borrower accounts and additional government stimulus payments into customer accounts, inclusive of stimulus payments received for municipal customers. Deposits increased $377.8 million while total borrowings decreased by $10.5 million since December 31, 2020. Total equity increased by $26.0 million due primarily to net income of $71.5 million, dividends declared and paid of $1.02 per share totaling $26.0 million, the day one CECL adjustment to retained earnings of $7.0 million net of tax, and a reduction to accumulated other comprehensive income of $16.8 million, driven primarily by a decrease in the fair value of available-for-sale securities.

***Impact of COVID-19***. The progression of the COVID-19 pandemic in the United States has had an impact on our financial condition and results of operations as of and for the three and nine months ended September 30, 2021 and 2020, and may have a complex and significant adverse impact on the economy, the banking industry and our Company in future fiscal periods, all subject to a high degree of uncertainty. As a result of the pandemic, our financial condition, capital levels and results of operations have been and could continue to be significantly affected, as described in further detail in this section.

*Active Management of Credit Risk*

The Company's Commercial Banking and Credit Administration leadership continues to review and refine the list of industries that the company believes are most likely to be materially impacted by the potential economic impact resulting from the COVID-19 pandemic. The current assessment of impacted industries has narrowed from year end 2020 and includes only one industry, hotel and accommodation, as compared to the initial list of ten potentially affected industries disclosed in the company's earnings release for the first quarter of 2020. The hotel and accommodation industry represents approximately 2.3%, or $94 million, of the company's total loan portfolio. The original ten industries represented a peak of $765 million, or 18.7%, as of March 31, 2020, excluding PPP loans.

The Company's commercial loan portfolio is highly diversified, and no industry sector represents more than 8% of the bank's loan portfolio, net of PPP, as of September 30, 2021. Agri-business and agricultural loans represented the highest specific industry concentrations, at 8% of total loans. The Company's Commercial Banking and Credit Administration teams continue to actively work with customers to understand their business challenges and credit needs during this time.

*COVID-19 Related Loan Deferrals*

Loan deferrals peaked on June 17, 2020, at $737 million, which represented 16% of the total loan portfolio. As of September 30, 2021, total deferrals attributable to COVID-19 were $22.3 million, representing three borrowers, or 0.5% of the total loan portfolio. Total deferrals as of September 30, 2021 represented a decline in deferral balances of 97.0% from peak levels in June 2020. Of the $22.3 million, two were commercial loan borrowers representing $22.3 million in loans, or 0.6% of total commercial loans, and there was one retail loan deferral with a balance less than $50,000. All COVID-19 related loan deferrals remain on accrual status, as each deferral is evaluated individually, and management has determined that all contractual cash flows are collectable at this time.

As of September 30, 2021, of the total commercial deferrals attributed to COVID-19, $8.0 million represented a second deferral action and $14.3 million represented a third deferral action. In accordance with Section 4013 of the CARES Act, these deferrals were not considered to be troubled debt restructurings. This provision was extended to January 1, 2022 under the Consolidated Appropriations Act, 2021. The third deferral action has been classified as a watch list credit and is adequately reserved for in the allowance for credit losses as of September 30, 2021. In addition, this credit was removed from COVID-19 deferral status in October 2021.

The Company's retail loan portfolio is comprised of 1-4 family mortgage loans, home equity lines of credit and other direct and indirect installment loans. A third-party vendor manages the Company's retail and commercial credit card program and the Company does not have any balance sheet exposure with respect to this program except for nominal recourse on limited commercial card accounts.

*The Paycheck Protection Program*

During the first half of 2021, the Company funded PPP loans totaling $165.1 million for its customers through the second round of the PPP program. In addition, the Bank has continued processing forgiveness applications for PPP loans made during the first and second rounds of the PPP program. As of September 30, 2021, the Bank had $91.9 million in PPP loans outstanding, net of deferred fees, consisting of $15.5 million from PPP round one and $76.4 million from PPP round two. Most of the PPP loans are for existing customers and 55% of the number of PPP loans originated are for amounts less than $50,000. As of September 30, 2021, the SBA has approved forgiveness for $538.9 million in PPP loans originated during round one and $86.0 million in PPP loans originated during round two. During 2021, the Bank has processed $320.1 million of PPP loan forgiveness. As of September 30, 2021, the Company has submitted forgiveness applications on behalf of customers in the amount of $14.6 million for PPP round one and $5.9 million for PPP round two that are awaiting SBA approval.

| | September 30, 2021 | | | | | |
|---|---|---|---|---|---|---|
| | Originated | | Forgiven | | Outstanding (1) | |
| | Number | Amount | Number | Amount | Number | Amount |
| **PPP Round 1** | 2,409 | $ 570,500 | 2,368 | $ 538,910 | 54 | $ 15,522 |
| **PPP Round 2** | 1,192 | 165,142 | 822 | 86,009 | 370 | 76,375 |
| **Total** | 3,601 | $ 735,642 | 3,190 | $ 624,919 | 424 | $ 91,897 |

(1) Outstanding balance includes deferred loan origination fees, net of costs, and any loans repaid by borrowers.

## CRITICAL ACCOUNTING POLICIES

The Company’s accounting policies are described in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2020.

Certain of the Company’s accounting policies are important to the portrayal of the Company’s financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Some of the facts and circumstances which could affect these judgments include changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for credit losses. See “Note 4 – Allowance for Credit Losses and Credit Quality” for more information on this critical accounting policy.

## RESULTS OF OPERATIONS

### Overview

Selected income statement information for the three and nine months ended September 30, 2021 and 2020 is presented in the following table:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | **2021** | 2020 |
| Income Statement Summary: | | | | |
| Net interest income | **$ 45,741** | $ 39,913 | **$ 133,081** | $ 118,295 |
| Provision for credit losses (1) | **1,300** | 1,750 | **1,077** | 13,850 |
| Noninterest income | **11,114** | 13,115 | **35,011** | 35,061 |
| Noninterest expense | **25,967** | 23,125 | **79,361** | 66,293 |
| Other Data: | | | | |
| Efficiency ratio (2) | **45.67 %** | 43.61 % | **47.21 %** | 43.23 % |
| Dilutive EPS | **$ 0.94** | $ 0.89 | **$ 2.79** | $ 2.33 |
| Tangible capital ratio (3) | **10.92 %** | 11.41 % | **10.92 %** | 11.41 % |
| Net charge offs (recoveries) to average loans | **0.00 %** | 0.00 % | **(0.05)%** | 0.12 % |
| Net interest margin | **3.13 %** | 3.05 % | **3.11 %** | 3.16 % |
| Net interest margin excluding PPP loans (4) | **2.95 %** | 3.17 % | **2.98 %** | 3.22 % |
| Noninterest income to total revenue | **19.55 %** | 24.73 % | **20.83 %** | 22.86 % |
| Pretax Pre-Provision Earnings (5) | **$ 30,888** | $ 29,903 | **$ 88,731** | $ 87,063 |

(1) Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

(2) Noninterest expense/net interest income plus noninterest income.

(3) Non-GAAP financial measure. The Company believes that disclosing non-GAAP financial measures provides investors with information useful to understanding the company’s financial performance. Additionally, these non-GAAP measures are used by management for planning and forecasting purposes, including measures based on “tangible common equity” which is “total equity” excluding intangible assets, net of deferred tax, and “tangible assets” which is “total assets” excluding intangible assets, net of deferred tax. See reconciliation on the next page.

(4) Non-GAAP financial measure. Calculated by subtracting the impact PPP loans had on average earnings assets, loan interest income, average interest bearing liabilities, and interest expense. Management believes this is an important measure because it provides for better comparability to prior periods, given the low fixed interest rate of 1.0% applicable to PPP loans, and because the accretion of net loan fee income can be accelerated upon borrower forgiveness and repayment by the SBA. Management is actively monitoring net interest margin on a fully tax equivalent basis with and without PPP loan impact for the duration of this program. See reconciliation on the next page.

(5) Non-GAAP financial measure. Pretax pre-provision earnings is calculated by adding net interest income to noninterest income and subtracting noninterest expense. Management believes this is an important measure because it may enable investors to identify the trends in the Company's earnings exclusive of the effects of tax and provision expense, which may vary significantly from period to period. See reconciliation on the next page.

Table of Contents

A reconciliation of non-GAAP measures is provided below (in thousands, except for per share data).

| (dollars in thousands) | Three Months Ended September 30, 2021 | Three Months Ended September 30, 2020 | Nine Months Ended September 30, 2021 | Nine Months Ended September 30, 2020 |
|---|---|---|---|---|
| Total Equity | **$ 683,202** | $ 636,839 | **$ 683,202** | $ 636,839 |
| Less: Goodwill | **(4,970)** | (4,970) | **(4,970)** | (4,970) |
| Plus: Deferred tax assets related to goodwill | **1,176** | 1,176 | **1,176** | 1,176 |
| Tangible Common Equity (A) | **679,408** | 633,045 | **679,408** | 633,045 |
| | | | | |
| Total Assets | **$ 6,222,916** | $ 5,551,108 | **$ 6,222,916** | $ 5,551,108 |
| Less: Goodwill | **(4,970)** | (4,970) | **(4,970)** | (4,970) |
| Plus: Deferred tax assets related to goodwill | **1,176** | 1,176 | **1,176** | 1,176 |
| Tangible Assets (B) | **6,219,122** | 5,547,314 | **6,219,122** | 5,547,314 |
| | | | | |
| Tangible Capital Ratio (A/B) | **10.92 %** | 11.41 % | **10.92 %** | 11.41 % |
| | | | | |
| Net Interest Income | **$ 45,741** | $ 39,913 | **$ 133,081** | $ 118,295 |
| Noninterest Income | **11,114** | 13,115 | **35,011** | 35,061 |
| Noninterest Expense | **(25,967)** | (23,125) | **(79,361)** | (66,293) |
| Pretax Pre-Provision Earnings | **$ 30,888** | $ 29,903 | **$ 88,731** | $ 87,063 |

Impact of Paycheck Protection Program on Net Interest Margin FTE

| | Three Months Ended September 30, 2021 | Three Months Ended September 30, 2020 | Nine Months Ended September 30, 2021 | Nine Months Ended September 30, 2020 |
|---|---|---|---|---|
| Total Average Earnings Assets | **$ 5,909,834** | $ 5,282,569 | **$ 5,825,275** | $ 5,078,509 |
| Less: Average Balance of PPP Loans | **(142,917)** | (557,290) | **(296,938)** | (339,149) |
| Total Adjusted Earning Assets | **5,766,917** | 4,725,279 | **5,528,337** | 4,739,360 |
| | | | | |
| Total Interest Income FTE | **$ 50,271** | $ 46,589 | **$ 147,351** | $ 145,045 |
| Less: PPP Loan Income | **(3,946)** | (3,294) | **(12,764)** | (6,323) |
| Total Adjusted Interest Income FTE | **46,325** | 43,295 | **134,587** | 138,722 |
| | | | | |
| Adjusted Earning Asset Yield, net of PPP Impact | **3.19 %** | 3.65 % | **3.25 %** | 3.91 % |
| | | | | |
| Total Average Interest Bearing Liabilities | **$ 3,737,707** | $ 3,433,326 | **$ 3,728,339** | $ 3,393,274 |
| Less: Average Balance of PPP Loans | **(142,917)** | (557,290) | **(296,938)** | (339,149) |
| Total Adjusted Interest Bearing Liabilities | **3,594,790** | 2,876,036 | **3,431,401** | 3,054,125 |
| | | | | |
| Total Interest Expense FTE | **$ 3,554** | $ 6,066 | **$ 11,816** | $ 24,954 |
| Less: PPP Cost of Funds | **(90)** | (350) | **(555)** | (630) |
| Total Adjusted Interest Expense FTE | **3,464** | 5,716 | **11,261** | 24,324 |
| | | | | |
| Adjusted Cost of Funds, net of PPP Impact | **0.24 %** | 0.48 % | **0.27 %** | 0.69 % |
| | | | | |
| Net Interest Margin FTE, net of PPP Impact | **2.95 %** | 3.17 % | **2.98 %** | 3.22 % |

**Net Income**

Net income was $71.5 million in the first nine months of 2021, an increase of $11.7 million, or 19.6%, versus net income of $59.7 million in the first nine months of 2020. The increase in net income for 2021 was primarily due to growth in net interest income of $14.8 million, or 12.5%, and a decrease in provision expense of $12.8 million, offset by an increase in noninterest expense of $13.1 million. The elevated provision in the first nine months of 2020 was driven by potential negative impacts on the Company's borrowers from the economic conditions resulting from the COVID-19 pandemic, which was calculated using the incurred loss model.

Net income was $24.1 million for the three months ended September 30, 2021, an increase of $1.3 million, or 5.9%, versus net income of $22.8 million for the three months ended September 30, 2020. The increase was primarily due to the Company recording a provision for credit losses of $1.3 million for the third quarter of 2021, a decrease of $450,000 compared to provision expense of $1.8 million for the third quarter of 2020. The higher provision in the third quarter of 2020 was driven by potential negative impacts on the Company’s borrowers from the economic conditions resulting from the COVID-19 pandemic, which was calculated using the incurred loss model. In addition, net income for the three months ended September 30, 2021 was positively impacted by a $5.8 million, or 14.6%, increase in net interest income. This increase was offset by a $2.0 million, or 15.3%, decrease in noninterest income and a $2.8 million, or 12.3%, increase in noninterest expense.

We anticipate that our net income for future fiscal periods will continue to be impacted as a result of the economic developments resulting from the COVID-19 pandemic. During the first nine months of 2021, provision expense declined relative to the first half provision expense of 2020. This decline was a result of improving economy, the declining balances of COVID-19 loan deferrals and a one-time recovery of $1.7 million in the second quarter of 2021. However, the economic impact of the pandemic continues to evolve and, as a result, we continue to monitor the impact to customers very closely. In particular, disruption to the labor market and supply chains have had, and may continue to have, a negative impact on our customers growth plans, with a corresponding effect on loan demand.

Net interest income, excluding the impacts of PPP loans, in 2021 has been negatively impacted by net interest margin compression that has resulted from excess liquidity and a shift in the mix of earning assets from loans to investment securities and short-term investments. During 2021, PPP loan forgiveness and continued deposit growth has contributed to the increased liquidity on the balance sheet. The combined impact of the low interest rate environment that resulted from the Federal Reserve Bank’s reductions to the target Federal Funds Rate in the first quarter of 2020, together with the Corporation’s asset sensitive balance sheet, has caused a reduction in net interest margin, excluding PPP loans, in the third quarter of 2021 when compared to the third quarter of 2020. Loan and investment security yields have been negatively impacted by the decline in interest rates. In addition, the increase in short-term investments and investment securities has contributed to the decline in earning asset yields in 2021. Correspondingly, deposit rates have also declined but have not fully offset the earning asset compression. Net interest margin will continue to be impacted from the PPP loan program and the low fixed rate of 1.0% on these loans. Borrowers that meet the loan forgiveness requirements outlined in the SBA program will result in loan balance paydowns for the Bank and an acceleration in unamortized PPP net loan fee income accretion through the income statement, as a component of loan yields. The timing and impact to net interest margin will be contingent on how quickly the PPP loans are submitted for forgiveness by borrowers and approved for forgiveness by the SBA. In addition, loans could be repaid by borrowers in lieu of forgiveness over the course of the next few years. PPP loan income, including both interest and fees, was $12.8 million and $3.9 million for the nine months and three months ended September 30, 2021, respectively. PPP loan income, including both interest and fees, was $6.3 million and $3.3 million for the nine months and three months ended September 30, 2020, respectively.

