AMERICAN RIVIERA BANK

2022 Annual Report

AMERICAN RIVIERA BANCORP

A Message to our Shareholders, Clients, and Community

We are pleased to report that American Riviera Bancorp reported record net income of $13.5 million ($2.38 per share) for 2022. Strong earnings were primarily attributable to steady loan growth and increased interest income on liquid assets in a rising rate environment. Our return on average assets was 1.00%, return on average equity was 15.81%, and we issued a 10% stock dividend to shareholders in November 2022. We are thankful to our loyal clients for making all this possible!

For the twelfth year in a row, the Bank achieved double-digit loan growth. Loans increased $114 million or 14% in 2022, without sacrificing credit quality. As of December 31, 2022, the Bank had no other real estate owned, no loans 90 days or more past due, and only $3.1 million or 0.34% of total loans on non-accrual status. Our ability to deliver the full complement of construction loans, mortgages, home equity lines, commercial real estate loans, business loans and lines of credit, agricultural loans, and SBA loans ensures that we can meet the diverse needs of our clients on the Central Coast of California.

Total deposits rose steadily until very late in the year when we saw a shift in rate sensitive deposit behavior brought on by the Federal Reserve's rapid and sizeable rate increases. Some clients chose to move excess funds out of the banking system into US Treasury securities and brokerage-based money market funds which are not FDIC insured to obtain more yield. As a result, our total deposits decreased modestly by $39 million or 3% from December 31, 2021, while remaining $291 million or 33% higher than total deposits as of December 31, 2020. Demand deposit accounts represent 56% and non-interest-bearing demand deposits represent 41%, respectively of total deposits as of December 31, 2022. The high percentage of checking account balances is indicative of our relationship-oriented deposit base which adds to franchise value and is meaningful to maintaining margins in a rising rate environment.

American Riviera Bank maintains robust and diverse sources of liquidity, ensuring access to our client's deposits and supporting community loan demand. Our $1.16 billion deposit base is comprised of a mix of personal and business accounts reflective of the diversity of our Central Coast community. We have no meaningful exposure to large, interconnected depositors, and have no venture lending or cryptocurrency exposure. As of December 31, 2022, American Riviera Bank had a loan to deposit ratio of 78% with $223 million in available-for-sale securities, $62 million in cash and deposits at other banks on our balance sheet, no brokered deposits, and over $350 million in unused borrowing capacity with the Federal Home Loan Bank, Federal Reserve and our correspondent banks.

Early in the year, we completed the formation of American Riviera Bancorp with American Riviera Bank as its wholly owned subsidiary. Our Bancorp assumed the Bank's former ticker symbol (OTCQX: ARBV) and our shareholder base from the Bank are now shareholders of the Bancorp. This holding company structure increases financial flexibility, and our Bancorp took advantage of the low-rate environment at that time to lock in $18 million of long-term subordinated notes at a rate of 3.75% with any proceeds contributed to the Bank receiving equity capital treatment. Healthy earnings have been retained to support current and future growth, with American Riviera Bank holding Common Equity Tier I Capital of $123 million or 11.9%, and Total Capital of $134 million or 13.0%, as of December 31, 2022, which exceeds regulatory guidelines for well capitalized institutions.

As we complete this letter in early 2023, we are also excited to share with you that we just opened a new office in Santa Maria. Our relationship focus will allow us to serve the growing needs of the Santa Maria Valley and further connect our Central Coast footprint. We are thankful for the loyalty of our clients and our team of dedicated bankers, who make **American Riviera Bank the Central Coast's community bank**!

Thank you for your support,

Lawrence Koppelman, Board Chair

Jeff DeVine, President and CEO

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AMERICAN RIVIERA
BANCORP

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2022 AND 2021
AND FOR THE YEARS THEN ENDED

Page

American Riviera Bancorp and American Riviera Bank:

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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
American Riviera Bancorp
Santa Barbara, California

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of American Riviera Bancorp, which comprise the consolidated balance sheets as of December 31, 2022 and 2021, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

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

We also have audited, in accordance with auditing standards generally accepted in the United States of America, American Riviera Bancorp's internal control over financial reporting as of December 31, 2022, based on criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 15, 2023 expressed an unmodified opinion.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of American Riviera Bancorp and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, American Riviera Bancorp completed a one-for-one share exchange of common stock with American Riviera Bank, effected in the form of an internal reorganization as of February 2022. Our opinion is not modified with respect to this matter.

(Continued)

Responsibilities of Management for the Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about American Riviera Bancorp's ability to continue as a going concern for one year from the date the consolidated financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about American Riviera Bancorp's ability to continue as a going concern for a reasonable period of time.

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

Crowe LLP

Crowe LLP

Sacramento, California
March 15, 2023

AMERICAN RIVIERA BANCORP AND AMERICAN RIVIERA BANK

CONSOLIDATED BALANCE SHEETS

December 31, 2022 and 2021
(Dollar amounts in thousands except share amounts)

	2022	2021
ASSETS		
Cash and due from banks	$ 12,096	$ 8,184
Interest-bearing deposits in other financial institutions	49,704	283,927
Available-for-sale investment securities	223,189	191,423
Held-to-maturity investment securities ($38,568 fair value)	41,293	-
Equity securities	92	120
Loans	907,685	793,490
Allowance for loan losses	(10,626)	(9,383)
Net Loans	897,059	784,107
Premises and equipment, net	5,752	5,916
Operating lease right-of-use asset	6,595	4,513
Cash surrender value of bank owned life insurance	9,863	8,641
Stock in other banks	5,300	4,288
Goodwill	4,800	4,800
Other intangibles, net	147	179
Accrued interest receivable and other assets	26,678	10,442
Total Assets	$ 1,282,568	$ 1,306,540
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing demand deposits	$ 478,519	$ 470,763
Interest-bearing demand deposits	176,088	181,546
Savings deposits	78,171	87,139
Money market deposits	377,911	433,416
Time deposits	52,839	29,226
Total Deposits	1,163,528	1,202,090
Subordinated notes	18,000	-
Operating lease liability	7,069	4,972
Accrued interest payable and other liabilities	6,875	3,205
Total Liabilities	1,195,472	1,210,267
Shareholders' Equity:		
Preferred stock - no par value; 10,000,000 and 5,000,000 shares as of 2022 and 2021, respectively authorized, none issued	-	-
Common stock - no par value; 50,000,000 and 10,000,000 shares authorized as of 2022 and 2021, respectively; 5,692,161 and 5,134,993 shares issued and outstanding in 2022 and 2021, respectively	66,346	56,564
Retained earnings	44,672	40,432
Accumulated other comprehensive (loss), net of taxes	(23,922)	(723)
Total Shareholders' Equity	$ 87,096	$ 96,273
Total Liabilities and Shareholders' Equity	$ 1,282,568	$ 1,306,540

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

AMERICAN RIVIERA BANCORP AND AMERICAN RIVIERA BANK

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2022 and 2021
(Dollar amounts in thousands except per share data)

	2022	2021
Interest income:		
Interest and fees on loans	$ 40,517	$ 37,972
Interest on investment securities	5,212	1,674
Interest on Federal funds sold	17	-
Interest on deposits in other financial institutions	3,032	391
Total interest income	48,778	40,037
Interest expense:		
Interest on interest-bearing demand deposits	107	86
Interest on savings deposits	101	64
Interest on money market deposits	1,058	698
Interest on time deposits	96	100
Total interest expense on deposits	1,362	948
Interest expense on borrowings	570	-
Total interest expense	1,932	948
Net interest income before provision for loan losses	46,846	39,089
Provision for loan losses	1,147	338
Net interest income after provision for loan losses	45,699	38,751
Non-interest income		
Service charges, commissions, and fees	2,855	2,511
Broker fees	48	620
(Loss) gain on sale of investment securities	(89)	8
Gain on sale of loans	533	446
Total non-interest income	3,347	3,585
Non-interest expense		
Salaries and employee benefits	18,300	16,007
Occupancy and equipment	3,155	2,872
Other non-interest expense	8,834	7,082
Total non-interest expense	30,289	25,961
Income before provision for taxes	18,757	16,375
Provision for taxes	5,263	4,546
Net Income	$ 13,494	$ 11,829
Earnings per share, basic and diluted	$ 2.38	$ 2.09