## Net Interest Income

The following table sets forth consolidated information regarding average balances and rates:

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2021 | | | 2020 | | |
| (fully tax equivalent basis, dollars in thousands) | **Average Balance** | **Interest** | **Yield (1)/ Rate** | Average Balance | Interest | Yield (1)/ Rate |
| Earning Assets | | | | | | |
| Loans: | | | | | | |
| Taxable (2)(3) | **$ 4,455,488** | **$ 128,828** | **3.87 %** | $ 4,339,274 | $ 130,759 | 4.03 % |
| Tax exempt (1) | **13,403** | **410** | **4.09** | 20,248 | 681 | 4.49 |
| Investments: | | | | | | |
| Available-for-sale (1) | **977,955** | **17,765** | **2.43** | 625,887 | 13,313 | 2.84 |
| Short-term investments | **2,273** | **2** | **0.12** | 32,671 | 67 | 0.27 |
| Interest bearing deposits | **376,156** | **346** | **0.12** | 60,429 | 225 | 0.50 |
| Total earning assets | **$ 5,825,275** | **$ 147,351** | **3.38 %** | $ 5,078,509 | $ 145,045 | 3.82 % |
| Less: Allowance for credit losses (4) | **(71,783)** | | | (57,111) | | |
| Nonearning Assets | | | | | | |
| Cash and due from banks | **69,066** | | | 60,695 | | |
| Premises and equipment | **59,652** | | | 60,676 | | |
| Other nonearning assets | **189,472** | | | 172,187 | | |
| Total assets | **$ 6,071,682** | | | $ 5,314,956 | | |
| Interest Bearing Liabilities | | | | | | |
| Savings deposits | **$ 353,058** | **$ 204** | **0.08 %** | $ 260,668 | $ 162 | 0.08 % |
| Interest bearing checking accounts | **2,334,480** | **4,905** | **0.28** | 1,796,270 | 7,683 | 0.57 |
| Time deposits: | | | | | | |
| In denominations under $100,000 | **223,486** | **1,650** | **0.99** | 268,485 | 3,569 | 1.78 |
| In denominations over $100,000 | **741,815** | **4,828** | **0.87** | 969,362 | 12,910 | 1.78 |
| Miscellaneous short-term borrowings | **500** | **7** | **1.87** | 40,460 | 458 | 1.51 |
| Long-term borrowings and subordinated debentures | **75,000** | **222** | **0.40 %** | 58,029 | 172 | 0.40 |
| Total interest bearing liabilities | **$ 3,728,339** | **$ 11,816** | **0.42 %** | $ 3,393,274 | $ 24,954 | 0.98 % |
| Noninterest Bearing Liabilities | | | | | | |
| Demand deposits | **1,627,522** | | | 1,252,112 | | |
| Other liabilities | **47,169** | | | 53,660 | | |
| Stockholders' Equity | **668,652** | | | 615,910 | | |
| Total liabilities and stockholders' equity | **$ 6,071,682** | | | $ 5,314,956 | | |
| Interest Margin Recap | | | | | | |
| Interest income/average earning assets | | **147,351** | **3.38 %** | | 145,045 | 3.82 % |
| Interest expense/average earning assets | | **11,816** | **0.27 %** | | 24,954 | 0.66 % |
| Net interest income and margin | | **$ 135,535** | **3.11 %** | | $ 120,091 | 3.16 % |

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 21 percent tax rate. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) adjustment applicable to nondeductible interest expenses. Taxable equivalent basis adjustments were $2.5 million and $1.8 million in the nine-month periods ended September 30, 2021 and 2020, respectively.

(2) Loan fees are included as taxable loan interest income. Net loan fees attributable to PPP loans were $10.5 million and $3.7 million for the nine months ended September 30, 2021 and 2020, respectively. All other loan fees were immaterial in relation to total taxable loan interest income for the periods presented.

(3) Nonaccrual loans are included in the average balance of taxable loans.

(4) Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

| (fully tax equivalent basis, dollars in thousands) | Three Months Ended September 30, 2021 Average Balance | Interest Income | Yield (1)/ Rate | Three Months Ended September 30, 2020 Average Balance | Interest Income | Yield (1)/ Rate |
|---|---|---|---|---|---|---|
| Earning Assets | | | | | | |
| Loans: | | | | | | |
| Taxable (2)(3) | $ 4,339,792 | $ 43,025 | 3.93 % | $ 4,541,608 | $ 42,056 | 3.68 % |
| Tax exempt (1) | 14,312 | 150 | 4.16 | 15,204 | 130 | 3.40 |
| Investments: | | | | | | |
| Available-for-sale (1) | 1,201,657 | 6,971 | 2.30 | 637,523 | 4,359 | 2.72 |
| Short-term investments | 2,304 | 0 | 0.00 | 8,865 | 3 | 0.13 |
| Interest bearing deposits | 351,769 | 125 | 0.14 | 79,369 | 41 | 0.21 |
| Total earning assets | $ 5,909,834 | $ 50,271 | 3.37 % | $ 5,282,569 | $ 46,589 | 3.51 % |
| Less: Allowance for credit losses (4) | (72,157) | | | (59,519) | | |
| Nonearning Assets | | | | | | |
| Cash and due from banks | 67,715 | | | 61,656 | | |
| Premises and equipment | 59,824 | | | 60,554 | | |
| Other nonearning assets | 188,118 | | | 175,601 | | |
| Total assets | $ 6,153,334 | | | $ 5,520,861 | | |
| Interest Bearing Liabilities | | | | | | |
| Savings deposits | $ 369,191 | $ 71 | 0.08 % | $ 282,456 | $ 53 | 0.07 % |
| Interest bearing checking accounts | 2,390,462 | 1,712 | 0.28 | 1,827,061 | 1,405 | 0.31 |
| Time deposits: | | | | | | |
| In denominations under $100,000 | 211,911 | 457 | 0.86 | 254,315 | 982 | 1.54 |
| In denominations over $100,000 | 691,143 | 1,239 | 0.71 | 972,436 | 3,501 | 1.43 |
| Miscellaneous short-term borrowings | 0 | 0 | 0.00 | 22,058 | 51 | 0.92 |
| Long-term borrowings and subordinated debentures | 75,000 | 75 | 0.40 | 75,000 | 74 | 0.39 |
| Total interest bearing liabilities | $ 3,737,707 | $ 3,554 | 0.38 % | $ 3,433,326 | $ 6,066 | 0.70 % |
| Noninterest Bearing Liabilities | | | | | | |
| Demand deposits | 1,681,565 | | | 1,401,403 | | |
| Other liabilities | 45,810 | | | 55,154 | | |
| Stockholders' Equity | 688,252 | | | 630,978 | | |
| Total liabilities and stockholders' equity | $ 6,153,334 | | | $ 5,520,861 | | |
| Interest Margin Recap | | | | | | |
| Interest income/average earning assets | | 50,271 | 3.37 | | 46,589 | 3.51 |
| Interest expense/average earning assets | | 3,554 | 0.24 | | 6,066 | 0.46 |
| Net interest income and margin | | $ 46,717 | 3.13 % | | $ 40,523 | 3.05 % |

(1) Tax exempt income was converted to a fully taxable equivalent basis at a 21 percent tax rate. The tax equivalent rate for tax exempt loans and tax exempt securities acquired after January 1, 1983 included the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) adjustment applicable to nondeductible interest expenses. Taxable equivalent basis adjustments were $976,000 and $610,000 in the three-month periods ended September 30, 2021 and September 30, 2020, respectively.

(2) Loan fees are included as taxable loan interest income. Net loan fees attributable to PPP loans were $3.6 million and $1.9 million for the three months ended September 30, 2021 and September 30, 2020, respectively. All other loan fees were immaterial in relation to total taxable loan interest income for the periods presented.

(3) Nonaccrual loans are included in the average balance of taxable loans.

(4) Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

Net interest income increased $14.8 million, or 12.5%, for the nine months ended September 30, 2021 to $133.1 million compared with $118.3 million for the first nine months of 2020. The increase in net interest income was largely driven by an increase in average earning assets of $746.8 million, due primarily to growth in investment securities of $352.1 million, growth in interest bearing deposits of $315.7 million and loan growth of $109.4 million. Average loans outstanding increased to $4.469 billion during the nine months ended September 30, 2021 compared to $4.360 billion during the the same period of 2020, with most of the growth being in fixed rate commercial loans. The average balance of PPP loans was $296.9 million for the first nine months of 2021 compared to $339.1 million for the first nine months of 2020. The earning asset growth was funded through an increase of deposits. Average deposits increased $733.5 million to $5.280 billion during the nine months ended September 30, 2021, compared to $4.547 billion for the same period of 2020. PPP loan proceeds to borrowers, additional economic impact payments to consumers, and stimulus payments to municipalities impacted the increase in deposits and core deposits during the first nine months of 2021, as these funds were deposited into customer checking and savings accounts at the Bank.

The tax equivalent net interest margin was 3.11% for the nine months ended September 30, 2021 compared to 3.16% during the first nine months of 2020. The yield on earning assets totaled 3.38% during the nine months ended September 30, 2021 compared to 3.82% in the same period of 2020. Cost of funds (expressed as a percentage of average earning assets) totaled 0.27% during the first nine months of 2021 compared to 0.66% in the same period of 2020. The lower margin was due to lower yields on loans and securities, partially offset by a lower cost of funds. The decline in net interest margin resulted from the Federal Reserve Bank decreases in the target Federal Funds Rate by 150 basis points during the first quarter of 2020, which brought the Federal Funds Rate back to the zero-bound range of 0.00% to 0.25% and excess liquidity on the Company's balance sheet. The earning asset mix has changed during 2021 to reflect increased investment securities and interest bearing deposits, which are lower yielding assets. The Bank deployed excess liquidity of $600 million to the investment security portfolio and to interest bearing deposits as a result of lower loan growth. Additionally, the Company's net interest margin was positively impacted by 13 basis points during the first nine months of 2021 due to interest income and fees earned on PPP loans. Net interest margin excluding PPP loans was 2.98% for the nine months ended September 30, 2021.

Net interest income increased by $5.8 million, or 14.6%, for the three months ended September 30, 2021 as compared to the three months ended September 30, 2020. The increased level of net interest income during the third quarter of 2021 was largely driven by an increase in average earning assets of $627.3 million, due primarily to growth in available-for-sale securities of $564.1 million and increases in interest bearing deposits of $272.4 million. The Company deployed $600 million in excess liquidity to its investment security portfolio since late 2020 in response to the surge in deposits that begin in 2020 and has continued into 2021. This earning asset growth was funded through an increase in deposits. Average deposits increased $606.6 million to $5.344 billion for the third quarter of 2021, compared to $4.738 billion for the comparable period of 2020. During this same period, average core deposits increased $803.4 million. The Company defines "core deposits" as total deposits (including all deposits by municipalities and other government agencies), excluding brokered deposits. Short-term borrowings have decreased by $22.1 million during these comparable periods.

The Company’s net interest margin increased 8 basis points to 3.13% for the third quarter of 2021 compared to 3.05% for the third quarter of 2020. The higher margin in the third quarter of 2021 as compared to the prior year period was due to higher yields on loans due to PPP interest income and fee accretion as well as lower costs of funds. As a result of the excess liquidity on the company's balance sheet, the mix of earning assets included lower earning assets consisting of balances at the Federal Reserve Bank and the investment securities portfolio. In addition, third quarter loan yields were impacted by the lower yield on the PPP loan portfolio, offset by fees earned as a result of PPP loan forgiveness.

The Company’s net interest margin excluding PPP related net interest income was 18 basis points lower at 2.95% for the third quarter of 2021 compared to actual net interest margin of 3.13%, and reflects a 22 basis point decline from net interest margin excluding PPP loans of 3.17% in the third quarter of 2020. Cost of funds decreased to a historical low of 0.24% for the three-month period ended September 30, 2021.

**Provision for Credit Losses**

The Company recorded a provision for credit losses expense of $1.3 million for the three months ended September 30, 2021 compared to a provision expense of $1.8 million during the comparable period of 2020, a decrease of $450,000. Net recoveries were $35,000 during the three month period ended September 30, 2021 compared to net charge offs of $22,000 during the comparable period of 2020. The Company recorded a provision for credit losses expense of $1.1 million for the nine months ended September 30, 2021 compared to a provision expense of $13.9 million during the comparable period of 2020. The primary factor impacting the provision expense in 2020 was the potential negative impact to the Company's borrowers as a result of the economic conditions resulting from the COVID-19 pandemic. Net recoveries were $1.5 million during the nine month period ended September 30, 2021 compared to net charge offs of $3.8 million during the comparable period of 2020. The Company adopted the CECL standard (ASU 2016-13) during the first quarter of 2021, effective January 1, 2021. Prior to this, provision expense was recorded under the incurred loss methodology. The day one impact of the adoption was an increase in the allowance for credit losses of $9.1 million, with an offset, net of taxes, to beginning stockholders' equity.

The Company has granted COVID-19 loan deferrals to customers, which peaked on June 17, 2020 at $737 million, or 16%, of the total loan portfolio. As of September 30, 2021, COVID-19 loan deferrals have declined to $22.3 million, representing three borrowers, or 0.5% of the total loan portfolio. Two were commercial loan borrowers and there was one retail borrower with COVID-19 deferrals. In accordance with Section 4013 of the CARES Act, loan deferrals granted to customers that resulted from the impact of COVID-19 and who were not past due at December 31, 2019 were not considered troubled debt restructurings as of September 30, 2021 and December 31, 2020. This provision was extended to January 1, 2022 under the Consolidated Appropriations Act, 2021. Management continues to monitor these deferrals and has considered these credits in the September 30, 2021 and December 31, 2020 allowance for credit losses balance. The recent credit cycle has not been as negative as originally expected in the prior year, and management is comfortable with the current levels of the Company's reserve.

The provision expense in the third quarter of 2021 was driven primarily by the downgrading of two commercial loan borrowers to nonaccrual status. The balance of these loans totaled $21.2 million as of September 30, 2021. The first credit relationship of $12.0 million was downgraded due to the severe impact on the business caused by the economic conditions resulting from the COVID-19 pandemic. The borrower is a retailer of party and special event supplies. During the third quarter of 2021, the borrower's challenges significantly worsened. As a result, loans to the borrower were downgraded and placed on nonaccrual status. Loans to this borrower are secured by a blanket lien on all assets, including buildings, inventory, accounts receivable and equipment. In addition, the exposure is supported by a partial personal guarantee. The second downgrade relates to a shared national credit participation of $9.2 million to a commercial borrower that operates grain elevators and handles feed processing and merchandising of agriculture products. Loans to this borrower are secured by a blanket lien on all assets, including buildings, inventory, accounts receivable and equipment. These downgrades resulted in an increase to the specific credit loss allocations for each credit as they are now individually analyzed credits. The loans to both borrowers are current on interest and principal payments through September 2021. The Bank believes that the allocations are adequate to cover any potential losses. Each of these downgrades resulted from a unique business challenge and management does not believe these downgrades are systemic as it relates to the Bank's broader loan portfolio.

Additional factors considered by management included key loan quality metrics, including reserve coverage of nonperforming loans and economic conditions in the Company's markets, and changes in the facts and circumstances of watch list credits, which includes the security position of the borrower. Management's overall view on current credit quality was also a factor in the determination of the provision for credit losses. The Company's management continues to monitor the adequacy of the provision based on loan levels, asset quality, economic conditions and other factors that may influence the assessment of the collectability of loans.

### Noninterest Income

Noninterest income categories for the nine-month and three-month periods ended September 30, 2021 and 2020 are shown in the following table:

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | Dollar Change | Percent Change |
| Wealth advisory fees | **$ 6,433** | $ 5,594 | $ 839 | 15.0 % |
| Investment brokerage fees | **1,560** | 1,148 | 412 | 35.9 % |
| Service charges on deposit accounts | **7,768** | 7,452 | 316 | 4.2 % |
| Loan and service fees | **8,823** | 7,470 | 1,353 | 18.1 % |
| Merchant card fee income | **2,226** | 1,933 | 293 | 15.2 % |
| Bank owned life insurance income | **2,101** | 1,476 | 625 | 42.3 % |
| Interest rate swap fee income | **934** | 4,105 | (3,171) | (77.2)% |
| Mortgage banking income | **1,756** | 2,945 | (1,189) | (40.4)% |
| Net securities gains | **797** | 363 | 434 | 119.6 % |
| Other income | **2,613** | 2,575 | 38 | 1.5 % |
| Total noninterest income | **$ 35,011** | $ 35,061 | $ (50) | (0.1)% |
| Noninterest income to total revenue | **20.83 %** | 22.86 % | | |

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | Dollar Change | Percent Change |
| Wealth advisory fees | **$ 2,177** | $ 1,930 | $ 247 | 12.8 % |
| Investment brokerage fees | **521** | 421 | 100 | 23.8 % |
| Service charges on deposit accounts | **2,756** | 2,491 | 265 | 10.6 % |
| Loan and service fees | **3,005** | 2,637 | 368 | 14.0 % |
| Merchant card fee income | **838** | 670 | 168 | 25.1 % |
| Bank owned life insurance income | **640** | 932 | (292) | (31.3)% |
| Interest rate swap fee income | **180** | 2,143 | (1,963) | (91.6)% |
| Mortgage banking income (loss) | **(32)** | 1,005 | (1,037) | (103.2)% |
| Net securities gains | **0** | 314 | (314) | (100.0)% |
| Other income | **1,029** | 572 | 457 | 79.9 % |
| Total noninterest income | **$ 11,114** | $ 13,115 | $ (2,001) | (15.3)% |
| Noninterest income to total revenue | **19.55 %** | 24.73 % | | |

The Company's noninterest income decreased $50,000, or 0.1%, to $35.0 million for the nine months ended September 30, 2021 compared to $35.1 million in the prior year period. Noninterest income was positively impacted by a $1.4 million increase, or 18.1%, in loan and service fees, a $1.3 million increase, or 18.6%, in wealth management and investment brokerage fees over the corresponding prior period. Noninterest income was also positively impacted by a $625,000 increase in bank owned life insurance income and an increase in net securities gains of $434,000 due to repositioning of the available-for-sale securities portfolio in response to the steepening yield curve during the first quarter of 2021. Noninterest income was negatively impacted by a $3.2 million decrease, or 77.2%, in interest rate swap fee income, and a $1.2 million decrease, or 40.4%, in mortgage banking income. Interest rate swaps have seen a decrease in customer demand during the first three quarters of 2021 compared to the record year in 2020. Additionally, mortgage banking income has been negatively impacted by the valuation of mortgage servicing rights due to increased amortization expense in the current rate environment. The increased prepayment speeds have resulted in increased mortgage servicing asset amortization expense of $900,000 for the nine months ended September 30, 2021.

The Company’s noninterest income decreased $2.0 million, or 15.3%, to $11.1 million for the third quarter of 2021, compared to $13.1 million for the third quarter of 2020. Noninterest income was positively impacted by elevated loan and service fees which increased by $368,000, or 14.0%, for these comparable periods due to increased debit card interchange fees. In addition, wealth and investment brokerage fees which increased by $347,000, or 14.8%, and service charges on deposit accounts were up $265,000, or 10.6%. Offsetting these increases were decreases of $2.0 million, or 91.6%, in interest rate swap fee income and $1.0 million, or 103.2%, in mortgage banking income. Both interest rate swap arrangements and mortgage banking have seen a decrease in demand during the third quarter of 2021 compared to the third quarter of 2020, and the carrying value of mortgage service rights has been impacted by increased prepayment speeds due to the current rate environment and appreciating single-home values. The increased prepayment speeds have resulted in increased mortgage servicing asset amortization expense of $650,000 during the third quarter of 2021 which offset mortgage banking income earned during the period.

Future noninterest income may continue to be impacted due to the effects of the COVID-19 pandemic, and the scope of any future governmental policy responses. For example, increased economic activity may result in higher merchant card fee income and higher interchange revenue that is reported in services charges on deposits accounts and loan and service fees. Conversely, increased infection rates due to COVID-19, and any governmental responses thereto, could reduce economic activity and thereby reduce these activity-driven fees.

**Noninterest Expense**

Noninterest expense categories for the nine-month and three-month periods ended September 30, 2021 and 2020 are shown in the following tables:

| | **Nine Months Ended September 30,** | | | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | Dollar Change | Percent Change |
| Salaries and employee benefits | **$ 44,377** | $ 35,696 | $ 8,681 | 24.3 % |
| Net occupancy expense | **4,343** | 4,336 | 7 | 0.2 % |
| Equipment costs | **4,134** | 4,216 | (82) | (1.9)% |
| Data processing fees and supplies | **9,692** | 8,736 | 956 | 10.9 % |
| Corporate and business development | **3,208** | 2,324 | 884 | 38.0 % |
| FDIC insurance and other regulatory fees | **1,707** | 1,224 | 483 | 39.5 % |
| Professional fees | **5,058** | 3,506 | 1,552 | 44.3 % |
| Other expense | **6,842** | 6,255 | 587 | 9.4 % |
| Total noninterest expense | **$ 79,361** | $ 66,293 | $ 13,068 | 19.7 % |
| Efficiency ratio | **47.21 %** | 43.23 % | | |

| | **Three Months Ended September 30,** | | | |
|---|---|---|---|---|
| (dollars in thousands) | **2021** | 2020 | Dollar Change | Percent Change |
| Salaries and employee benefits | **$ 14,230** | $ 12,706 | $ 1,524 | 12.0 % |
| Net occupancy expense | **1,413** | 1,404 | 9 | 0.6 % |
| Equipment costs | **1,371** | 1,369 | 2 | 0.1 % |
| Data processing fees and supplies | **3,169** | 3,025 | 144 | 4.8 % |
| Corporate and business development | **1,000** | 586 | 414 | 70.6 % |
| FDIC insurance and other regulatory fees | **748** | 554 | 194 | 35.0 % |
| Professional fees | **1,342** | 1,306 | 36 | 2.8 % |
| Other expense | **2,694** | 2,175 | 519 | 23.9 % |
| Total noninterest expense | **$ 25,967** | $ 23,125 | $ 2,842 | 12.3 % |
| Efficiency ratio | **45.67 %** | 43.61 % | | |

The Company’s noninterest expense increased by $13.1 million, or 19.7%, to $79.4 million in the first nine months of 2021 compared to $66.3 million in the corresponding prior year period. The increase was driven by salaries and employee benefits which increased $8.7 million, or 24.3%, primarily due to higher performance-based incentive compensation expense and health insurance costs. Professional fees increased $1.6 million, or 44.3%, driven by expenses related to the Company's implementation of Lake City Bank Digital, an innovative digital banking platform, in the first quarter of 2021, as well as an increase in legal and regulatory expense. Data processing expenses associated with the PPP digital solution totaled $578,000 during the first nine months of 2021. In addition, the Company made a $500,000 contribution to its foundation in the first quarter of 2021 which is included in corporate and business development expense.

The Company’s noninterest expense increased $2.8 million, or 12.3%, to $26.0 million in the third quarter of 2021, compared to $23.1 million in the third quarter of 2020. Salaries and employee benefits increased $1.5 million, or 12.0%, driven by higher performance-based incentive compensation expense and higher employee health insurance expense. Corporate and business development expenses increased $414,000, or 70.6%, due to the timing of planned advertising campaigns and increased business development costs, as in-person meetings with clients and prospects have resumed. FDIC insurance and other regulatory fees increased $194,000, or 35.0%, driven by the company's rapid balance sheet growth year-over-year.

The Company's efficiency ratio was 47.21% for the nine months ended September 30, 2021 compared to 43.23% in the prior period. The Company’s efficiency ratio was 45.67% for the third quarter of 2021, compared to 43.61% for the third quarter of 2020.

As previously disclosed, in the third quarter of 2019, the Bank discovered potentially fraudulent activity by a former treasury management client involving multiple banks. The former client subsequently filed several related bankruptcy cases, captioned *In re Interlogic Outsourcing, Inc., et al*., which are pending in the United States Bankruptcy Court for the Western District of Michigan. On April 27, 2021, the bankruptcy court entered an order approving an amended plan of liquidation, which was filed by the former client, other debtors and bankruptcy plan proponents, and approving the consolidation of the assets in the aforementioned cases under the Khan IOI Consolidated Estate Trust. On August 9, 2021, the liquidating trustee for the bankruptcy estates filed a complaint against the Bank, and has agreed to stay prosecution of the action through December 31, 2021. The action is focused on a series of business transactions among the client, related entities, and the Bank, which the liquidating trustee alleges are voidable under applicable federal bankruptcy and state law. The complaint also addresses treatment of the Bank’s claims filed in the bankruptcy cases. Based on current information, we have determined that a loss is neither probable nor estimable at this time, and the Bank intends to vigorously defend itself against all allegations asserted in the compliant.

Future noninterest expense may continue to be impacted due to the COVID-19 pandemic. For example, continued economic reopening and growth may impact balance sheet growth and resulting revenue growth which could increase the amount the Company pays in incentive-based compensation. In addition, prolonged supply chain disruptions and increased infection rates due to COVID-19 could halt the economic recovery and result in elevated provision expense which may reduce net income and diluted earnings per share, another key performance metric that impacts the incentive-based compensation targets.

The Company’s income tax expense increased $2.7 million and $92,000, respectively, in the nine-month and three-month periods ended September 30, 2021 compared to the same periods in 2020. The effective tax rate was 18.5% in the nine-month and three-month periods ended September 30, 2021, compared to 18.4% and 19.1%, respectively, for the comparable periods of 2020. The quarter-to-date effective tax rate for 2021 decreased as compared to the prior year period primarily due a higher percentage of income being derived from tax-advantaged sources.

**FINANCIAL CONDITION**

**Overview**

Total assets of the Company were $6.223 billion as of September 30, 2021, an increase of $392.5 million, or 6.7%, when compared to $5.830 billion as of December 31, 2020. This increase was primarily due to a $307.3 million increase in cash and cash equivalents and a $504.9 million increase in securities available-for-sale, offset by a decrease in gross loans of $409.7 million, or 8.8%. The outstanding balance of Paycheck Protection Program (PPP) loans at September 30, 2021, was $91.9 million versus $412.0 million at December 31, 2020. Loans excluding PPP loans decreased by $89.6 million, or 2.1%, from $4.237 billion at December 31, 2020 to $4.148 billion at September 30, 2021. Total deposits increased $377.8 million, or 7.5%, while total borrowings decreased by $10.5 million, or 12.3%. The increase in deposits was primarily driven by growth in core deposits of $381.8 million, or 7.6%, offset by a decrease in wholesale funding of $4.0 million. Core deposits were $5.404 billion as of September 30, 2021 compared to $5.022 billion as of December 31, 2020. Additionally, commercial deposits increased by $203.3 million, or 10.5%, to $2.144 billion at September 30, 2021 compared to $1.940 billion at December 31, 2020. The increase in commercial and retail core deposits has resulted from proceeds from the PPP loan program, federal stimulus payments made to individuals, customer liquidity events and an increase in the savings rate during the pandemic.

**Uses of Funds**

**Total Cash and Cash Equivalents**

Total cash and cash equivalents increased by $307.3 million, or 123.0% to $557.2 million at September 30, 2021, from $249.9 million at December 31, 2020. Cash and cash equivalents at September 30, 2021 reflect repayments on loans as well as cash inflows from federal stimulus programs and an overall increase in the savings rate during the pandemic and include short-term investments. Short-term investments include cash on deposit that earns interest such as excess liquidity maintained at the Federal Reserve Bank. Cash and cash equivalents balances will vary depending on the cyclical nature of the bank's liquidity position.

**Investment Portfolio**

The amortized cost and the fair value of securities as of September 30, 2021 and December 31, 2020 were as follows:

| | **September 30, 2021** | | December 31, 2020 | |
|---|---|---|---|---|
| (dollars in thousands) | **Amortized Cost** | **Fair Value** | Amortized Cost | Fair Value |
| U.S Treasury securities | **$ 900** | **$ 900** | $ 0 | $ 0 |
| U.S government sponsored agencies | **118,681** | **116,461** | 36,492 | 36,487 |
| Mortgage-backed securities: residential | **430,388** | **431,833** | 270,231 | 279,503 |
| Mortgage-backed securities: commercial | **23,699** | **24,182** | 35,877 | 36,881 |
| State and municipal securities | **650,561** | **666,339** | 355,306 | 381,974 |
| Total | **$ 1,224,229** | **$ 1,239,715** | $ 697,906 | $ 734,845 |

At September 30, 2021 and December 31, 2020, there were no holdings of securities of any one issuer, other than the U.S. government agencies and government sponsored entities, in an amount greater than 10% of stockholders' equity. Management is aware that, as interest rates rise, any unrealized loss in the investment portfolio will increase, and as interest rates fall the unrealized gain in the investment portfolio will rise. Since the majority of the bonds in the investment portfolio are fixed-rate, with only a few adjustable-rate bonds, we would expect our investment portfolio to follow this market value pattern. This is taken into consideration when evaluating the gain or loss of investment securities in the portfolio and the potential for an allowance for credit losses.