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

AMERICAN RIVIERA BANCORP AND AMERICAN RIVIERA BANK

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2022 and 2021
(Dollar amounts in thousands)

	2022	2021
Net income	$ 13,494	$ 11,829
Other comprehensive (loss):		
Change in debt securities available-for-sale:		
Unrealized holding (losses) arising during the period	(33,299)	(1,848)
Reclassification of the unrealized loss at the time of transfer to held-to-maturity	7,037	-
Income tax effect	7,763	547
Unrealized (losses) on available-for-sale debt securities	(18,499)	(1,301)
Change in debt securities held-to-maturity:		
Unrealized loss of on securities on transfer from available-for-sale	(7,037)	-
Amortization of unrealized losses on securities transferred from available-for-sale	365	-
Income tax effect	1,972	-
Changes from securities held-to-maturity	(4,700)	-
Total other comprehensive (loss)	(23,199)	(1,301)
Comprehensive (loss) income	$ (9,705)	$ 10,528

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

AMERICAN RIVIERA BANCORP AND AMERICAN RIVIERA BANK

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2022 and 2021
(Dollar amounts in thousands except share amounts)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (loss) (Net of taxes)	Total Shareholders' Equity
	Shares	Amount			
Balance, January 1, 2020	5,083,648	$ 55,738	$ 28,603	$ 578	$ 84,919
Net income			11,829		11,829
Other comprehensive (loss)				(1,301)	(1,301)
Exercise of stock options, net shares issued	11,730	105			105
Restricted stock awards granted	63,485				
Restricted stock awards forfeited	(13,667)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(10,203)	(150)			(150)
Share-based compensation expense		871			871
Balance, December 31, 2021	5,134,993	$ 56,564	$ 40,432	$ (723)	$ 96,273
Net income			13,494		13,494
Other comprehensive (loss)				(23,199)	(23,199)
Restricted stock awards granted	69,949				-
Restricted stock awards forfeited	(9,908)				-
Shares surrendered:					
To pay taxes on vesting of restricted stock	(16,544)	(344)			(344)
Share-based compensation expense		1,020			1,020
10% stock dividend, fractional shares paid in cash	513,671	9,106	(9,254)		(148)
Balance, December 31, 2022	5,692,161	$ 66,346	$ 44,672	$ (23,922)	$ 87,096

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

AMERICAN RIVIERA BANCORP AND AMERICAN RIVIERA BANK

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2022 and 2021
(Dollar amounts in thousands)

	2022	2021
Cash flows from operating activities:		
Net income	$ 13,494	$ 11,829
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,147	338
Depreciation and amortization	1,216	1,600
Change in cash surrender value of BOLI	(222)	(225)
Deferred income tax benefit	(733)	(722)
(Decrease) in deferred loan origination fees, net of costs	(855)	(274)
Net amortization of investment security premiums and discounts	1,531	1,216
Net realized loss (gain) on sales of investment securities	89	(8)
Net loss on sale of disposed assets	3	-
Net gain on sale of loans	(533)	(446)
Share-based compensation expense	1,020	871
Loss (gain) on equity securities	28	(55)
Lessee improvement allowances	-	(49)
Increase in accrued interest receivable and other assets	(6,312)	(1,575)
Increase (decrease) in accrued interest payable and other liabilities	3,669	81
Net cash provided by operating activities	13,542	12,581
Cash flows from investing activities:		
Change in interest-bearing deposits in other financial institutions	234,223	(162,843)
Increase in loans, net	(112,716)	(66,064)
Proceeds from principal payments of available-for-sale investment securities	17,979	13,868
Purchase of available-for-sale investment securities	(129,482)	(126,429)
Sales of available-for-sale investment securities	3,890	3,996
Calls and maturities of available-for-sale investment securities	-	1,011
Purchase of Federal Home Loan Bank stock	(1,012)	(913)
Purchase of BOLI	(1,000)	-
Purchase of premises and equipment	(605)	(563)
Net cash provided by (used) in investing activities	11,277	(337,936)
Cash flows from financing activities:		
Increase (decrease) in demand, interest bearing and savings deposits, net	(62,175)	338,355
Increase (decrease) in time deposits, net	23,612	(8,418)
Increase (decrease) in borrowings, net	18,000	(5,000)
Restricted shares surrendered to pay taxes	(344)	(150)
Proceeds from exercise of stock options, including tax benefit	-	105
Net cash (used) provided by financing activities	(20,907)	324,892
(Increase) decrease in cash and cash equivalents	3,912	(463)
Cash and cash equivalents at beginning of year	8,184	8,647
Cash and cash equivalents at end of year	$ 12,096	$ 8,184
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest expense	$ 1,643	$ 1,105
Income taxes	$ 3,625	$ 4,885

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

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The consolidated financial statements include American Riviera Bancorp and its wholly owned subsidiary, American Riviera Bank ("the Bank"), together referred to as "the Company". American Riviera Bancorp (the "Bancorp") completed a one-for-one share exchange of common stock with the Bank, effected in the form of an internal reorganization as of February 2022. Intercompany transactions and balances are eliminated in consolidation.

American Riviera Bancorp (OTCQX: ARBV) is a registered bank holding company headquartered in Santa Barbara, California. American Riviera Bank, the 100% owned subsidiary of the Bancorp, is a full-service community bank focused on serving the lending and deposit needs of businesses and consumers on the Central Coast of California. The state-chartered bank opened for business on July 18, 2006, with the support of local shareholders. Full-service branches are located in Santa Barbara, Montecito, Goleta, San Luis Obispo, Santa Maria, and Paso Robles. The Bank provides commercial business, commercial real estate, residential mortgage, construction, and Small Business Administration lending services, as well as convenient online and mobile technology.

The Bancorp is subject to regulation by the Federal Reserve Bank of San Francisco ("FRB"). As a state-chartered non-member bank, the Bank is subject to regulation by the California Department of Financial Protection and Innovation ("DFPI"), and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits.

Effective January 1, 2016, the Bank and The Bank of Santa Barbara ("BSB"), headquartered in Santa Barbara, California, completed a merger under which BSB, with one full-service office in Santa Barbara and one in Goleta, merged with and into the Bank, in an all-stock transaction.

The accounting and reporting policies of the Company and the Bank conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Subsequent Events

No material subsequent events have occurred from December 31, 2022, through March 15, 2023, the date the financial statements were available to be issued.

Use of Estimates

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Cash Flows

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks with maturities less than 90 days, and Federal funds sold. Generally, Federal funds are sold for one day periods. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds sold and purchased.

Interest-Bearing Deposits in Other Financial Institutions

Interest-bearing deposits in other financial institutions represent short term deposits with other banks with original maturities of 90 days or greater.

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale ("AFS") securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income within shareholders' equity.
- Held-to-maturity ("HTM") securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value.

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. In addition, unrealized losses that are other-than-temporary are recognized as a charge to earnings for all investments.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on, at least, a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investment Securities *(continued)*

is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Company will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Loans

All classes of loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. Interest income on construction, real estate-commercial, real estate-residential and commercial loans is discontinued, and the loan is moved to non-accrual status at the time the loan is ninety days delinquent, unless the loan is well-secured and in process of collection in accordance with the Company's policy. Consumer and other loans are typically charged off no later than ninety days past due. For all classes of loans, past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of interest or principal is considered doubtful.

All interest accrued but not received for a loan placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Under the cost recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash -basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, future payments are reasonably assured, and payments are maintained current for a minimum of six months.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment

of yield using the level-yield method without anticipating prepayments, to be amortized to interest income over the contractual term of the loan. In certain circumstances, the Company may accelerate amortization on premiums paid for purchased loans when prepayments are likely prior to the contractual term. The unamortized balance of deferred fees and costs is reported as a component of net loans.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Purchase Credit Impaired Loans

The Company has loans that were acquired in an acquisition, for which there was, at acquisition, evidence of deterioration of credit quality since origination and for which it was probable, at acquisition, that all contractually required payments would not be collected. These purchased credit impaired loans are recorded at the amount paid, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses. The Company estimates the amount and timing of expected cash flows for each loan and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses

The allowance for loan losses (the "allowance") is a valuation allowance for probable incurred credit losses. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

For all classes of loans, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans determined to be impaired are individually evaluated for impairment. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's original contractual interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely through the sale or operation of the collateral.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Allowance for Loan Losses *(continued)*

A restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, to include, but not limited to, consideration of actual historical losses based on the previous forty quarters' average; historical losses of the Bank's peers based on the previous forty quarters' average, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio as a whole.