Purchases of securities available-for-sale totaled $640.4 million in the first nine months of 2021. The purchases consisted of mortgage-backed securities issued by government sponsored entities and state and municipal securities. The investment security purchases reflect the deployment of excess liquidity to the investment portfolio. The Company deployed $100 million in December 2020, $100 million during the first quarter of 2021 and an additional $400 million during the second quarter of 2021. The deployment was due to the surge in deposits balances that began in 2020 and has continued into 2021. Paydowns from prepayments and scheduled payments of $97.5 million were received in the first nine months of 2021, and the amortization of premiums, net of the accretion of discounts, was $3.5 million. Maturities and calls of securities totaled $4.9 million in the first nine months of 2021. Proceeds from sales of securities totaled $14.0 million in the first nine months of 2021. No allowance for credit losses was recognized in the first nine months of 2021.

Purchases of securities available-for-sale totaled $89.9 million in the first nine months of 2020. The purchases consisted primarily of state and municipal securities and purchases of mortgage-backed securities issued by government sponsored entities. Paydowns from prepayments and scheduled payments of $63.0 million were received in the first nine months of 2020, and the amortization of premiums, net of the accretion of discounts, was $3.0 million. Maturities and calls of securities totaled $6.3 million in the first nine months of 2020. Proceeds from sales of securities totaled $6.4 million in the first nine months of 2020. No other-than-temporary impairment was recognized in the first nine months of 2020.

The investment portfolio is managed by a third-party firm to provide for an appropriate balance between liquidity, credit risk, interest rate risk management and investment return and to limit the Company's exposure to credit risk in the investment securities portfolio to an acceptable level. The Company does not trade or invest in or sponsor certain unregistered investment companies defined as hedge funds and private equity funds under what is commonly referred to as the "Volcker Rule" of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

**Real Estate Mortgage Loans Held-for-Sale**

Real estate mortgage loans held-for-sale decreased by $3.2 million, or 29.0%, to $8.0 million at September 30, 2021, from $11.2 million at December 31, 2020. The balance of this asset category is subject to a high degree of variability depending on, among other things, recent mortgage loan rates and the timing of loan sales into the secondary market. The Company generally sells conforming qualifying mortgage loans it originates on the secondary market. Proceeds from sales of residential mortgages totaled $98.7 million in the first nine months of 2021 compared to $90.6 million in the first nine months of 2020. Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans were $374.0 million and $351.0 million as of September 30, 2021 and December 31, 2020, respectively.

**Loan Portfolio**

The loan portfolio by portfolio segment as of September 30, 2021 and December 31, 2020 is summarized as follows:

| (dollars in thousands) | **September 30, 2021** | | December 31, 2020 | | Current Period Change |
|---|---|---|---|---|---|
| Commercial and industrial loans | **$ 1,441,784** | **34.0 %** | $ 1,791,378 | 38.5 % | $ (349,594) |
| Commercial real estate and multi-family residential loans | **1,954,554** | **46.0** | 1,895,014 | 40.7 | 59,540 |
| Agri-business and agricultural loans | **324,080** | **7.6** | 429,644 | 9.2 | (105,564) |
| Other commercial loans | **83,595** | **2.0** | 94,013 | 2.0 | (10,418) |
| Consumer 1-4 family mortgage loans | **348,172** | **8.2** | 343,518 | 7.4 | 4,654 |
| Other consumer loans | **92,169** | **2.2** | 103,616 | 2.2 | (11,447) |
| Subtotal, gross loans | **4,244,354** | **100.0 %** | 4,657,183 | 100.0 % | (412,829) |
| Less: Allowance for credit losses (1) | **(73,048)** | | (61,408) | | (11,640) |
| Net deferred loan fees | **(4,901)** | | (8,027) | | 3,126 |
| Loans, net | **$ 4,166,405** | | $ 4,587,748 | | $ (421,343) |

(1) Beginning January 1, 2021 calculation is based on the current expected credit loss methodology. Prior to January 1, 2021 calculation was based on the incurred loss methodology.

Total loans, excluding real estate mortgage loans held-for-sale and deferred fees, decreased by $412.8 million to $4.244 billion at September 30, 2021 from $4.657 billion at December 31, 2020. The decrease was primarily driven by the forgiveness of PPP loans and was also concentrated in the commercial and industrial and agribusiness categories and was driven by seasonal paydowns in these loan segments. We anticipate that the portion of our loan portfolio attributable to PPP loans will continue to decline in future quarters, as borrowers avail themselves of loan forgiveness opportunities under the PPP. Total loans excluding PPP loans decreased by $89.6 million, as of September 30, 2021 as compared to December 31, 2020. The balance of net deferred loans fees attributable to PPP loans was $2.7 million as of September 30, 2021. PPP round one and round two unamortized loan fees, net of deferred costs, were $0.1 and $2.6 million, respectively, as of September 30, 2021. Since the start of the pandemic, loan line utilization declined from 48% as of March 31, 2020 to 41% as of September 30, 2021, thereby decreasing loans outsanding.

The following table summarizes the Company's non-performing assets as of September 30, 2021 and December 31, 2020:

| (dollars in thousands) | September 30, 2021 | December 31, 2020 |
|---|---|---|
| Nonaccrual loans including nonaccrual troubled debt restructured loans | $ 30,978 | $ 11,986 |
| Loans past due over 90 days and still accruing | 18 | 116 |
| Total nonperforming loans | 30,996 | 12,102 |
| Other real estate owned | 316 | 316 |
| Repossessions | 20 | 6 |
| Total nonperforming assets | $ 31,332 | $ 12,424 |
| | | |
| Individually analyzed loans including troubled debt restructurings | $ 41,148 | $ 20,177 |
| | | |
| Nonperforming loans to total loans | 0.73 % | 0.26 % |
| Nonperforming assets to total assets | 0.50 % | 0.21 % |
| | | |
| Performing troubled debt restructured loans | $ 4,973 | $ 5,237 |
| Nonperforming troubled debt restructured loans (included in nonaccrual loans) | 6,093 | 6,476 |
| Total troubled debt restructured loans | $ 11,066 | $ 11,713 |

Total nonperforming assets increased by $18.9 million, or 152.2%, to $31.3 million during the nine month period ended September 30, 2021. The ratio of nonperforming assets to total assets at September 30, 2021 increased from 0.21% at December 31, 2020 to 0.50% at September 30, 2021.

The increase in nonperforming assets was driven primarily by the downgrading of two commercial loan relationships to nonaccrual status during the third quarter of 2021, which totaled $21.2 million. The first credit relationship of $12.0 million was downgraded due to the severe impact on the business caused by the economic conditions resulting from the COVID-19 pandemic. The borrower is a retailer of party and special event supplies. During the third quarter of 2021, the borrower's challenges significantly worsened. As a result, loans to the borrower were downgraded and placed on nonaccrual status. Loans to this borrower are secured by a blanket lien on all assets, including buildings, inventory, accounts receivable and equipment. In addition, the exposure is supported by a partial personal guarantee. The second downgrade relates to a shared national credit participation of $9.2 million to a commercial borrower that operates grain elevators and handles feed processing and merchandising of agriculture products. Loans to this borrower are secured by a blanket lien on all assets, including buildings, inventory, accounts receivable and equipment. These downgrades resulted in an increase to the specific credit loss allocations for each credit as they are now individually analyzed credits. The loans to both borrowers are current on interest and principal payments through September 2021. The Bank believes that the allocations are adequate to cover any potential losses. Each of these downgrades resulted from a unique business challenge and management does not believe these downgrades are systemic as it relates to the Bank's broader loan portfolio.

A loan is individually analyzed when full payment under the original loan terms is not expected. The analysis for smaller loans that are similar in nature and which are not in nonaccrual or troubled debt restructured status, such as residential mortgage, consumer, and credit card loans, is determined based on the class of loans. If a loan is individually analyzed, a portion of the allowance may be allocated so that the loan is reported, net, at the present value of estimated future cash flows or at the fair value of collateral if repayment is expected solely from the collateral. Total individually analyzed loans increased by $21.0 million to $41.1 million at September 30, 2021 from $20.2 million at December 31, 2020. The increase was primarily driven by the downgrading of two commercial loan relationships, discussed above.

As a result of the COVID-19 pandemic impact on the economy, we anticipate that our commercial, commercial real estate, residential and consumer borrowers may continue to encounter economic difficulties, which could lead to increases in our levels of nonperforming assets and troubled debt restructurings in future periods. Additionally, the balances of troubled debt restructurings could increase due to the expiration of relief for temporary COVID-19 related accommodations.

Loans are charged against the allowance for credit losses when management believes that the principal is uncollectible. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb current expected credit losses relating to specifically identified loans based on an evaluation of the loans by management, as well as other current expected losses in the loan portfolio. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to repay. Management also considers trends in adversely classified loans based upon a monthly review of those credits. An appropriate level of general allowance is determined after considering the following factors: application of loss percentages using a PD/LGD approach subject to a floor, emerging market risk, commercial loan focus and large credit concentrations, new industry lending activity and current economic conditions. Federal regulations require insured institutions to classify their own assets on a regular basis. The regulations provide for three categories of classified loans: Substandard, Doubtful and Loss. The regulations also contain a Special Mention category. Special Mention applies to loans that do not currently expose an insured institution to a sufficient degree of risk to warrant classification as Substandard, Doubtful or Loss but do possess credit deficiencies or potential weaknesses deserving management's close attention. The Company's policy is to establish a specific allowance for credit losses for any assets where management has identified conditions or circumstances that indicate an asset is nonperforming. If an asset or portion thereof is classified as a loss, the Company's policy is to either establish specified allowances for credit losses in the amount of 100% of the portion of the asset classified loss or charge-off such amount.

At September 30, 2021, the allowance for credit losses was 1.72% of total loans outstanding, versus 1.32% of total loans outstanding at December 31, 2020, which was calculated under the incurred loss methodology prior to January 1, 2021. The allowance for credit losses as a percentage of total loans outstanding, excluding PPP loans of $91.9 million, as of September 30, 2021, was 1.76%. This reflects a more comparable ratio to prior periods, as PPP loans are fully guaranteed by the SBA and have not been allocated for within the allowance for credit losses calculation. The allowance for credit losses at September 30, 2021 included a $9.1 million, day one impact from the adoption of CECL at January 1, 2021. At September 30, 2021, management believed the allowance for credit losses was at a level commensurate with the overall risk exposure of the loan portfolio. However, if economic conditions fail to recover or deteriorate due to the COVID-19 pandemic, certain borrowers may experience difficulty and the level of nonperforming loans, charge-offs and delinquencies could rise and require increases in the allowance for credit losses. The process of identifying credit losses is a subjective process.

The Company has a relatively high percentage of commercial and commercial real estate loans, which are extended to businesses with a broad range of revenue and within a wide variety of industries. Traditionally, this type of lending may have more credit risk than other types of lending because of the size and diversity of the credits. The Company manages this risk by utilizing conservative credit structures, by adjusting its pricing to the perceived risk of each individual credit and by diversifying the portfolio by customer, product, industry and market area.

As of September 30, 2021, based on management's review of the loan portfolio, the Company had 88 credit relationships totaling $257.8 million on the classified loan list versus 96 credit relationships totaling $286.1 million on December 31, 2020. The decrease in classified loans for the first nine months of 2021 resulted primarily from paydowns as well as upgrades to previously classified loans on the non-individually analyzed portion of the watchlist. As of September 30, 2021, the Company had $185.6 million of assets classified as Special Mention, $72.2 million classified as Substandard, $0 classified as Doubtful and $0 classified as Loss as compared to $251.9 million, $34.2 million, $0 and $0, respectively, at December 31, 2020.

Allowance estimates are developed by management after taking into account actual loss experience adjusted for current economic conditions and a reasonably supportable forecast period. The Company has regular discussions regarding this methodology with regulatory authorities. Allowance estimates are considered a prudent measurement of the risk in the Company's loan portfolio based upon loan segment. In accordance with CECL accounting guidance, the allowance is based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts. For a more thorough discussion of the allowance for credit losses methodology see the Critical Accounting Policies section of this Item 2.

The allowance for credit losses increased 19.0%, or $11.6 million, from $61.4 million at December 31, 2020 to $73.0 million at September 30, 2021. The increase included a $9.1 million adjustment on January 1, 2021 related to the day one CECL adoption. Most of the Company's recent loan growth has been concentrated in the commercial loan portfolio, which can result in overall asset quality being influenced by a small number of credits. Management has historically considered growth and portfolio composition when determining credit loss allocations.

Prior to the pandemic, economic conditions in the Company's markets were stable. During the past 18 months some industries have performed well during the pandemic, while others have not. The Company is monitoring industries and borrowers impacted by the pandemic as discussed. Watch list loans were $27.6 million lower at $258.5 million as of September 30, 2021 compared to $286.1 million at December 31, 2020. Watch list loans represent 6.10% of total loans at September 30, 2021 compared to 6.15% at December 31, 2020. Watch list loans excluding PPP loans, were 6.23% of total loans at

September 30, 2021 compared to 6.75% at December 31, 2020. This reflects a more comparable ratio to prior periods, as PPP loans are fully guaranteed by the SBA and have not been allocated for within the allowance for credit losses calculation. The Company's continued growth strategy promotes diversification among industries as well as continued focus on the enforcement of a disciplined credit culture and a conservative position in loan work-out situations.

As of September 30, 2021, total deferrals attributed to COVID-19 were $22.3 million, representing two commercial loan borrowers and a consumer loan. This represented 0.5% of the total loan portfolio and 0.6% of commercial loans.

A summary of loan deferrals attributed to COVID-19, by loan segment, as of September 30, 2021 is as follows:

| (dollars in thousands) | Borrowers | | Balance | |
|---|---|---|---|---|
| CRE - Nonowner Occupied | 1 | 33.4 % | $ 14,347 | 64.3 % |
| CRE - Owner Occupied | 1 | 33.3 | 7,954 | 35.6 |
| Installment - other consumer | 1 | 33.3 | 12 | 0.1 |
| Total | 3 | 100.0 % | $ 22,313 | 100.0 % |

As of September 30, 2021, one borrower with loans outstanding of $8.0 million was in their second deferral period. Additionally, one borrower with aggregate loans outstanding of $14.3 million was in their third deferral period. This borrower was removed from the deferral listing in October 2021. All COVID-19 related loan deferrals remain on accrual status, as each deferral is evaluated individually, and management has determined that all contractual cash flows are collectable at this time.

**Sources of Funds**

The average daily deposits and borrowings together with average rates paid on those deposits and borrowings for the nine months ended September 30, 2021 and 2020 are summarized in the following table:

| | Nine months ended September 30, | | | |
|---|---|---|---|---|
| | 2021 | | 2020 | |
| (dollars in thousands) | Balance | Rate | Balance | Rate |
| Noninterest bearing demand deposits | $ 1,627,522 | 0.00 % | $ 1,252,112 | 0.00 % |
| Savings and transaction accounts: | | | | |
| Savings deposits | 353,058 | 0.08 | 260,668 | 0.08 |
| Interest bearing demand deposits | 2,334,480 | 0.28 | 1,796,270 | 0.57 |
| Time deposits: | | | | |
| Deposits of $100,000 or more | 741,815 | 0.87 | 969,362 | 1.78 |
| Other time deposits | 223,486 | 0.99 | 268,485 | 1.78 |
| Total deposits | $ 5,280,361 | 0.29 % | $ 4,546,897 | 0.71 % |
| FHLB advances and other borrowings | 75,500 | 0.41 | 98,489 | 0.85 |
| Total funding sources | $ 5,355,861 | 0.29 % | $ 4,645,386 | 0.72 % |

**Deposits and Borrowings**

As of September 30, 2021, total deposits increased by $377.8 million, or 7.5%, from December 31, 2020. Core deposits increased by $381.8 million to $5.404 billion as of September 30, 2021 from $5.022 billion as of December 31, 2020. Total brokered deposits were $11.0 million at September 30, 2021 compared to $15.0 million at December 31, 2020 reflecting a $4.0 million decrease during the first nine months of 2021. PPP loan proceeds to borrowers and government stimulus to consumers impacted the increase in deposits during 2021 as loan proceeds and stimulus payments were deposited into customer checking and savings accounts at the Bank.

Since December 31, 2020, the change in core deposits was comprised of increases in commercial deposits of $203.3 million, retail deposits of $51.4 million and public funds deposits of $127.1 million. Total public funds deposits, including public funds transaction accounts, were $1.290 billion at September 30, 2021 and $1.162 billion at December 31, 2020.

The following table summarizes deposit composition at September 30, 2021 and December 31, 2020:

| (dollars in thousands) | **September 30, 2021** | December 31, 2020 | Current Period Change |
|---|---|---|---|
| Retail | **$ 1,970,447** | $ 1,919,040 | $ 51,407 |
| Commercial | **2,143,576** | 1,940,306 | 203,270 |
| Public funds | **1,289,603** | 1,162,457 | 127,146 |
| Core deposits | **$ 5,403,626** | $ 5,021,803 | $ 381,823 |
| Brokered deposits | **11,012** | 15,002 | (3,990) |
| Total deposits | **$ 5,414,638** | $ 5,036,805 | $ 377,833 |

Total borrowings decreased by $10.5 million, or 12.3%, from December 31, 2020, due to repayment of the Company's holding company line of credit. The Company utilizes wholesale funding, including brokered deposits and Federal Home Loan Bank advances, to supplement funding of assets, which is primarily used for loan and investment securities growth. Management anticipates that the Company's deposit balances may fluctuate more than usual during the remainder of 2021 due to the impact of PPP loan originations, which are made to PPP loan recipient deposit accounts. The timing and use of these funds in addition to draws on unfunded commitments could impact our need to borrow throughout the year.

**Capital**

As of September 30, 2021, total stockholders' equity was $683.2 million, an increase of $26.0 million, or 4.0%, from $657.2 million at December 31, 2020. Net income of $71.5 million increased equity. Offsetting the increase to stockholders' equity was dividends declared and paid in the amount of $26.0 million, a decrease of $16.8 million in accumulated other comprehensive income, which was primarily driven by a net decrease in the fair value of available-for-sale securities, and the day one CECL adjustment, net of taxes, of $7.0 million.

The impact on equity for other comprehensive income (loss) is not included in regulatory capital. The banking regulators have established guidelines for leverage capital requirements, expressed in terms of Tier 1, or core capital, as a percentage of average assets, to measure the soundness of a financial institution. In addition, banking regulators have established risk-based capital guidelines for U.S. banking organizations. As of September 30, 2021, the Company's capital levels remained characterized as "well-capitalized".

The actual capital amounts and ratios of the Company and the Bank as of September 30, 2021 and December 31, 2020, are presented in the table below. Capital ratios for September 30, 2021 are preliminary until the Call Report and FR Y-9C are filed.

| | Actual | | Minimum Required For Capital Adequacy Purposes | | For Capital Adequacy Purposes Plus Capital Conservation Buffer | | Minimum Required to Be Well Capitalized Under Prompt Corrective Action Regulations | |
|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of September 30, 2021: | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | |
| Consolidated | **$ 726,278** | **15.44 %** | **$ 376,342** | **8.00 %** | **$ 493,949** | **N/A** | **N/A** | **N/A** |
| Bank | **$ 708,540** | **15.10 %** | **$ 375,365** | **8.00 %** | **$ 492,667** | **10.50 %** | **$ 469,207** | **10.00 %** |
| Tier I Capital (to Risk Weighted Assets) | | | | | | | | |
| Consolidated | **$ 667,210** | **14.18 %** | **$ 282,257** | **6.00 %** | **$ 399,864** | **N/A** | **N/A** | **N/A** |
| Bank | **$ 649,622** | **13.85 %** | **$ 281,524** | **6.00 %** | **$ 398,826** | **8.50 %** | **$ 375,365** | **8.00 %** |
| Common Equity Tier 1 (CET1) | | | | | | | | |
| Consolidated | **$ 667,210** | **14.18 %** | **$ 211,693** | **4.50 %** | **$ 329,300** | **N/A** | **N/A** | **N/A** |
| Bank | **$ 649,622** | **13.85 %** | **$ 211,143** | **4.50 %** | **$ 328,445** | **7.00 %** | **$ 304,984** | **6.50 %** |
| Tier I Capital (to Average Assets) | | | | | | | | |
| Consolidated | **$ 667,210** | **10.91 %** | **$ 244,665** | **4.00 %** | **$ 244,665** | **N/A** | **N/A** | **N/A** |
| Bank | **$ 649,622** | **10.65 %** | **$ 244,063** | **4.00 %** | **$ 244,063** | **4.00 %** | **$ 305,079** | **5.00 %** |
| As of December 31, 2020: | | | | | | | | |
| Total Capital (to Risk Weighted Assets) | | | | | | | | |
| Consolidated | $ 682,778 | 14.65 % | $ 372,921 | 8.00 % | $ 489,459 | N/A | N/A | N/A |
| Bank | $ 678,034 | 14.56 % | $ 372,560 | 8.00 % | $ 488,985 | 10.50 % | $ 465,700 | 10.00 % |
| Tier I Capital (to Risk Weighted Assets) | | | | | | | | |
| Consolidated | $ 624,381 | 13.39 % | $ 279,691 | 6.00 % | $ 396,229 | N/A | N/A | N/A |
| Bank | $ 619,693 | 13.31 % | $ 279,420 | 6.00 % | $ 395,845 | 8.50 % | $ 372,560 | 8.00 % |
| Common Equity Tier 1 (CET1) | | | | | | | | |
| Consolidated | $ 624,381 | 13.39 % | $ 209,768 | 4.50 % | $ 326,306 | N/A | N/A | N/A |
| Bank | $ 619,693 | 13.31 % | $ 209,565 | 4.50 % | $ 325,990 | 7.00 % | $ 302,705 | 6.50 % |
| Tier I Capital (to Average Assets) | | | | | | | | |
| Consolidated | $ 624,381 | 10.93 % | $ 228,406 | 4.00 % | $ 228,406 | N/A | N/A | N/A |
| Bank | $ 619,693 | 10.88 % | $ 227,900 | 4.00 % | $ 227,900 | 4.00 % | $ 284,875 | 5.00 % |

**FORWARD-LOOKING STATEMENTS**

This document (including information incorporated by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of such term in the federal securities law. Forward-looking statements are not historical facts and are generally identifiable by the use of words such as “believe,” “expect,” “anticipate,” “project,” “possible,” “continue,” “plan,” “intend,” “estimate,” “may,” “will,” “would,” “could,” “should” or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

The Company’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain and, accordingly, the reader is cautioned not to place undue reliance on any forward-looking statement made by the Company. Actual results could differ materially from those addressed in the forward-looking statements as a result of numerous factors, including, without limitation:

- the effects of future economic, business and market conditions and changes, both domestic and foreign;
- the effects of the COVID-19 pandemic, including its effects on our customers, local economic conditions, our operations and vendors, and the responses of federal, state and local governmental authorities;
- the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities and other interest sensitive assets and liabilities;
- changes in borrowers’ credit risks and payment behaviors;
- the timing and scope of any legislative and regulatory changes, including changes in tax and banking laws and regulations and their application by our regulators;
- the failure of assumptions and estimates used in our reviews of our loan portfolio, underlying the establishment of reserves for possible credit losses, our analysis of our capital position and other estimates;
- changes in the prices, values and sales volumes of residential and commercial real estate;
- changes in the scope and cost of FDIC insurance, the state of Indiana’s Public Deposit Insurance Fund and other coverages;
- the effects of disruption and volatility in capital markets on the value of our investment portfolio;
- changes in the availability and cost of credit and capital in the financial markets;
- The phase out of most LIBOR tenors by mid-2023 and establishment of a new reference rate;
- the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;
- the risks of mergers, acquisitions and divestitures, including, without limitation, the related time and costs of implementing such transactions, integrating operations as part of these transactions and possible failures to achieve expected gains, revenue growth and/or expense savings from such transactions;
- governmental monetary, tax and fiscal policies and the impact the most recent election will have on these;
- changes in accounting policies, rules and practices, including as a result of adopting CECL on January 1, 2021;
- changes in technology or products that may be more difficult or costly, or less effective than anticipated, including in connection with our Lake City Bank Digital platform;
- cyber-security risks and or cyber-security damage that could result from attacks on the Company’s or third-party service providers networks or data of the Company;
- the effects of any employee or customer fraud;
- the risk of trade policy and tariffs could impact loan demand from the manufacturing sector;
- the effects of war or other conflicts, acts of terrorism or other catastrophic events, including storms, droughts, tornados and flooding, that may affect general economic conditions, including agricultural production and demand and prices for agricultural goods and land used for agricultural purposes, generally and in our markets; and

- the risks noted in the Risk Factors discussed under Item 1A of Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2020, as well as other risks and uncertainties set forth from time to time in the Company’s other filings with the SEC.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Interest rate risk represents the Company’s primary market risk exposure. The Company does not have a material exposure to foreign currency exchange risk, does not have any material amount of derivative financial instruments and does not maintain a trading portfolio. The Corporate Risk Committee of the Board of Directors annually reviews and approves the policy used to manage interest rate risk. The policy was last reviewed and approved in July 2021. The policy sets guidelines for balance sheet structure, which are designed to protect the Company from the impact that interest rate changes could have on net income but do not necessarily indicate the effect on future net interest income. The Company, through the Bank's Asset and Liability Committee, manages interest rate risk by monitoring the computer simulated earnings impact of various rate scenarios and general market conditions. The Company then modifies its long-term risk parameters by attempting to generate the types of loans, investments, and deposits that currently fit the Company’s needs, as determined by the Asset and Liability Committee. This computer simulation analysis measures the net interest income impact of various interest rate scenario changes during the next twelve months. The Company continually evaluates the assumptions used in the model. The current balance sheet structure is considered to be within acceptable risk levels.

Interest rate scenarios for the base, falling 25 basis points, rising 25 basis points, rising 50 basis points, rising 100 basis points, rising 200 basis points and rising 300 basis points are listed below based upon the Company’s rate sensitive assets and liabilities at September 30, 2021. The net interest income shown represents cumulative net interest income over a twelve-month time horizon. Balance sheet assumptions used for the base scenario are the same for the rising and falling simulations.

The base scenario is an annual calculation that is highly dependent on numerous assumptions embedded in the model. While the base sensitivity analysis incorporates management’s best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact will likely differ from that projected. For certain assets, the base simulation model captures the expected prepayment behavior under changing interest rate environments. Assumptions and methodologies regarding the interest rate or balance behavior of indeterminate maturity core deposit products, such as savings, money market, NOW and demand deposits reflect management’s best estimate of expected future behavior.

| (dollars in thousands) | Base | Falling (25 Basis Points) | Rising (25 Basis Points) | Rising (50 Basis Points) | Rising (100 Basis Points) | Rising (200 Basis Points) | Rising (300 Basis Points) |
|---|---|---|---|---|---|---|---|
| Net interest income | $ 171,170 | $ 168,237 | $ 173,749 | $ 176,433 | $ 181,938 | $ 193,754 | $ 205,556 |
| Variance from Base | | $ (2,933) | $ 2,579 | $ 5,263 | $ 10,768 | $ 22,584 | $ 34,386 |
| Percent of change from Base | | (1.71)% | 1.51 % | 3.07 % | 6.29 % | 13.19 % | 20.09 % |

**ITEM 4 – CONTROLS AND PROCEDURES**

As required by Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) were effective as of September 30, 2021. Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended September 30, 2021, there were no changes to the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

## PART II – OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings to which the Company or its subsidiaries is a party other than ordinary routine litigation incidental to their respective businesses.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. of Part I of the Company’s Form 10-K for the year ended December 31, 2020. Please refer to that section of the Company’s Form 10-K for disclosures regarding the risks and uncertainties related to the Company’s business.

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

None

### ISSUER PURCHASES OF EQUITY SECURITIES

On April 13, 2021, the Company's board of directors reauthorized and extended a share repurchase program through April 30, 2023, under which the Company is authorized to repurchase, from time to time as the Company deems appropriate, shares of the Company's common stock with an aggregate purchase price of up to $30 million. Repurchases may be made in the open market, through block trades or otherwise, and in privately negotiated transactions. The repurchase program does not obligate the Company to repurchase any dollar amount or number of shares, and the program may be extended, modified, suspended or discontinued at any time. There were no repurchases under this plan during the three months ended September 30, 2021.