The Company determines a separate allowance for each portfolio segment defined by FFIEC call report code instructions. These portfolio segments include loans secured by real estate, loans to finance agricultural production, commercial and industrial loans, and loans to individuals. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Company's overall allowance, which is included in the balance sheets and available for all loss exposures.

The Company assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed reviews of all individual loans or aggregated loan relationships with commitments of $750,000 or more, to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Bank's regulators. During the Company's internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the estimated fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

> **Pass** – A Pass loan represents a credit that satisfactorily meets all of the Company's underwriting criteria and provides adequate protection for the Company through the paying capacity of the borrower and/or the margin (value) and marketability (liquidity) of the collateral.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Allowance for Loan Losses *(continued)*

Special Mention - A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special Mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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

Doubtful - A Doubtful loan has all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable.

Loss - A Loss loan is considered uncollectable and charged off immediately.

The general reserve component of the allowance for loan losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Commercial – Commercial and industrial loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Secured by real estate – Adverse economic developments, or an overbuilt market, impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Allowance for Loan Losses *(continued)*

Construction and land loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and timelines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Loans to individuals – Consumer loans are comprised of loans to individuals, including installment loans, revolving lines of credit and term loans. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions, and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, the FDIC and the DFPI, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Reserve for Off-Balance Sheet Credit Exposures

The Company also maintains a separate reserve for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The reserve for off-balance sheet commitments is included in accrued interest payable and other liabilities on the balance sheet.

Servicing Rights

When loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. Servicing assets related to Small Business Administration ("SBA") loans are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Servicing Rights *(continued)*

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income.

Changes in valuation allowances are reported in non-interest income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

At this time, the Company believes that all servicing fees received related to residential mortgage loans are at a value equal to the cost incurred to service. As such, there are no residential mortgage servicing right assets on the balance sheet and all servicing fee income related to residential mortgage loans, which is reported on the income statement as Service Charges, Commissions and Fees, is based on a contractual percentage of the outstanding principal and is recorded as income when received.

Servicing fees totaled $0.3 million and $0.2 million for the years ended December 31, 2022 and 2021, respectively. Late fees and ancillary fees related to loan servicing are not material.

Premises and Equipment

Company premises and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures, and equipment are estimated to be three to seven years. Leasehold improvements are amortized over the lesser of the respective lease term (including renewal periods that are reasonably assured), or their useful lives.

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Company evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Leases

Certain operating leases contain scheduled and specified rent increases or incentives in the form of tenant improvement allowances or credits. The scheduled rent increases are recognized on a straight-line basis over the lease term as an increase in the amount of rental expense recognized each period. Lease incentives reduce the right-of-use asset at the inception of the lease and are amortized on a straight-line basis over the lease term as a reduction of rental expense. Amounts accrued in excess of amounts paid related to the scheduled rent increases and the unamortized deferred leasehold improvement credits are included in operating right-of-use asset and operating lease liability on the balance sheet.

Other Real Estate Owned

Other real estate owned (“OREO”) is comprised of property acquired through foreclosure proceedings or acceptance of deeds-in-lieu of foreclosure. Losses recognized at the time of acquiring property in full or partial satisfaction of loans are charged against the allowance for loan losses. OREO is initially recorded at fair value less estimated disposition costs. Fair value of OREO is generally based on an independent appraisal of the property. Subsequent to initial measurement, OREO is carried at the lower of the recorded investment or fair value less costs to sell. Revenues and expenses associated with OREO, and subsequent adjustment to the fair value of the property and to the estimated costs of disposal, are realized and reported as a component of non-interest expense when incurred.

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (“FHLB”) system, the Bank is required to maintain an investment in the capital stock of the FHLB. The level of investment varies based on the amount of borrowings and other factors. The investment is carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Investment in The Independent Bankers Bank Stock

The Bank maintains an investment in the capital stock of The Independent Bankers Bank (“TIB”) a correspondent bank that provides certain services to the Bank. The investment is carried at cost and is periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Investment in Farmer Mac Stock

The Bank maintains an investment in the capital stock of Farmer Mac. The Bank is required to maintain an investment with Farmer Mac in order to conduct ongoing transactions with the agency. The investment is carried at fair value based on quoted market prices with changes in fair value recognized in net income. Cash dividends are reported as income.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance ("BOLI") is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2022 and 2021 represents the excess of the cost of the acquired bank over the net of the amounts assigned to assets acquired and liabilities assumed in the transaction accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

The Company has selected October 31 as the date to perform the annual impairment test. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment. Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2022, so goodwill was not required to be retested. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

Intangible Assets

The intangible assets at December 31, 2022, and 2021, represent the estimated fair value of the core deposit relationships acquired in the acquisition of BSB. Core deposit intangibles are being amortized using a method that approximates the effective interest method over an estimated life of seven years from the date of acquisition. As of December 31, 2022, the remaining unamortized value was zero.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed, and a valuation allowance is recorded if it is

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income Taxes *(continued)*

"more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon our analysis of available evidence, we have determined that all of our deferred income tax assets as of December 31, 2022 and 2021, were more likely than not to be fully realized, therefore no valuation allowance was recorded.

Accounting for Uncertainty in Income Taxes

We use a comprehensive model for recognizing, measuring, presenting, and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the statements of income.

Earnings Per Share

Basic earnings per share ("EPS"), which excludes dilution, is computed by dividing net income by the weighted-average number of common shares outstanding for the period.

Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and unvested restricted stock awards, result in the issuance of common stock which share in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options and unvested restricted stock in computing diluted earnings per share.

Share-Based Payments

The Company records compensation cost for all share-based payments based on the estimated fair value of the options or the restricted stock on the grant date.

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on the historical volatility of the Company's common stock over a preceding period commensurate with the expected term of the option. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. Expected dividend yield was not considered in the option pricing formula since the Company has not paid cash dividends to date. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Share-Based Payments *(continued)*

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Restricted stock awards are grants of shares of the Company's common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or service and/or achieving specified performance goals. During the period of restriction, restricted share awards have voting and cash dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors as reflected in each award agreement. Restricted stock awards which vest based on continuing employment are included in common shares outstanding.

Upon the exercise of stock options or the grant of each restricted stock award, the Company issues the associated common shares from its inventory of authorized common shares. The shares associated with any awards that are forfeited or fail to vest become available for re-issuance. All outstanding awards immediately vest in the event of a change of control of the Company as defined in each award agreement.

Comprehensive Income

Comprehensive income includes net income and unrealized gains and losses on available-for-sale investment securities which are also recognized as a separate component of shareholders' equity. In 2022, comprehensive income also includes the unrealized losses and amortization of unrealized losses on securities that were transferred from AFS to HTM.

Equity

Stock dividends in excess of 20% are reported by transferring the par value of the stock issued from retained earnings to common stock. Stock dividends for 20% or less are reported by transferring the fair value, as of the ex-dividend date, of the stock issued from retained earnings to common stock and additional paid-in capital. Fractional share amounts are paid in cash with a reduction in retained earnings.

Retirement Plans

Employee 401(k) and profit-sharing plan expense represents the amount of matching and discretionary contributions.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Footnote 2. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for such

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Fair Value of Financial Instruments *(continued)*

instruments. Changes in assumptions or in market conditions could significantly affect these estimates.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable, and an amount

or range of loss can be reasonably estimated. Management does not believe there are such matters at this time that will have a material effect on the financial statements.

Reclassifications

There were no reclassifications in the current year, nor prior year, for presentation purposes.