The following table provides information as of September 30, 2021 with respect to shares of common stock repurchased by the Company during the quarter then ended:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Appropriate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| July 1-31 | 0 | $ 0 | 0 | $ 19,998,273 |
| August 1-31 | 3,383 | 63.47 | 0 | 19,998,273 |
| September 1-30 | 0 | 0 | 0 | 19,998,273 |
| Total | 3,383 | $ 63.47 | 0 | $ 19,998,273 |

(a) The shares purchased during August were credited to the deferred share accounts of non-employee directors under the Company’s directors’ deferred compensation plan. These shares were purchased in the ordinary course of business and consistent with past practice.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

N/A

Item 5. Other Information

None

Item 6. Exhibits

| | |
|---|---|
| 10.1 | Lakeland Financial Corporation Amended and Restated 2017 Equity Incentive Plan |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | Interactive Data File |
| | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of September 30, 2021 and December 31, 2020; (ii) Consolidated Statements of Income for the three months and nine months ended September 30, 2021 and September 30, 2020; (iii) Consolidated Statements of Comprehensive Income for the three months and nine months ended September 30, 2021 and September 30, 2020; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three months and nine months ended September 30, 2021 and September 30, 2020; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2021 and September 30, 2020; and (vi) Notes to Unaudited Consolidated Financial Statements. |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

## 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.

LAKELAND FINANCIAL CORPORATION
(Registrant)

| | |
|---|---|
| Date: October 27, 2021 | /s/ David M. Findlay |
| | David M. Findlay – President and<br>Chief Executive Officer |
| Date: October 27, 2021 | /s/ Lisa M. O'Neill |
| | Lisa M. O'Neill – Executive Vice President and<br>Chief Financial Officer<br>(principal financial officer) |
| Date: October 27, 2021 | /s/ Brok A. Lahrman |
| | Brok A. Lahrman – Senior Vice President and Chief Accounting Officer<br>(principal accounting officer) |

Exhibit 10.1

# Lakeland Financial Corporation

## Amended and Restated 2017 Equity Incentive Plan

## Article 1
## Introduction

**Section 1.1** **Purpose, Effective Date and Term.** The purpose of this **Lakeland Financial Corporation Amended and Restated 2017 Equity Incentive Plan** is to: (a) promote the growth, profitability, and long-term financial success of **Lakeland Financial Corporation** and its Subsidiaries; (b) incentivize officers, other employees, non-employee directors, and other service providers of the Company and its Subsidiaries to achieve long-term corporate objectives; (c) attract and retain officers, other employees, non-employee directors, and other service providers who can and do contribute to such financial success, and to further align their interests with those of the Company's Shareholders; and (d) provide such individuals with an opportunity to acquire Shares of the Company's common stock. The "**Effective Date**" of the Plan is April 11, 2017, the date of the approval of the Plan by the Shareholders. The Plan shall remain in effect as long as any Awards are outstanding; *provided, however,* that no Awards may be granted after the 10-year anniversary of the Effective Date.

**Section 1.2** **Participation.** Each employee and director of, and service provider (with respect to which issuances of securities may be registered under Form S-8) to, the Company and each Subsidiary who is granted, and currently holds, an Award in accordance with the provisions of the Plan shall be a "**Participant**" in the Plan. Award recipients shall be limited to employees and directors of, and service providers (with respect to which issuances of securities may be registered under Form S-8) to, the Company and its Subsidiaries; *provided, however,* that an Award (other than an ISO) may be granted to an individual prior to the date on which he or she first performs services as an employee, director or service provider, *provided* that such Award does not become vested prior to the date such individual commences such services.

**Section 1.3** **Definitions.** Capitalized terms in the Plan shall be defined as set forth in the Plan (including the definition provisions of **Article 8**).

## Article 2
## Awards

**Section 2.1** **General.** Any Award may be granted singularly, in combination with another Award (or Awards), or in tandem whereby the exercise or vesting of one Award held by a Participant cancels another Award held by the Participant. Each Award shall be subject to the provisions of the Plan and such additional provisions as the Committee may provide with respect to such Award and as may be evidenced in the Award Agreement. Subject to the provisions of **Section 3.4(b)**, an Award may be granted as an alternative to or replacement of an existing award under the Plan, any other plan of the Company or a Subsidiary or as the form of payment for grants or rights earned or due under any other compensation plan or arrangement of the Company or a Subsidiary, including the plan of any entity acquired by the Company or a Subsidiary. The types of Awards that may be granted include the following:

**(a)** *Stock Options*. A stock option represents the right to purchase Shares at an exercise price established by the Committee. Any stock option may be either an ISO or a nonqualified stock option that is not intended to be an ISO. No ISOs may be (i) granted after the 10-year anniversary of the Effective Date or (ii) granted to a non-employee. To the extent the aggregate Fair Market Value (determined at the time of grant) of Shares with respect to which ISOs are exercisable for the first time by any Participant during any calendar year under all plans of the Company and its Subsidiaries exceeds $100,000, the stock options or portions thereof that exceed such limit shall be treated as nonqualified stock options. Unless otherwise specifically provided by the Award Agreement, any stock option granted under the Plan shall be a nonqualified stock option. All or a portion of any ISO granted under the Plan that does not qualify as an ISO for any reason shall be deemed to be a nonqualified stock option. In addition, any ISO granted under the Plan may be unilaterally modified by the Committee to disqualify such stock option from ISO treatment such that it shall become a nonqualified stock option.

**(b)** *Stock Appreciation Rights.* A stock appreciation right (an "**SAR**") is a right to receive, in cash, Shares or a combination of both (as shall be reflected in the respective Award Agreement), an amount equal to or based upon the excess of (i) the Fair Market Value at the time of exercise of the SAR over (ii) an exercise price established by the Committee.

**(c)** *Stock Awards.* A stock award is a grant of Shares or a right to receive Shares (or their cash equivalent or a combination of both, as shall be reflected in the respective Award Agreement) in the future, excluding Awards designated as stock options, SARs or cash incentive awards by the Committee. Such Awards may include bonus shares, performance shares, performance units, restricted stock, restricted stock units or any other equity-based Award as determined by the Committee.

**(d)** *Cash Incentive Awards*. A cash incentive award is the grant of a right to receive a payment of cash (or Shares having a value equivalent to the cash otherwise payable, excluding Awards designated as stock options, SARs or stock awards by the Committee, all as shall be reflected in the respective Award Agreement), determined on an individual basis or as an allocation of an incentive pool that is contingent on the achievement of performance objectives established by the Committee.

**Section 2.2** **Exercise of Stock Options and SARs.** A stock option or SAR shall be exercisable in accordance with such provisions as may be established by the Committee; *provided, however*, that a stock option or SAR shall expire no later than 10 years after its grant date (five years in the case of an ISO granted to a 10% Shareholder). The exercise price of each stock option and SAR shall be not less than 100% of the Fair Market Value on the grant date; *provided, however,* that the exercise price of an ISO shall not be less than 110% of Fair Market Value on the grant date in the case of a 10% Shareholder; and *provided, further,* that, to the extent permitted under Code Section 409A, and subject to **Section 3.4(b)**, the exercise price may be higher or lower in the case of stock options and SARs granted in replacement of existing awards held by an employee, director or service provider granted by an acquired entity. The payment of the exercise price of a stock option shall be by cash or, subject to limitations imposed by applicable law, by any of the following means unless otherwise determined by the Committee from time to time: (a) by tendering, either actually or by attestation, Shares acceptable to the Committee and valued at Fair Market Value as of the day of exercise; (b) by irrevocably authorizing a third party, acceptable to the Committee, to sell Shares acquired upon exercise of the stock option and to remit to the Company no later than the third business day following exercise of a sufficient portion of the sale proceeds to pay the entire exercise price and any tax withholding resulting from such exercise; (c) by payment through a "net exercise" process such that, without the payment of any funds, the Participant may exercise the option using Award shares as payment of the exercise price and applicable taxes and receive the net number of Shares equal in value to (i) the number of Shares as to which the option is being exercised, multiplied by (ii) a fraction, the numerator of which is the Fair Market Value (on the date of exercise) less the exercise price, and the denominator of which is such Fair Market Value (the number of net Shares to be received shall be rounded down to the nearest whole number of Shares); (d) by personal, certified or cashiers' check; (e) by other property deemed acceptable by the Committee or (f) by any combination thereof.

**Section 2.3** **Minimum Vesting Period**. If the right to become vested in an Award granted to an employee Participant is conditioned on the completion of a specified period of service with the Company or its Subsidiaries, without achievement of performance measures or other performance objectives (whether or not related to the performance measures) being required as a condition of vesting, and without it being granted in lieu of, or in exchange for, other compensation, or other Awards, then the required period of service for full vesting shall not be less than one (1) year (subject to acceleration of vesting, to the extent permitted by the Committee, as provided herein); *provided, however*, that the required period of service for full vesting with respect to such stock awards shall not apply to Awards that do not in the aggregate exceed 5% of the total Share reserve set forth in **Section 3.2(a)**.

**Section 2.4** **Dividends and Dividend Equivalents.** Any Award may provide the Participant with the right to receive dividend payments or dividend equivalent payments with respect to Shares subject to the Award, which payments may be made currently or credited to an account for the Participant, may be settled in cash or Shares and may be subject to terms or provisions similar to the underlying Award or such other terms and conditions as the Committee may deem appropriate.

**Section 2.5** **Forfeiture of Awards.** Unless specifically provided to the contrary in an Award Agreement, upon notification of Termination of Service for Cause, any outstanding Award held by a Participant, whether vested or unvested, shall terminate immediately, such Award shall be forfeited and the Participant shall have no further rights thereunder.

**Section 2.6** **Deferred Compensation.** The Plan is, and all Awards are, intended to be exempt from (or, in the alternative, to comply with) Code Section 409A, and each shall be construed, interpreted and administered accordingly. The Company does not guarantee that any benefits that may be provided under the Plan will satisfy all applicable provisions of Code Section 409A. If any Award would be considered "deferred compensation" under Code Section 409A ("**Deferred Compensation**"), the Committee reserves the absolute right (including the right to delegate such right) to unilaterally amend the Plan or the applicable Award Agreement, without the consent of the Participant, to avoid the application of, or to maintain compliance with, Code Section 409A. Any amendment by the Committee to the Plan or an Award Agreement pursuant to this **Section 2.6** shall maintain, to the extent practicable, the original intent of the applicable provision without violating Code Section 409A. A Participant's acceptance of any Award shall be deemed to constitute the Participant's acknowledgment of, and consent to, the rights of the Committee under this **Section 2.6**, without further consideration or action. Any discretionary authority retained by the Committee pursuant to the terms of the Plan or pursuant to an Award Agreement shall not be applicable to an Award that is determined to constitute Deferred Compensation, if such discretionary authority would contravene Code Section 409A.

## Article 3
## Shares Subject to Plan

**Section 2.1** **Available Shares.** The Shares with respect to which Awards may be granted shall be Shares currently authorized but unissued, currently held or, to the extent permitted by applicable law, subsequently acquired by the Company, including Shares purchased in the open market or in private transactions.

**Section 2.2** **<u>Share Limitations</u>.**

**(a)** *Share Reserve*. Subject to the following provisions of this **Section 3.2**, the maximum number of Shares that may be delivered under the Plan shall be 1,000,000 (all of which may be granted as ISOs and all of which may be granted as full value awards). The maximum number of Shares available for delivery under the Plan (including the number that may be granted as ISOs) and the number of Shares subject to outstanding Awards shall be subject to adjustment as provided in **Section 3.4**. Following the Effective Date, no new awards will be granted from a Prior Plan.

(i) To the extent any Shares covered by an Award under the Plan or a Prior Plan are not delivered to a Participant or beneficiary for any reason, including because the Award is forfeited (including unvested stock awards), canceled, or settled in cash, such Shares shall not be deemed to have been delivered for purposes of determining the maximum number of Shares available for delivery under the Plan and shall again become eligible for delivery under the Plan.

(ii) With respect to SARs or, following the Effective Date, a stock appreciation right under a Prior Plan, that are settled in Shares, the full number of covered Shares set forth in the Award Agreement shall be counted for purposes of determining the maximum number of Shares available for delivery under the Plan.

(iii) If the exercise price of any stock option granted under the Plan or, following the Effective Date, a stock option under a Prior Plan, is satisfied by tendering Shares to the Company (whether by actual delivery or by attestation and whether or not such surrendered Shares were acquired pursuant to an award) or by the net exercise of the award, the full number of covered Shares set forth in the Award Agreement shall be deemed delivered for purposes of determining the maximum number of Shares available for delivery under the Plan.

**(b)** *Reuse of Shares*. If the withholding tax liabilities arising from an Award are satisfied by the tendering of Shares to the Company (whether by actual delivery or by attestation and whether or not such tendered Shares were acquired pursuant to an award) or by the withholding of or reduction of Shares by the Company, such Shares shall be deemed to have been delivered for purposes of determining the maximum number of Shares available for delivery under the Plan.

**Section 2.3** **<u>Limitations on Grants to Director Participants</u>.** The following limitations shall apply with respect to Awards:

**(a)** *Stock Options and SARs*. The maximum number of Shares that may be subject to stock options or SARs granted to any one Director Participant during any calendar year shall be 10,000.

**(b)** *Stock Awards*. The maximum number of Shares that may be subject to stock awards that are granted to any one Director Participant during any calendar year shall be 10,000.

**(c)** *Director Election*. The foregoing limitations shall not apply to cash-based Director fees that the Director elects to receive in the form of Shares or Share based units equal in value to the cashbased Director fee.

**Section 2.4** **<u>Corporate Transactions; No Repricing</u>.**

**(a)** *Adjustments*. To the extent permitted under Code Section 409A, and to the extent applicable, in the event of a corporate transaction involving the Company or the Shares (including any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination or exchange of shares, or other similar event which the Committee determines affects the Shares such that an adjustment pursuant to this **Section 3.4(a)** is appropriate to prevent the enlargement or dilution of rights), all outstanding Awards, the number of Shares available for delivery under the Plan under **Section 3.2** and each of the specified limitations set forth in **Section 3.3** shall be adjusted automatically to proportionately and uniformly reflect such transaction; *provided*, *however,* that, subject to **Section 3.4(b)**, the Committee may otherwise adjust Awards (or prevent such automatic adjustment) as it deems necessary, in its sole discretion, to preserve the benefits or potential benefits of the Awards and the Plan. Action by the Committee under this **Section 3.4(a)** may include: (i) adjustment of the number and kind of shares that may be delivered under the Plan; (ii) adjustment of the number and kind of shares subject to outstanding Awards; (iii) adjustment of the exercise price of outstanding stock options and SARs; and (iv) any other adjustments that the Committee determines to be equitable (which may include (A) replacement of an Award with another award that the Committee determines has comparable value and that is based on stock of a company resulting from a corporate transaction, and (B) cancellation of an Award in return for cash payment of the current value of the Award, determined as though the Award were fully vested at the time of payment, *provided* that in the case of a stock option or SAR, the amount of such payment shall be the excess of the value of the stock subject to the option or SAR at the time of the transaction over the exercise price, and *provided*, *further,* that no such payment shall be required in consideration for the cancellation of the Award if the exercise price is greater than or equal to the value of the stock at the time of such corporate transaction).

**(b)** *No Repricing*. Notwithstanding any provision of the Plan to the contrary, no adjustment or reduction of the exercise price of any outstanding stock option or SAR in the event of a decline in Stock price shall be permitted without approval by the Shareholders or as otherwise expressly provided under **Section 3.4(a)**. The foregoing prohibition includes (i) reducing the exercise price of outstanding stock options or SARs, (ii) cancelling outstanding stock options or SARs in connection with the granting of stock options or SARs with a lower exercise price to the same individual, (iii) cancelling stock options or SARs with an exercise price in excess of the current Fair Market Value in exchange for a cash or other payment, and (iv) taking any other action that would be treated as a repricing of a stock option or SAR under the rules of the primary securities exchange or similar entity on which the Shares are listed.

**Section 2.5** **<u>Delivery of Shares</u>.** Delivery of Shares or other amounts under the Plan shall be subject to the following:

**(a)** *Compliance with Applicable Laws.* Notwithstanding any provision of the Plan to the contrary, the Company shall have no obligation to deliver any Shares or make any other distribution of benefits under the Plan unless such delivery or distribution complies with all applicable laws and the applicable requirements of any securities exchange or similar entity.

**(b)** *No Certificates Required.* To the extent that the Plan provides for the delivery of Shares, the delivery may be effected on a non-certificated basis, to the extent not prohibited by applicable law or the applicable rules of any securities exchange or similar entity.

## Article 4
## Change in Control

**Section 4.1** **Consequence of a Change in Control**. Subject to the provisions of **Section 3.4** (relating to the adjustment of Shares), and except as otherwise provided in the Plan or in any Award Agreement, and subject to any forfeiture and expiration provisions otherwise applicable to the respective Awards, all stock options and SARs under the Plan then held by the Participant at the time of a Change in Control (whether time-vested or performance-vested awards) shall become fully exercisable, and all stock awards and cash incentive awards under the Plan then held by the Participant at the time of a Change in Control shall become fully earned and vested, immediately upon the occurrence of either of the following:

**(a)** immediately following a Change in Control the Plan and the respective Award Agreements are not the obligations of the entity, whether the Company, a successor thereto or an assignee thereof, that conducts following a Change in Control substantially all of the business conducted by the Company and its Subsidiaries immediately prior to such Change in Control, or

**(b)** the Plan and the respective Award Agreements are the obligations of the entity, whether the Company, a successor thereto or an assignee thereof, that conducts following a Change in Control substantially all of the business conducted by the Company and its Subsidiaries immediately prior to such Change in Control and the Participant incurs a Termination of Service without Cause or the Participant resigns for Good Reason following such Change in Control.

**Section 4.2** **Definition of Change in Control.**

**(a)** If the Participant is subject to an employment agreement (or other similar agreement) with the Company or a Subsidiary that provides a definition of "change in control" (or the like), then, for purposes of the Plan, the term "**Change in Control**" has the meaning set forth in such agreement; and in the absence of such a definition, "**Change in Control**" means the first to occur of the following:

(i) The date of the consummation of the acquisition by any "person" (as such term is defined in Section 13(d) and 14(d) of the Exchange Act) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of fifty percent (50%) or more of the combined voting power of the then outstanding securities eligible to vote for the election of the Board (the "**Company Voting Securities**"); or

(ii) During any twelve (12) month period, the individuals who are members of the Board cease for any reason to constitute a majority of the Board, unless the election, or nomination for election by the Company shareholders, of a new Company director was approved by a vote of a majority of the Board, and such new director shall, for purposes of the Plan, be considered as a member of the Board; or

(iii) The date of the consummation by the Company of (i) a merger or consolidation of the Company, if the Company shareholders immediately before such merger or consolidation, do not, as a result of such merger or consolidation, own directly or indirectly, more than fifty percent (50%) of the combined voting power of the then outstanding voting securities of the entity resulting from such merger or consolidation, in substantially the same proportion as their ownership of the combined voting power of the Company Voting Securities outstanding immediately before such merger or consolidation or (ii) a complete liquidation or dissolution or an agreement for the sale or other disposition of all or substantially all of the assets of the Company.

**(b)** Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because fifty percent (50%) or more of the Company Voting Securities is acquired by (i) a trustee or other fiduciary holding securities under one or more employee benefit plans maintained for employees of the entity or (ii) any corporation which, immediately prior to such acquisition, is owned directly or indirectly by the stockholders of the Company in substantially the same proportion as their ownership of stock of the Company immediately prior to such acquisition.

**(c)** In the event that any benefit under the Plan constitutes deferred compensation under Code Section 409A and the settlement of or distribution of benefits under this Plan is to be triggered by a Change in Control, then such settlement or distribution shall be subject to the event constituting the Change in Control also constituting a "change in control event" under Section 409A.

## Article 5
## <u>Committee</u>

**Section 5.1** **<u>Administration</u>.** The authority to control and manage the operation and administration of the Plan shall be vested in the Committee in accordance with this **Article 5**. The Committee shall be selected by the Board, *provided* that the Committee shall consist of two or more members of the Board, each of whom is a "non-employee director" (within the meaning of Rule 16b-3 promulgated under the Exchange Act), and an "independent director" (within the meaning of the rules of the securities exchange which then constitutes the principal listing for the Stock), in each case to the extent required by the Exchange Act or the applicable rules of the securities exchange which then constitutes the principal listing for the Stock, respectively. Subject to the applicable rules of any securities exchange or similar entity, if the Committee does not exist, or for any other reason determined by the Board, the Board may take any action under the Plan that would otherwise be the responsibility of the Committee.

**Section 5.2** **<u>Powers of Committee</u>.** The Committee's administration of the Plan shall be subject to the other provisions of the Plan and the following:

**(a)** The Committee shall have the authority and discretion to select from among the Company's and the Subsidiary's employees, directors and service providers those persons who shall receive Awards, to determine the time or times of receipt, to determine the types of Awards and the number of Shares covered by the Awards, to establish the terms of Awards, to cancel or suspend Awards and to reduce or eliminate any restrictions or vesting requirements applicable to an Award at any time after the grant of the Award.

**(b)** The Committee shall have the authority and discretion to interpret the Plan, to establish, amend and rescind any rules and regulations relating to the Plan and to make all other determinations that may be necessary or advisable for the administration of the Plan.

**(c)** The Committee shall have the authority to define terms not otherwise defined in the Plan.

**(d)** Any interpretation of the Plan by the Committee and any decision made by it under the Plan shall be final and binding on all persons.

**(e)** In controlling and managing the operation and administration of the Plan, the Committee shall take action in a manner that conforms to the articles and bylaws of the Company and to all applicable law.

**Section 5.3** **Delegation by Committee.** Except to the extent prohibited by applicable law, the applicable rules of any securities exchange or similar entity, the Plan, the charter of the Committee, or as necessary to comply with the exemptive provisions of Rule 16b-3 of the Exchange Act, the Committee may allocate all or any portion of its responsibilities and powers to any one or more of its members and may delegate all or any part of its responsibilities and powers under the Plan to any person or persons selected by it. The acts of such delegates shall be treated under the Plan as acts of the Committee and such delegates shall report regularly to the Committee regarding the delegated duties and responsibilities and any Awards granted. Any such allocation or delegation may be revoked by the Committee at any time.

**Section 5.4** **Information to be Furnished to Committee.** As may be permitted by applicable law, the Company and each Subsidiary shall furnish the Committee with such data and information as it determines may be required for it to discharge its duties under the Plan. The records of the Company and each Subsidiary as to an employee's or Participant's employment, termination of employment, leave of absence, reemployment and compensation shall be conclusive with respect to all persons unless determined by the Committee to be manifestly incorrect. Subject to applicable law, Participants and other persons entitled to benefits under the Plan shall furnish the Committee such evidence, data or information as the Committee considers desirable to carry out the terms of the Plan.

**Section 5.5** **Expenses and Liabilities.** All expenses and liabilities incurred by the Committee in the administration and interpretation of the Plan or any Award Agreement shall be borne by the Company. The Committee may employ attorneys, consultants, accountants or other persons in connection with the administration and interpretation of the Plan, and the Company, and its officers and directors, shall be entitled to rely upon the advice, opinions and valuations of any such persons.

## Article 6
## Amendment and Termination

**Section 6.1** **General.** Unless otherwise determined by the Board, Shareholder approval of any amendment or termination of the Plan will be obtained only to the extent necessary to comply with any applicable laws, regulations or rules of a securities exchange on which the Shares are traded or self-regulatory agency, and subject to the foregoing, the Board may, as permitted by law, at any time, amend or terminate the Plan, and may amend any Award Agreement; *provided*, *however*, that no amendment or termination may (except as provided in **Section 2.6**, **Section 3.4** and **Section 6.2**), in the absence of written consent to the change by the affected Participant (or, if the Participant is not then living, the affected beneficiary), impair the rights of any Participant or beneficiary under any Award granted prior to the date such amendment or termination is adopted by the Board; and *provided, further*, that no amendment may (a) materially increase the benefits accruing to Participants under the Plan, (b) materially increase the aggregate number of securities that may be delivered under the Plan other than pursuant to **Section 3.4**, or (c) materially modify the requirements for participation in the Plan, unless the amendment under (a), (b) or (c) immediately above is approved by the Shareholders.

**Section 6.2** **Amendment to Conform to Law.** Notwithstanding any provision of the Plan or an Award Agreement to the contrary, the Committee may amend the Plan or any Award Agreement, to take effect retroactively or otherwise, as deemed necessary or advisable for the purpose of conforming the Plan or the Award Agreement to any applicable law. By accepting an Award, the Participant shall be deemed to have acknowledged and consented to any amendment to an Award made pursuant to this **Section 6.2**, **Section 2.6** or **Section 3.4** without further consideration or action.

## Article 7
## General Terms

**Section 7.1 No Implied Rights.**

**(a)** *No Rights to Specific Assets.* No person shall by reason of participation in the Plan acquire any right in or title to any assets, funds or property of the Company or any Subsidiary, including any specific funds, assets, or other property that the Company or a Subsidiary, in its sole discretion, may set aside in anticipation of a liability under the Plan. A Participant shall have only a contractual right to the Shares or amounts, if any, distributable in accordance with the provisions of the Plan, unsecured by any assets of the Company or any Subsidiary, and nothing contained in the Plan or an Award Agreement shall constitute a guarantee that the assets of the Company or any Subsidiary shall be sufficient to provide any benefits to any person.

**(b)** *No Contractual Right to Employment or Future Awards.* The Plan does not constitute a contract of employment, and selection as a Participant shall not give any person the right to be retained in the service of the Company or a Subsidiary or any right or claim to any benefit under the Plan, unless such right or claim has specifically accrued under the Plan. No individual shall have the right to be selected to receive an Award, or, having been so selected, to receive a future Award.

**(c)** *No Rights as a Shareholder*. Except as otherwise provided in the Plan, no Award shall confer upon the holder thereof any rights as a Shareholder prior to the date on which the individual fulfills all conditions for receipt of such rights.

**Section 7.2 Transferability.** Except as otherwise provided by the Committee, Awards are not transferable except as designated by the Participant by will or by the laws of descent and distribution or pursuant to a domestic relations order. The Committee shall have the discretion to permit the transfer of Awards; *provided, however,* that such transfers shall be limited to immediate family members of Participants, trusts, partnerships, limited liability companies and other entities that are permitted to exercise rights under Awards in accordance with Form S-8 established for the primary benefit of such family members or to charitable organizations; and *provided, further,* that such transfers shall not be made for value to the Participant and in no event shall any Award be sold, assigned, or transferred to any third-party financial institution.

**Section 7.3 Designation of Beneficiaries.** A Participant hereunder may file with the Company a designation of a beneficiary or beneficiaries under the Plan and may from time to time revoke or amend any such designation. Any designation of beneficiary under the Plan shall be controlling over any other disposition, testamentary or otherwise; *provided, however,* that if the Committee is in doubt as to the entitlement of any such beneficiary to any Award, the Committee may determine to recognize only the legal representative of the Participant in which case the Company, the Committee and the members thereof shall not have any further liability to anyone.

**Section 7.4 Non-Exclusivity.** Neither the adoption of the Plan by the Board nor the submission of the Plan to the Shareholders for approval shall be construed as creating any limitations on the power of the Board or the Committee to adopt such other incentive arrangements as either may deem desirable.

**Section 7.5** **<u>Award Agreement</u>.** Each Award shall be evidenced by an Award Agreement. A copy of the Award Agreement, in any medium chosen by the Committee, shall be made available to the Participant, and the Committee may require that the Participant sign a copy of the Award Agreement.

**Section 7.6** **<u>Form and Time of Elections</u>.** Unless otherwise specified in the Plan, each election required or permitted to be made by any Participant or other person entitled to benefits under the Plan, and any permitted modification, or revocation thereof, shall be filed with the Company at such times, in such form, and subject to such terms or conditions, not inconsistent with the provisions of the Plan, as the Committee may require.

**Section 7.7** **<u>Evidence</u>.** Evidence required of anyone under the Plan may be by certificate, affidavit, document or other information that the person acting on it considers pertinent and reliable, and signed, made or presented by the proper party or parties.

**Section 7.8** **<u>Tax Withholding</u>.** All distributions under the Plan shall be subject to withholding of all applicable taxes and the Committee may condition the delivery of any Shares or other benefits under the Plan on satisfaction of the applicable withholding obligations. Except as otherwise provided by the Committee, such withholding obligations may be satisfied (a) through cash payment by the Participant; (b) through the surrender of Shares that the Participant already owns or (c) through the surrender of Shares to which the Participant is otherwise entitled under the Plan; *provided, however,* that except as otherwise specifically provided by the Committee, such Shares under clause (c) may not be used to satisfy more than the maximum individual statutory tax rate for each applicable tax jurisdiction or such lesser amount as established by the Company.

**Section 7.9** **<u>Successors</u>.** All obligations of the Company under the Plan shall be binding upon and inure to the benefit of any successor to the Company.

**Section 7.10** **<u>Indemnification</u>.** To the fullest extent permitted by law, each person who is or shall have been a member of the Committee or the Board, or an officer of the Company to whom authority was delegated in accordance with **Section 5.2**, or an employee of the Company shall be indemnified and held harmless by the Company against and from any loss (including amounts paid in settlement), cost, liability or expense (including reasonable attorneys' fees) that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such action, suit, or proceeding against him or her (*provided* that he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf), unless such loss, cost, liability or expense is a result of his or her own willful misconduct or except as expressly provided by statute. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's charter or bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

**Section 7.11** **<u>No Fractional Shares</u>.** Unless otherwise permitted by the Committee, no fractional Shares shall be delivered pursuant to the Plan or any Award. The Committee shall determine whether cash, Shares or other property shall be delivered or paid in lieu of fractional Shares or whether such fractional Shares or any rights thereto shall be forfeited or otherwise eliminated.

**Section 7.12** **Governing Law.** The Plan, all Awards, and all actions taken in connection herewith and therewith shall be governed by and construed in accordance with the laws of the State of Indiana without reference to principles of conflict of laws, except as superseded by applicable federal law.

**Section 7.13** **Benefits Under Other Plans.** Except as otherwise provided by the Committee, Awards granted to a Participant (including the grant and the receipt of benefits) shall be disregarded for purposes of determining the Participant's benefits under, or contributions to, any qualified retirement plan, nonqualified plan and any other benefit plan maintained by the Participant's employer.