New Accounting Standards That Have Not Yet Been Adopted

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326)
In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance. The standard will be effective for the December 31, 2023, annual financial statements. The Bank's Directors Loan Committee is responsible for the oversight of CECL implementation. Vendor due diligence and selection was performed, data assessments were performed, and historical data has been utilized to run various models accepted under the new standard. The Bank Company expects to recognize a one-time cumulative effect adjustment to the allowance for credit losses as of the beginning of January 1, 2023. The Company expects the adoption may result in a material increase to the allowance for credit losses balance; however, at this time, the impact is being determined and evaluated.

2. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

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 market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include management judgment and estimation, which may be significant.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities, or total earnings.

The methods and assumptions used to estimate fair values are described as follows:

(a) Cash and Cash Equivalents

The carrying amounts of cash, due from banks and Federal funds sold approximate fair values and are classified as either Level 1 or Level 2.

(b) Interest-bearing Deposits in Other Financial Institutions

Fair values for interest-bearing deposits in other financial institutions are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the Company for deposits with similar remaining maturities, resulting in a Level 2 classification.

(c) Investment Securities

Fair values for investment securities are based on quoted market prices for similar securities using matrix pricing, resulting in a Level 2 classification.

(d) Loans

Fair values of loans are based on the exit price and estimated using discounted cash flow analyses. The estimation of fair values of loans results in a Level 3 classification as it requires various assumptions and considerable judgement to incorporate factors relevant when selling loans to market participants, including assumptions related to market interest rates and expected credit losses.

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

(e) Equity Securities

Fair values of equity securities are based on quoted market prices, resulting in a Level 1 classification.

(f) Deposits

The fair values disclosed for demand deposits (e.g., interest and non-interest checking), passbook savings, and certain types of money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

(g) Borrowings

The carrying amounts of Federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

(h) Other Borrowings

The fair values of the Company’s long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

(i) Accrued Interest Receivable/Payable

The carrying amounts of accrued interest receivable and payable are based on the fair value hierarchy of the related asset or liability.

(j) Off-balance Sheet Instruments

Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties’ credit standing. The fair value of commitments is not material.

2. FAIR VALUE MEASUREMENTS *(continued)*

<u>Fair Value Hierarchy *(continued)*</u>

The estimated carrying and fair values of the Company's financial instruments at December 31, 2022, and 2021 are as follows *(Dollars in thousands)*:

	2022				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 12,096	$ 12,096	$ -	$ -	$ 12,096
Interest-bearing deposits in other financial institutions	49,704	-	49,572	-	49,572
Investment securities available-for-sale	223,189		223,189		223,189
Investment securities held-to-maturity	41,293	-	38,569		38,569
Equity securities	92	92	-	-	92
Loans, net	897,059	-	-	834,967	834,967
Accrued interest receivable	5,371	-	1,802	3,569	5,371
Financial liabilities:					
Deposits	$ 1,163,528	$ -	$ 959,362	$ -	$ 959,362
Accrued interest payable	91	-	91	-	91
Subordinated debt	18,000	-	15,359		15,359

	2021				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 8,184	$ 8,184	$ -	$ -	$ 8,184
Interest-bearing deposits in other financial institutions	283,927	-	283,922	-	283,922
Investment securities available-for-sale	191,423	-	191,423	-	191,423
Equity securities	120	120	-	-	120
Loans, net	784,107	-	-	784,073	784,073
Accrued interest receivable	4,087	-	1,052	3,035	4,087
Financial liabilities:					
Deposits	$ 1,202,090	$ -	$ 1,109,413	$ -	$ 1,109,413
Accrued interest payable	28	-	28	-	28

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

The estimated fair values do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Assets and Liabilities Recorded at Fair Value

There were no changes in the valuation techniques used during 2022. The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2022, and 2021:

Recurring Basis

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2022, and 2021 *(Dollars in thousands):*

	2022			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 34,515	$ -	$ 34,515	$ -
State and political subdivision	39,277	-	39,277	-
Residential mortgage-backed securities	138,220	-	138,220	-
Corporate debt	11,177	-	11,177	-
Equity Securities	92	-	92	-
Total assets measured at fair value on a recurring basis	$ 223,281	$ -	$ 223,281	$ -

	2021			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 28,326	$ -	$ 28,326	$ -
State and political subdivision	67,304	-	67,304	-
Residential mortgage-backed securities	86,885	-	86,885	-
Corporate debt	8,908	-	8,908	-
Equity Securities	120	-	120	-
Total assets measured at fair value on a recurring basis	$ 191,543	$ -	$ 191,543	$ -

During the years ended December 31, 2022, and 2021, there were no transfers in or out of Levels 1 or 2.

2. FAIR VALUE MEASUREMENTS *(continued)*

Non-recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis.

These include assets that are measured at the lower of cost or fair value that were recognized at fair value, which was below cost as of December 31, 2022 and 2021 *(Dollars in thousands):*

	2022				
Description	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans					
Commercial	$ 16	$ -	$ -	$ 16	$ (555)
Consumer and other	-	-	-	-	3
Total impaired loans	16	-	-	16	(552)
Total assets measured at fair value on a non-recurring basis	$ 16	$ -	$ -	$ 16	$ (552)

	2021				
Description	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans					
Commercial	$ 8	$ -	$ -	$ 8	$ 5
Consumer and other	-	-	-	-	4
Total impaired loans	8	-	-	8	9
Total assets measured at fair value on a non-recurring basis	$ 8	$ -	$ -	$ 8	$ 9

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $604,000, with a valuation allowance of $588,000 at December 31, 2022, resulting in $588,000 of additional provision for loan losses for the year ended December 31, 2022. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $44,000, with a valuation allowance of $36,000 at December 31, 2021, resulting in $36,000 of additional provision for loan losses for the year ended December 31, 2021.

2. FAIR VALUE MEASUREMENTS *(continued)*

<u>Non-recurring Basis *(continued)*</u>

The fair value of collateral dependent impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are often significant and result in a Level 3 classification of the inputs for determining fair value. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method is not considered a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate.

Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or account receivable aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Non-real estate impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other real estate owned ("OREO") is measured at fair value, less estimated costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are often significant and result in a Level 3 classification of the inputs for determining fair value. OREO properties are evaluated on a semi-annual basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the appraisal management group engaged by the Company. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Both collateral-dependent impaired loans and OREO which are not in escrow are appraised every six months to ensure a fair market value is being used to calculate possible collateral shortfalls. For those properties in escrow the Company uses the contract price less actual cost of sale as that price is determined to be market value.

The Company had no OREO as of December 31, 2022 and 2021. There were no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2022 and 2021.

3. INVESTMENT SECURITIES

During the third quarter of 2022, $43.0 million of the Company's AFS securities were moved to HTM classification to protect the Company from further decline in mark-to-market value if rates continue to rise. The transfer occurred at fair value. The related unrealized loss of $7.0 million included in other comprehensive income remained in other comprehensive income, to be amortized out of other comprehensive income with an offsetting entry to interest income as a yield adjustment through earnings over the remaining term of the securities. No gain or loss was recorded at the time of transfer.

The amortized cost and estimated fair value of investment securities at December 31, 2022 and 2021 consisted of the following *(Dollars in thousands)*:

	2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available for Sale				
U.S. government agencies mortgage-backed securities	$ 24,030	$ 11	$ (1,432)	$ 22,609
State and political subdivision	56,792	110	(5,719)	51,183
Residential mortgage-backed securities	156,952	30	(18,761)	138,221
Corporate Debt	12,704	-	(1,528)	11,176
Total Available for Sale	$ 250,478	$ 151	$ (27,440)	$ 223,189
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value
Securities Held to Maturity				
U.S. government agencies mortgage-backed securities	$ -	$ -	$ -	$ -
State and political subdivision	38,753	-	(2,407)	36,346
Residential mortgage-backed securities	2,541	-	(318)	2,223
Corporate Debt	-	-	-	-
Total Held to Maturity	41,294	-	(2,725)	38,569
Total Investment Securities	**$ 291,772**	**$ 151**	**$ (30,165)**	**$ 261,758**

3. INVESTMENT SECURITIES *(continued)*

	2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available for Sale				
U.S. government agencies mortgage-backed securities	$ 28,389	$ 15	$ (123)	$ 28,281
State and political subdivision	66,737	889	(277)	67,349
Residential mortgage-backed securities	88,364	71	(1,551)	86,884
Corporate Debt	8,960	9	(60)	8,909
Total Available for Sale	$ 192,450	$ 984	$ (2,011)	$ 191,423

Net unrealized losses on investment securities totaling $33.3 million were recorded net of tax for $23.2 million as accumulated other comprehensive income within shareholders' equity at December 31, 2022. Net unrealized losses on investment securities totaling $1.0 million were recorded net of tax for $0.7 million as accumulated other comprehensive income within shareholders' equity at December 31, 2021.