**Section 7.14** **Validity.** If any provision of the Plan is determined to be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining provisions of the Plan, and the Plan shall be construed and enforced as if such illegal or invalid provision had never been included in the Plan.

**Section 7.15** **Notice.** Unless provided otherwise in an Award Agreement or policy adopted from time to time by the Committee, all communications to the Company provided for in the Plan, or any Award Agreement, shall be delivered personally or sent by registered or certified mail, return receipt requested, postage prepaid (*provided* that international mail shall be sent via overnight or two-day delivery), or prepaid overnight courier to the Company at the address set forth below:

Lakeland Financial Corporation
202 East Center Street
P.O. Box 1387
Warsaw, Indiana 46581-1387

Such communications shall be deemed given:

**(a)** In the case of delivery by overnight service with guaranteed next day delivery, the next day or the day designated for delivery; and

**(b)** In the case of certified or registered U.S. mail, five days after deposit in the U.S. mail;

*provided*, *however*, that in no event shall any communication be deemed to be given later than the date it is actually received, *provided* it is actually received. In the event a communication is not received, it shall be deemed received only upon the showing of an original of the applicable receipt, registration or confirmation from the applicable delivery service provider. Communications that are to be delivered by U.S. mail or by overnight service to the Company shall be directed to the attention of the Company's senior human resources officer and corporate secretary.

**Section 7.16** **Clawback Policy.** Any Award, amount or benefit received under the Plan shall be subject to potential cancellation, recoupment, rescission, payback or other similar action in accordance with any applicable Company clawback policy (the "**Policy**") or any applicable law. A Participant's receipt of an Award shall be deemed to constitute the Participant's acknowledgment of and consent to the Company's application, implementation and enforcement of (i) the Policy and any similar policy established by the Company that may apply to the Participant, whether adopted prior to or following the making of any Award and (ii) any provision of applicable law relating to cancellation, rescission, payback or recoupment of compensation, as well as the Participant's express agreement that the Company may take such actions as are necessary to effectuate the Policy, any similar policy and applicable law, without further consideration or action.

**Section 7.17** **Breach of Restrictive Covenants.** Except as otherwise provided by the Committee, notwithstanding any provision of the Plan to the contrary, if the Participant breaches a non-competition, non-solicitation, non-disclosure, non-disparagement or other restrictive covenant set forth in an Award Agreement or any other agreement between the Participant and the Company or a Subsidiary, whether before or after the Participant's Termination of Service, in addition to and not in limitation of any other rights, remedies, damages, penalties or restrictions available to the Company under the Plan, an Award Agreement, any other agreement between the Participant and the Company or a Subsidiary, or otherwise at law or in equity, the Participant shall forfeit or pay to the Company:

**(a)** Any and all outstanding Awards granted to the Participant, including Awards that have become vested or exercisable;

**(b)** Any Shares held by the Participant in connection with the Plan that were acquired by the Participant after the Participant's Termination of Service and within the 12-month period immediately preceding the Participant's Termination of Service;

**(c)** The profit realized by the Participant from the exercise of any stock options and SARs that the Participant exercised after the Participant's Termination of Service and within the 12-month period immediately preceding the Participant's Termination of Service, which profit is the difference between the exercise price of the stock option or SAR and the Fair Market Value of any Shares or cash acquired by the Participant upon exercise of such stock option or SAR; and

**(d)** The profit realized by the Participant from the sale, or other disposition for consideration, of any Shares received by the Participant in connection with the Plan after the Participant's Termination of Service and within the 12-month period immediately preceding the Participant's Termination of Service and where such sale or disposition occurs in such similar time period.

Unless the applicable Award Agreement expressly displaces or limits the Company's rights under this **Section 7.17** with a reference to the same, any forfeiture provision contained in an Award Agreement shall be construed as an additional, non-exclusive remedy in the event of the Participant's breach of a restrictive covenant.

## Article 8
## Defined Terms; Construction

**Section 8.1** **Definitions.** In addition to the other definitions contained in the Plan, unless otherwise specifically provided in an Award Agreement, the following definitions shall apply:

**(a)** "**10% Shareholder**" means an individual who, at the time of grant, owns Company Voting Securities possessing more than 10% of the total combined voting power of the Company Voting Securities.

**(b)** "**Award**" means an award under the Plan.

**(c)** "**Award Agreement**" means the document that evidences the terms and conditions of an Award. Such document shall be referred to as an agreement regardless of whether a Participant's signature is required. Each Award Agreement shall be subject to the terms and conditions of the Plan, and, if there is any conflict between the Award Agreement and the Plan, the Plan shall control.

**(d)** "**Board**" means the Board of Directors of the Company.

**(e)** If the Participant is subject to an employment or change in control agreement (or other similar agreement) with the Company or a Subsidiary that provides a definition of termination for "cause" (or the like), then, for purposes of the Plan, the term "**Cause**" has the meaning set forth in such agreement; and in the absence of such a definition, "**Cause**" means (i) any act by the Participant of (A) fraud or intentional misrepresentation or (B) embezzlement, misappropriation, or conversion of assets or opportunities of the Company or a Subsidiary, (ii) willful violation of any law, rule, or regulation in connection with the performance of a Participant's duties to the Company or a Subsidiary (other than traffic violations or similar offenses), (iii) with respect to any employee of the Company or a Subsidiary, commission of any act of moral turpitude or conviction of a felony, or (iv) the willful or negligent failure of the Participant to perform the Participant's duties to the Company or a Subsidiary in any material respect.

Further, the Participant shall be deemed to have terminated for Cause if, after the Participant's Termination of Service, facts and circumstances arising during the course of the Participant's employment with the Company are discovered that would have constituted a termination for Cause.

Further, all rights a Participant has or may have under the Plan shall be suspended automatically during the pendency of any investigation by the Board or its designee or during any negotiations between the Board or its designee and the Participant regarding any actual or alleged act or omission by the Participant of the type described in the applicable definition of "Cause."

**(f)** "**Change in Control**" has the meaning ascribed to it in **Section 4.2**.

**(g)** "**Code**" means the Internal Revenue Code of 1986.

**(h)** "**Code Section 409A**" means the provisions of Section 409A of the Code and any rules, regulations and guidance promulgated thereunder.

**(i)** "**Committee**" means the Committee acting under **Article 5**, and in the event a Committee is not currently appointed, the Board.

**(j)** "**Company**" means Lakeland Financial Corporation, an Indiana corporation.

**(k)** "**Company Voting Securities**" has the meaning ascribed to it in **Section 4.2(a)**.

**(l)** "**Director Participant**" means a Participant who is a member of the Board or the board of directors of a Subsidiary who is not otherwise an employee of the Company or a Subsidiary.

**(m)** "**Disability**" means the Participant is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or last for a continuous period of not less than 12 months, or is, by reason of any medically determinable physical or mental impairment that can be expected to result in death or last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident or health plan covering the Company's or a Subsidiary's employees.

**(n)** "**Effective Date**" has the meaning ascribed to it in **Section 1.1**.

**(o)** “**Exchange Act**” means the Securities Exchange Act of 1934.

**(p)** **“Fair Market Value”** means, as of any date, the officially-quoted closing selling price of the Shares on such date on the principal national securities exchange on which Shares are listed or admitted to trading or, if there have been no sales with respect to Shares on such date, such price on the most immediately preceding date on which there have been such sales, or if the Shares are not so listed or admitted to trading, the Fair Market Value shall be the value established by the Committee in good faith and, to the extent required, in accordance with Code Section 409A and Section 422 of the Code.

**(q)** “**Form S-8**” means a Registration Statement on Form S-8 promulgated by the U.S. Securities and Exchange Commission or any successor thereto.

**(r)** If the Participant is subject to an employment or change in control agreement (or other similar agreement) with the Company or a Subsidiary that provides a definition of termination for “good reason” (or the like), then, for purposes of the Plan, the term “**Good Reason**” has the meaning set forth in such agreement; and in the absence of such a definition, “**Good Reason**” means the occurrence of any one of the following events, unless the Participant agrees in writing that such event shall not constitute Good Reason:

(i) A material, adverse change in the nature, scope or status of the Participant’s position, authorities or duties from those in effect immediately prior to the applicable Change in Control;

(ii) A material reduction in the Participant’s aggregate compensation or benefits in effect immediately prior to the applicable Change in Control; or

(iii) Relocation of the Participant’s primary place of employment of more than 50 miles from the Participant’s primary place of employment immediately prior to the applicable Change in Control, or a requirement that the Participant engage in travel that is materially greater than prior to the applicable Change in Control.

Notwithstanding any provision of this definition to the contrary, prior to the Participant’s Termination of Service for Good Reason, the Participant must give the Company written notice of the existence of any condition set forth in clause (i) – (iii) immediately above within 90 days of its initial existence and the Company shall have 30 days from the date of such notice in which to cure the condition giving rise to Good Reason, if curable. If, during such 30-day period, the Company cures the condition giving rise to Good Reason, the condition shall not constitute Good Reason. Further notwithstanding any provision of this definition to the contrary, in order to constitute a termination for Good Reason, such termination must occur within 12 months of the initial existence of the applicable condition.

**(s)** “**ISO**” means a stock option that is intended to satisfy the requirements applicable to an “incentive stock option” described in Section 422(b) of the Code.

**(t)** “**Participant**” has the meaning ascribed to it in **Section 1.2**.

**(u)** “**Plan**” means the Lakeland Financial Corporation 2017 Equity Incentive Plan.

**(v)** “**Policy**” has the meaning ascribed to it in **Section 7.16**.

**(w)** "**Prior Plans**" means the Lakeland Financial Corporation 2008 Equity Incentive Plan and the Lakeland Financial Corporation 2013 Equity Incentive Plan.

**(x)** "**SAR**" has the meaning ascribed to it in **Section 2.1(b)**.

**(y)** "**Securities Act**" means the Securities Act of 1933.

**(z)** "**Share**" means a share of Stock.

**(aa)** "**Shareholders**" means the shareholders of the Company.

**(ab)** "**Stock**" means the common stock of the Company, no par value per share.

**(ac)** "**Subsidiary**" means any corporation or other entity that would be a "subsidiary corporation" as defined in Section 424(f) of the Code with respect to the Company.

**(ad)** **"Termination of Service"** means the first day occurring on or after a grant date on which the Participant ceases to be an employee and director of, and service provider to, the Company and each Subsidiary, regardless of the reason for such cessation, subject to the following:

(i) The Participant's cessation as an employee or service provider shall not be deemed to occur by reason of the Participant's being on a leave of absence from the Company or a Subsidiary approved by the Company or Subsidiary otherwise receiving the Participant's services.

(ii) If, as a result of a sale or other transaction, the Subsidiary for whom the Participant is employed (or to whom the Participant is providing services) ceases to be a Subsidiary, and the Participant is not, following the transaction, an employee or director of, or service provider to, the Company or an entity that is then a Subsidiary, then the occurrence of such transaction shall be treated as the Participant's Termination of Service caused by the Participant being discharged by the entity for whom the Participant is employed or to whom the Participant is providing services.

(iii) A service provider, other than an employee or director, whose services to the Company or a Subsidiary are governed by a written agreement with such service provider shall cease to be a service provider at the time the provision of services under such written agreement ends (without renewal); and such a service provider whose services to the Company or a Subsidiary are not governed by a written agreement with the service provider shall cease to be a service provider on the date that is 90 days after the date the service provider last provides services requested by the Company or a Subsidiary.

(iv) Notwithstanding the foregoing, in the event that any Award constitutes Deferred Compensation, the term Termination of Service shall be interpreted by the Committee in a manner consistent with the definition of "separation from service" as defined under Code Section 409A.

**Section 8.2** **<u>Construction</u>.** In the Plan, unless otherwise stated, the following uses apply:

**(a)** Actions permitted under the Plan may be taken at any time in the actor's reasonable discretion;

**(b)** References to a statute shall refer to the statute and any amendments and any successor statutes, and to all regulations promulgated under or implementing the statute, as amended, or its successors, as in effect at the relevant time;

**(c)** In computing periods from a specified date to a later specified date, the words “from” and “commencing on” (and the like) mean “from and including,” and the words “to,” “until” and “ending on” (and the like) mean “to and including”;

**(d)** References to a governmental or quasi-governmental agency, authority or instrumentality shall also refer to a regulatory body that succeeds to the functions of the agency, authority or instrumentality;

**(e)** Indications of time of day shall be based upon the time applicable to the location of the principal headquarters of the Company;

**(f)** The words “include,” “includes” and “including” mean “include, without limitation,” “includes, without limitation” and “including, without limitation,” respectively;

**(g)** All references to articles and sections are to articles and sections in the Plan unless otherwise specified;

**(h)** All words used shall be construed to be of such gender or number as the circumstances and context require;

**(i)** The captions and headings of articles and sections appearing in the Plan have been inserted solely for convenience of reference and shall not be considered a part of the Plan, nor shall any of them affect the meaning or interpretation of the Plan or any of its provisions;

**(j)** Any reference to an agreement, plan, policy, form, document or set of documents, and the rights and obligations of the parties under any such agreement, plan, policy, form, document or set of documents, shall mean such agreement, plan, policy, form, document or set of documents as amended from time to time, and any and all modifications, extensions, renewals, substitutions or replacements thereof; and

**(k)** All accounting terms not specifically defined in the Plan shall be construed in accordance with GAAP.

Exhibit 31.1

I, David M. Findlay, Chief Executive Officer of Lakeland Financial Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lakeland Financial Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose 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 that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting, and;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) All significant deficiencies and material weaknesses in the design or operation of internal controls 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: October 27, 2021

/s/ David M. Findlay
David M. Findlay
Chief Executive Officer

Exhibit 31.2

I, Lisa M. O’Neill, Chief Financial Officer of Lakeland Financial Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lakeland Financial Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose 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 that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting, and;

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent function):

   a. All significant deficiencies and material weaknesses in the design or operation of internal controls 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: October 27, 2021

/s/ Lisa M. O’Neill
Lisa M. O’Neill
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Lakeland Financial Corporation (the “Company”) on Form 10-Q for the period ending September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, David M. Findlay, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report 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 the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ David M. Findlay
David M. Findlay
Chief Executive Officer
October 27, 2021

A signed original of this written statement required by Section 906 has been provided to Lakeland Financial Corporation and will be retained by Lakeland Financial Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Lakeland Financial Corporation (the “Company”) on Form 10-Q for the period ending September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Lisa M. O’Neill, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report 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 the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Lisa M. O’Neill
Lisa M. O’Neill
Chief Financial Officer
October 27, 2021

A signed original of this written statement required by Section 906 has been provided to Lakeland Financial Corporation and will be retained by Lakeland Financial Corporation and furnished to the Securities and Exchange Commission or its staff upon request.