The following table summarizes the securities sold and called for the year ended December 31, 2022 and 2021 *(Dollars in thousands)*:

	2022		
	Proceeds	Gross Gains	Gross Losses
Sales	$ 3,890	$ -	$ (89)
Calls	-	-	-
Total	$ 3,890	$ -	$ (89)

	2021		
	Proceeds	Gross Gains	Gross Losses
Sales	$ 3,996	$ 9	$ (1)
Calls	1,011	-	-
Total	$ 5,007	$ 9	$ (1)

3. INVESTMENT SECURITIES (continued)

The following tables summarize securities with unrealized and unrecognized losses at December 31, 2022, and December 31, 2021, aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position *(Dollars in thousands):*

	2022					
	Less Than 12 Months		12 months of Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available for Sale						
U.S. government agencies	$ 11,573	$ (417)	$ 8,947	$ (1,015)	$ 20,520	$ (1,432)
State and Political Subdivision	22,773	(1,555)	22,960	(4,164)	45,733	(5,719)
Residential Mortgage-backed securities	76,286	(5,142)	58,271	(13,619)	134,557	(18,761)
Corporate Debt	4,989	(761)	6,187	(767)	11,176	(1,528)
Total Available for Sale	$ 115,621	$ (7,875)	$ 96,365	$ (19,565)	$ 211,986	$ (27,440)
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Securities Held to Maturity						
U.S. government agencies	$ -	$ -	$ -	$ -	$ -	$ -
State and Political Subdivision	7,423	(343)	28,923	(2,064)	36,346	(2,407)
Residential Mortgage-backed securities	-	-	2,223	(318)	2,223	(318)
Corporate Debt	-	-	-	-	-	-
Total Held to Maturity	$ 7,423	$ (343)	$ 31,146	$ (2,383)	$ 38,569	$ (2,725)
Total Investment Securities	$ 123,044	$ (8,218)	$ 127,511	$ (21,947)	$ 250,555	$ (30,165)

	2021					
	Less Than 12 Months		12 months of Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available for Sale						
U.S. government agencies	$ 6,918	$ (68)	$ 5,889	$ (55)	$ 12,807	$ (123)
State and Political Subdivision	27,106	(225)	4,204	(52)	31,310	(277)
Residential Mortgage-backed securities	67,195	(1,018)	17,360	(533)	84,555	(1,551)
Corporate Debt	4,912	(38)	1,987	(22)	6,899	(60)
Total Available for Sale	$ 106,131	$ (1,349)	$ 29,440	$ (662)	$ 135,571	$ (2,011)

3. INVESTMENT SECURITIES *(continued)*

Unrealized losses on all securities have not been recognized into income because the issuer's securities are of high credit quality, management does not intend to sell, it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates

and other market conditions. The fair value is expected to recover as the bonds approach maturity. The Company has adequate liquidity and the ability and intent to hold these securities to maturity, resulting in full recovery of the indicated impairment. Accordingly, none of the unrealized losses on the securities have been determined to be other than temporary.

As of December 31, 2022, the Company's security portfolio consisted of 200 securities, 189 of which were in an unrealized loss position. At December 31, 2022, 98% of the mortgage-backed securities held by the Company were issued by U.S. government-sponsored entities and agencies. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities and it is likely that is will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired ("OTTI") at December 31, 2022.

The Company's mortgage-backed securities portfolio includes non-agency collateralized mortgage obligations with a fair value of $4.0 million which had unrealized losses of approximately $605,0000 at December 31, 2022. These non-agency mortgage-backed securities were rated AAA at purchase. The Company believes there is no OTTI and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The issuers continue to make timely principal and interest payments on the bonds.

The Company's debt securities portfolio includes 65 municipal securities with a market value of $82.1 million which had unrealized or unrecognized losses of $8.1 million at December 31, 2022. The Company monitors certain credit characteristics of each municipal security issuer as necessary, and these issuers appear to be able to service all outstanding debt. The Company believes there is no OTTI and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

The Company's corporate debt securities portfolio includes 10 securities with a market value of $11.2 million which had unrealized losses of $1.5 million at December 31, 2022. The Company monitors certain credit characteristics of each corporate issuer on a quarterly basis and these issuers appear to be able to service all outstanding debt. The Company believes there is no OTTI and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

3. INVESTMENT SECURITIES *(continued)*

The amortized cost and estimated fair value of investment securities at December 31, 2022 and 2021 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately *(Dollars in thousands):*

	2022		2021	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Securities available-for-sale				
Due in one year or less	$ -	$ -	$ -	$ -
After one through five years	38,875	37,270	2,510	2,482
After five years through ten years	43,640	39,960	991	978
After ten years	11,011	7,739	4,200	6,214
Residential Mortgage-backed securities	156,952	138,220	88,364	86,884
Total	250,478	223,189	96,065	96,558
Securities held-to-maturity				
Due in one year or less	$ -	$ -	$ -	$ -
After one year through five years	-	-	-	-
After five years through ten years	-	-	-	-
After ten years	38,753	36,346	-	-
Residential Mortgage-backed securities	2,541	2,223	-	-
Total	41,294	38,569	-	-
Total	$ 291,772	$ 261,758	$ 96,065	$ 96,558

4. LOANS

Outstanding loans at December 31, 2022 and 2021 are summarized below *(Dollars in thousands)*:

	2022	2021
Commercial	$ 89,423	$ 133,830
Real estate – commercial	607,565	504,986
Real estate – residential	169,214	126,577
Construction	43,020	29,981
Consumer and other	193	701
Total gross loans	909,415	796,075
Deferred loan origination fees, net of costs	(1,730)	(2,585)
Allowance for loan losses	(10,626)	(9,383)
Loans, net	$ 897,059	$ 784,107

The table above includes loans acquired at fair value on January 1, 2016, with outstanding balances of $7.5 million and $11.0 million as of December 31, 2022, and 2021, respectively.

The Company deferred $0.6 million and $0.7 million in salaries and employee benefits as loan origination costs for the years ended December 31, 2022, and 2021, respectively.

Loans with a fair value of approximately $204.2 million and $216.6 million were pledged to secure borrowing arrangements as of December 31, 2022, and 2021, respectively (see Note 12).

Loan Servicing

The Company services SBA loans for the SBA and other institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2022, and 2021, the Bank was servicing approximately $13.6 million and $10.3 million in SBA loans previously sold. The net carrying value of servicing rights associated with these loans was approximately $279,000 and $76,000 as of December 31, 2022, and 2021, respectively. The carrying value approximated the fair value at December 31, 2022, and 2021.

SBA Paycheck Protection Program Loans

The Company participated in the SBA Paycheck Protection Program ("PPP") which are federally guaranteed loans intended to provide loans to small businesses to pay their employees, rent, mortgage interest and utilities. The loans may be forgiven upon certain conditions being met including the borrower providing payroll documentation evidencing compliance with the program. The Company began accepting PPP applications in April 2020 and originated $118.4 million of PPP loans in 2020. The Company originated an

4. LOANS *(continued)*

SBA Paycheck Protection Program Loans *(continued)*

additional $72.0 million of PPP loans during 2021. The Company had $0.1 million and $39.9 million in PPP loans outstanding as of December 31, 2022, and 2021, respectively. The Company recognized $1.4 million and $4.6 million as interest and fees on PPP loans in the Statements of Income for the years ended December 31, 2022, and 2021, respectively. Deferred processing fees outstanding were $8,000 and $2.0 million at December 31, 2022, and 2021, respectively. Processing fees were deferred and are recognized over the contractual life of the loan and accelerated at forgiveness.

5. ALLOWANCE FOR LOAN LOSSES

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2022 and 2021 *(Dollars in thousands):*

December 31, 2022	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	$ 1,240	$ 6,812	$ 1,027	$ 294	$ 10	$ 9,383
Provision(benefit)	94	433	528	98	(6)	1,147
Charge-offs	-	-	-	-	-	-
Recoveries	96	-	-	-	-	96
Ending balance	$ 1,430	$ 7,245	$ 1,555	$ 392	$ 4	$ 10,626

December 31, 2021	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	$ 2,326	$ 4,893	$ 917	$ 320	$ 11	$ 8,467
Provision(benefit)	(1,664)	1,919	110	(26)	(1)	338
Charge-offs	(150)	-	-	-	-	(150)
Recoveries	728	-	-	-	-	728
Ending balance	$ 1,240	$ 6,812	$ 1,027	$ 294	$ 10	$ 9,383

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows the allocation of the allowance for loan losses at December 31, 2022, by portfolio segment and by impairment methodology *(Dollars in thousands)*:

	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Unallocated	Total
Allowance for Credit Losses							
Ending balance allocated to portfolio segments	$ 1,430	$ 7,245	$ 1,555	$ 392	$ 4	$ -	$ 10,626
Ending balance: individually evaluated for impairment	585	-	-	-	3	-	588
Ending balance: collectively evaluated for impairment	$ 845	$ 7,245	$ 1,555	$ 392	$ 1	$ -	$ 10,038
Loans							
Ending balance	$ 89,423	$ 607,565	$ 169,214	$ 43,020	$ 193	$ -	$ 909,415
Ending balance: individually evaluated for impairment	777	2,286	-	-	3	-	3,066
Ending balance: collectively evaluated for impairment	$ 88,646	$ 605,279	$ 169,214	$ 43,020	$ 190	$ -	$ 906,349

The following table shows the allocation of the allowance for loan losses at December 31, 2021, by portfolio segment and by impairment methodology *(Dollars in thousands)*:

	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Unallocated	Total
Allowance for Credit Losses							
Ending balance allocated to portfolio segments	$ 1,240	$ 6,812	$ 1,027	$ 294	$ 10	$ -	$ 9,383
Ending balance: individually evaluated for impairment	30	-	-	-	6	-	36
Ending balance: collectively evaluated for impairment	$ 1,210	$ 6,812	$ 1,027	$ 294	$ 4	$ -	$ 9,347
Loans							
Ending balance	$ 133,830	$ 504,986	$ 126,577	$ 29,981	$ 701	$ -	$ 796,075
Ending balance: individually evaluated for impairment	296	2,566	-	-	6	-	2,868
Ending balance: collectively evaluated for impairment	$ 133,534	$ 502,420	$ 126,577	$ 29,981	$ 695	$ -	$ 793,207

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2022 (*Dollars in thousands*):

	Credit Exposure Credit Risk Profile by Internally Assigned Grade					
	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Grade:						
Pass	$ 85,994	593,499	169,214	43,020	193	$ 891,920
Special Mention	1,047	11,192	-	-	-	12,239
Substandard	2,382	2,874	-	-	-	5,256
Total	$ 89,423	$ 607,565	$ 169,214	$ 43,020	$ 193	$ 909,415

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2021 (*Dollars in thousands*):

	Credit Exposure Credit Risk Profile by Internally Assigned Grade					
	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Grade:						
Pass	$ 127,329	$ 487,869	$ 126,479	$ 29,981	$ 701	$ 772,359
Special Mention	689	5,269	-	-	-	5,958
Substandard	5,812	11,848	98	-	-	17,758
Total	$ 133,830	$ 504,986	$ 126,577	$ 29,981	$ 701	$ 796,075

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2022 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 777	$ 777	$ 88,646	$ 89,423
Real Estate – Commercial	-	-	2,286	2,286	605,279	607,565
Real Estate – Residential	-	-	-	-	169,214	169,214
Construction	-	-	-	-	43,020	43,020
Consumer and Other	-	-	3	3	190	193
Total	$ -	$ -	$ 3,066	$ 3,066	$ 906,349	$ 909,415

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2021 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 297	$ 297	$ 133,533	$ 133,830
Real Estate – Commercial	-	-	2,566	2,566	502,420	504,986
Real Estate – Residential	-	-	-	-	126,577	126,577
Construction	-	-	-	-	29,981	29,981
Consumer and Other	-	-	6	6	695	701
Total	$ -	$ -	$ 2,869	$ 2,869	$ 793,206	$ 796,075

During the years ended December 31, 2022 and 2021, the Company had $0.2 million and $0.3 million of interest income foregone from loans on non-accrual status.

The following table shows information related to impaired loans at and for the year ended December 31, 2022 (*Dollars in thousands*):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without an allowance recorded:					
Commercial	$ 176	$ 176	$ -	$ 214	$ -
Real Estate – Residential	-	-	-	-	-
Real Estate – Commercial	2,286	2,286	-	2,414	-
With an allowance recorded:					
Commercial	601	601	585	615	-
Consumer and Other	3	3	3	5	-
Total:					
Commercial	777	777	585	829	-
Real Estate – Residential	-	-	-	-	-
Real Estate – Commercial	2,286	2,286	-	2,414	-
Consumer and Other	3	3	3	5	-
Total impaired loans	$ 3,066	$ 3,066	$ 588	$ 3,248	$ -

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows information related to impaired loans at and for the year ended December 31, 2021 (*Dollars in thousands*):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without an allowance recorded:					
Commercial	$ 259	$ 259	$ -	$ 335	$ -
Real Estate – Residential	-	-	-	213	17
Real Estate – Commercial	2,566	2,566	-	2,830	-
With an allowance recorded:					
Commercial	37	37	30	781	20
Consumer and Other	6	6	6	8	-
Total:					
Commercial	296	296	30	1,116	20
Real Estate – Residential	-	-	-	213	17
Real Estate – Commercial	2,566	2,566	-	2,830	-
Consumer and Other	6	6	6	8	-
Total impaired loans	$ 2,868	$ 2,868	$ 36	$ 4,167	$ 37

The recorded investment in loans excludes accrued interest receivable and loan origination fees due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

For the years ended December 31, 2022 and 2021, the Company did not recognize any income on a cash basis.

Troubled Debt Restructurings

Included in impaired loans at December 31, 2022 and 2021, are four and three loans totaling $604,000 and $265,000, respectively, which are considered to be troubled debt restructurings. The Company has allocated $588,000 and $36,000 of specific reserves to these loans that have been modified in troubled debt restructurings as of December 31, 2022 and 2021, respectively.

The Company has not committed to lend any additional funds to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2022.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2022 (*Dollars in thousands*):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial	2	$ 570	$ 570

During 2021, a single borrower with two commercial loans presented in the table above, qualified for modifications under the CARES Act. Subsequently in 2022, another modification was provided to the same borrower, which was determined to be a troubled debt restructuring. Both loans were fully reserved as of December 31, 2022. The troubled debt restructurings described above, increased the allowance for loan losses by $570,000 and $36,000, and resulted in zero charge-offs during the years ending December 31, 2022, and 2021.

There were no new loans modified as troubled debt restructurings during the year ending December 31, 2021.

There were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ending December 31, 2022, and 2021.

The Company provided loan principal and interest payment deferrals to certain borrowers impacted by COVID-19 who were current in their payments at the inception of the Company's loan modification program. As of December 31, 2022, and 2021, the Bank had no loans on principal and interest deferral. The Bank had zero loans as of December 31, 2022, and nine loans with outstanding balances totaling $13.7 million as of December 31, 2021, on principal-only deferral.

All of the COVID-19 deferrals are excluded from troubled debt restructuring classification under Section 4013 of the CARES Act or under applicable interagency guidance of the federal banking regulators. These loans will not be reported as past due during the deferral period. The borrowers are all required to resume making regularly scheduled loan payments at the end of the deferral period.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31, 2022 and 2021 *(Dollars in thousands)*:

	2022	2021
Furniture fixtures and equipment	$ 3,208	$ 3,198
Leasehold improvements	4,962	4,962
Construction in progress	588	-
Building	1,224	1,224
Building improvements	1,593	1,593
Land	774	774
Total bank premises and equipment	12,349	11,751
Accumulated Depreciation and amortization	(6,597)	(5,835)
Premises and equipment, net	$ 5,752	$ 5,916

Depreciation and amortization included in occupancy and equipment expense totaled $0.8 million for the years ending December 31, 2022 and 2021.

7. LEASES

The Company enters into leases in the normal course of business primarily for full-service branches and lending centers. The Company's leases have remaining terms ranging from 2 to 9 years, some of which include renewal options to extend the lease for up to 20 years.

The Company leases its headquarters, branch facilities (except Paso Robles which is owned by the Company) and lending offices under non-cancelable operating leases. During 2020, the Bank exercised its five-year renewal option for its headquarters and Santa Barbara branch and amended the lease to include two additional five-year renewal options. The Bank also received a tenant improvement allowance of $65,000 as part of the amended lease agreement. The lease includes an annual rent adjustment based on changes in the Consumer Price Index (CPI) with a floor of 3% and a cap of 8%.

The lease for the Montecito branch expires on April 30, 2028, and has one ten-year renewal option. The lease includes rent adjustments every three years based on changes in the Consumer Price Index (CPI) with a floor of 2% and a cap of 5%.

The lease for the Goleta branch expires on August 31, 2027, and has two five-year renewal options. The lease includes no annual scheduled rent increases of fixed amounts.

The lease for the Residential Lending Department and Administrative office expires on March 31, 2023. The Company plans to relocate respective staff to a new administrative office, therefore the Company entered into a lease for the new Administrative office on November 2, 2022. The lease expires on November 30, 2032, has two five-year renewal options, and includes an annual rent increase adjustment of 3%.

7. LEASES *(continued)*

The lease for the Santa Barbara Commercial Lending Center commenced in May 2018 and expires in May 2023. The lease has two five-year renewal options and includes an annual rent adjustment of 3%. The Company also received a $40,000 tenant improvement allowance as part of the lease agreement.

The lease for the full-service branch in San Luis Obispo expires in May 2029. The lease includes an annual rent adjustment of 3% and has four five-year renewal options. The Company received a lessee improvement allowance of $100,000 as part of the lease agreement. The lease for the loan production office in San Luis Obispo commenced on June 1, 2019, and expires in May 2029. The lease includes an annual rent adjustment of 3% and has four five-year renewal options. The Company received a lessee improvement allowance of $146,000 as part of the lease agreement.

The Company includes lease extension and termination options in the lease term, if, after considering relevant economic factors, it is reasonably certain the Company will exercise the option. In addition, the Company has elected to account for any non-lease components in its real estate leases as part of the associated lease component. The Company has also elected not to recognize leases with original lease terms of twelve months or less (short-term leases) on the Company's balance sheet.

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the US Treasury rate, adjusted for the lease term and other factors.

As of December 31, 2022 and 2021, all of the Company's leases are classified as operating leases. Right-of-use assets were $6.6 million and $4.5 million and lease liabilities were $7.1 million and $5.0 million as of December 31, 2022, and 2021, respectively.

Rental expense, net of sublease income, included in occupancy and equipment expense totaled $1.4 million and $1.2 million for the years ended December 31, 2022, and 2021, respectively.

7. LEASES *(continued)*

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2022, are as follows *(Dollars in thousands)*:

Year Ending December 31,	Operating Lease
2023	$ 1,270
2024	1,350
2025	1,159
2026	955
2027	932
Thereafter	2,388
Total undiscounted lease payments	8,054
Less: imputed interest	(985)
Net lease liabilities	$ 7,069

Supplemental Lease Information

	December 31, 2022	December 31, 2021
Operating lease weighted average remaining lease term (years)	7	6
Operating lease weighted average discount rate	2.54%	2.12%

8. OTHER REAL ESTATE OWNED

At December 31, 2022 and December 31, 2021 the Company had no properties acquired through foreclosure or deed in lieu.

9. GOODWILL AND INTANGIBLE ASSETS

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2022 and 2021 was $4.8 million. Total goodwill at December 31, 2022 and 2021 represented the excess of the cost of BSB over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2022, so goodwill was not required to be retested.

At December 31, 2022, the net carrying value of intangible assets was zero. The intangible assets at December 31, 2021, represented the estimated fair value of the core deposit relationships acquired in the acquisition of BSB. Core deposit intangibles were amortized using a method that approximates the effective interest method over an estimated life of seven years from the date of acquisition. At December 31, 2021, the gross carrying value of intangible assets was $1.3 million and accumulated amortization totaled $1.1 million. Amortization expense recognized was $0.2 million for 2022 and 2021 and considered fully amortized as of the year-end 2022.

10. TIME DEPOSITS

Time deposits as of December 31, 2022, have the following maturities by year *(Dollars in thousands)*:

Maturity Year	Amount
2023	$ 51,160
2024	906
2025	771
2026	-
2027	2
Total	$ 52,839

Time deposits with balances of more than $250,000 totaled $22.9 million and $15.6 million at December 31, 2022, and 2021, respectively.

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2022, and 2021 consisted of the following *(Dollars in thousands)*:

	2022	**2021**
Current:		
Federal	$ 3,634	$ 3,356
State	2,362	1,912
Total	5,996	5,268
Deferred:		
Federal	(425)	(560)
State	(308)	(162)
Total	(733)	(722)
Provision for income taxes	$ 5,263	$ 4,546

Effective tax rates differ from the federal statutory rate of 21% applied to income before income taxes due to the following *(Dollars in thousands):*

	2022	**2021**
Federal statutory rate times financial statement income	$ 3,939	$ 3,439
Effect of:		
State income taxes, net of federal tax benefit	1,623	1,388
Share-based compensation	(25)	(24)
Tax-exempt interest	(308)	(245)
Other, net	34	(12)
Total	$ 5,263	$ 4,546

11. INCOME TAXES *(continued)*

Deferred tax assets (liabilities) at December 31, 2022, and 2021 consisted of the following and are recorded on the balance sheet with accrued interest receivable and other assets or accrued interest payable and other liabilities *(Dollars in thousands)*:

	2022	2021
Deferred tax assets:		
Lease liability	$ 2,090	$ 1,470
Allowance for loan losses	3,141	2,774
Accrued expenses	1,012	869
Share-based compensation	428	418
Unrealized loss on available-for-sale investment securities	10,039	304
Net operating loss carryforward	281	307
Fair value adjustments	16	-
State taxes	492	422
Other	206	150
Total deferred tax assets	$ 17,705	$ 6,714
Deferred tax liabilities:		
Deferred loan costs	(666)	(515)
Right-of-use asset	(1,950)	(1,334)
Premises and equipment	(311)	(515)
Fair value adjustments	-	(32)
Prepaid expenses	(28)	(41)
Other	(19)	(14)
Total deferred tax liabilities	(2,974)	(2,451)
Net deferred tax asset	$ 14,731	$ 4,263

As of December 31, 2022 and 2021, management performed an evaluation of the Company's net deferred tax asset and determined that it was more likely than not that the Company would be able to utilize its net deferred tax asset. Therefore, no valuation allowance is necessary for 2022.

The Company files income tax returns in the United States and California jurisdictions. The Company is no longer subject to examination by federal taxing authorities for tax years prior to 2019 and is no longer subject to examination by California taxing authorities for tax years prior to 2018. There are currently no pending federal or state income tax examinations by tax authorities.

11. INCOME TAXES *(continued)*

The Company has no uncertain tax positions and has not accrued for any interest or penalties as of December 31, 2022 or 2021. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

As of December 31, 2022, the Company has net operating losses (“NOLs”) available to carry-forward for federal tax purposes totaling $1.3 million. Federal NOL carry-forwards will expire at various dates from 2029 to 2035, if unused. All federal NOLs were acquired in the BSB acquisition in 2016. The utilization of these NOL carry-forwards by the Company for federal tax purposes is subject to Internal Revenue Code Sec. 382 with limitations placed on the amount of NOLs that can be utilized annually. The annual 382 limitation is approximately $0.5 million for federal purposes. The Company does not, however, believe that the annual limitation will impact the ultimate deductibility of these NOL carry-forwards.

12. BORROWING ARRANGEMENTS

The Company has unsecured Federal funds lines of credit with five of its correspondent banks under which it can borrow up to $110.0 million in the aggregate. There were zero borrowings outstanding under these arrangements as of December 31, 2022, and 2021.

In addition, the Company has an arrangement with the Federal Home Loan Bank (“FHLB”) under which it may borrow an amount not to exceed 25% of total assets which must be fully secured by qualifying loans. At December 31, 2022, amounts pledged and available under such limits at the FHLB were approximately $118.7 million and $121.0 million, respectively. As of December 31, 2022, and 2021, the Company had zero FHLB borrowings outstanding. As of December 31, 2022, and 2021, the Company is the obligor on a letter of credit issued by the FHLB to secure local agency deposits in the amount of $30.0 million and $20.0 million, respectively.

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company has pledged certain loans to secure borrowings. The borrowing capacity under the agreement varies depending on the amount and type of loans pledged. There were no borrowings outstanding under the agreement at December 31, 2022, or 2021, and the Company had $16.2 million of readily available borrowing capacity at December 31, 2022, based on currently pledged loans.

The Company has one unsecured line of credit with The Independent Bankers Bank of $10.0 million dollars. As of December 31, 2022, the balance on the line of credit was zero.

The Company completed a private placement of $18.0 million in fixed-to-floating rate subordinated notes due March 1, 2032 (the “Notes”) to certain qualified buyers and accredited investors issued February 28, 2022. The subordinated notes are structured to qualify as Tier 2 capital for the Company for regulatory purposes and will carry a fixed rate of 3.75% until March 1, 2027. Thereafter, the Notes will pay interest at a floating rate, reset quarterly, equal to the then current three-month SOFR plus 212 basis points. The subordinated notes are redeemable by the Company at its option, in whole or in part, on any interest payment date on or after March 1, 2027, or at any time, in whole or in part, upon certain other specified events prior to the Notes’ maturity on March 1, 2032.

13. COMMITMENTS AND CONTINGENCIES

Financial Instruments With Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments consist of the following *(Dollars in thousands)*:

	December 31,	
	2022	2021
Commitments to extend credit	$ 174,911	$ 140,692
Standby letters of credit	$ 3,892	$ 2,339

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for loans included on the balance sheets.

Commitments to extend credit are agreements to lend to a borrower as long as there is no violation of any covenant established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. These commitments are normally unfunded portions of previously approved lines of credit. The Company evaluates each borrower's creditworthiness on a case-by-case basis.

The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include deposit accounts, marketable securities, accounts receivable, inventory, equipment, and deeds of trust on commercial or residential real estate.

Standby letters of credit are conditional commitments issued to guarantee the performance of a client to a third-party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2022 and 2021. The Company recognizes these fees as revenue over the term of the commitment.

As of December 31, 2022, unsecured commercial loan commitments represent approximately 59% of total commitments and the majority of these commitments have variable interest rates. Other real estate loans, which are collateralized and generally have adjustable interest rates, represent approximately 5% of total commitments. Home equity lines of credit, which are collateralized and generally have variable interest rates, represent approximately 22% of total commitments. Secured construction loan commitments represent approximately 10% of total commitments and have primarily fixed rates. Agricultural production represents approximately 2% of total commitments and generally have variable rates. The remaining 1% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

Financial Instruments With Off-Balance Sheet Risk *(continued)*

As of December 31, 2021, unsecured commercial loan commitments represent approximately 50% of total commitments and the majority of these commitments have variable interest rates. Other real estate loans, which are collateralized and generally have adjustable interest rates, represent approximately 5% of total commitments. Home equity lines of credit, which are collateralized and generally have variable interest rates, represent approximately 25% of total commitments. Secured construction loan commitments represent approximately 14% of total commitments and have primarily fixed rates. Agricultural production represents approximately 3% of total commitments and generally have variable rates. The remaining 3% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

Concentrations of Credit Risk

A concentration of credit is defined by the Federal Reserve Bank as loans and or loan commitments to: (1) any individual borrower; (2) small, interrelated group of individuals; (3) single repayment source with normal credit risk or greater; and (4) an individual project that represents 25% or more of a bank's Tier 1 capital and reserves.

The Company grants real estate construction and commercial loans to customers in Santa Barbara County, San Luis Obispo County and surrounding areas and a substantial portion of its portfolio is secured by commercial and residential real estate.

Concentrations may also exist when certain types of loans exceed 100% of the Bank total capital ("TC") or 100% of the Company's total shareholders' equity (TE).

At December 31, 2022, a concentration representing approximately 455% of the Bank's TC and 698% of the Company's TE was in Real Estate – Commercial loans. These loans include both owner-occupied and non-owner-occupied commercial real estate loans and are within a variety of types. Residential real estate loans also represented a concentration of approximately 127% of the Bank's TC and 194% of the Company's TE. These loans include owner occupied and non-owner occupied adjustable residential real estate loans, variable home equity lines and fixed rate, short term non-revolving credits.

At December 31, 2021, a concentration representing approximately 498% of the Bank's TC was in Real Estate – Commercial loans. These loans include both owner-occupied and non-owner-occupied commercial real estate loans and are within a variety of types. Residential real estate loans also represented a concentration of approximately 125% of the Bank's TC. These loans include owner occupied and non-owner occupied adjustable residential real estate loans, variable home equity lines and fixed rate, short term non-revolving credits.

Although management believes the loans within these concentrations have no more than the normal risk of collectability, a continued substantial decline in the performance of the economy or a continued decline in real estate values in the Company's primary market area could have an adverse impact on the collectability of these loans.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

Concentrations in Deposit and Loan Relationships

As of December 31, 2022 and 2021, the Company did not have any deposit customers that exceed 5% of total deposits.

As of December 31, 2022 and 2021, the Company did not have any loan customers that exceed 10% of total loans.

Federal Reserve Requirements

Generally, banks are required to maintain reserves with the Federal Reserve Bank of San Francisco (the "FRB") equal to a percentage of their reservable deposits. It was announced on March 15, 2020, that the Board of Governors of the Federal Reserve System reduced reserve requirement ratios to zero percent effective March 26, 2020, eliminating reserve requirements for all depository institutions. As such, as of December 31, 2022, the Bank was not required to maintain reserves with the FRB.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. The Bank maintains funds in money market accounts at certain correspondent banks. As of December 31, 2022, the Bank had $110.0 million of uninsured deposits.

14. SHARE-BASED PAYMENT

On December 31, 2022, the Company had one share-based compensation plan, which is described below. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise or grant of restricted stock.

On September 2, 2015, the Company adopted the American Riviera Bank 2015 Omnibus Stock Incentive Plan (the "Plan") which has been approved by its shareholders and permits the grant of equity compensation in the form of Options, Restricted Stock Awards, Performance Awards, and Restricted Stock Units for up to 1,091,782 shares of the Company's common stock. The remaining shares available for issuance are reduced by shares reserved and shares outstanding under the 2015 Plan, leaving 270,596 available for issuance under the Plan at December 31, 2022. In connection with the Bancorp reorganization in February 2022, the Plan became an equity incentive plan of the Company and all outstanding award agreements of Bank shares became shares of the Company with the same terms, conditions, and restrictions.

14. SHARE-BASED PAYMENT *(continued)*

There were 69,949 and 63,485 restricted shares granted in 2022 and 2021, respectively. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Company's operating results and government regulations. The Plan requires that the option or grant price may not be less than the fair market value of the stock at the date the award is granted, and that the exercise price per share must be paid in full or shares tendered for sale “net exercise” at the time the option is exercised. All of the options granted under the Plan have a 10-year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The employee stock options, and restricted stock awards generally vest over a four to five-year period from the date of the grant. The Plan permits the use of vested, in the money stock options to be used as a cashless exercise.

Non-Qualified Stock Option Awards

In 2016, in connection with the merger with BSB, 20,073 replacement non-qualified stock options were granted to certain non-employee directors to replace options previously granted and fully vested under the BSB Omnibus Stock Plan. As the BSB options were fully vested, there was no related stock-based compensation associated with these awards. There was no related share-based compensation expense related to non-qualified stock options recorded for each of the years ended December 31, 2022, and 2021. A summary of the award activity under the Plan for the years ended December 31, 2022, and 2021 is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at January 1, 2021	11,730	$ 11.41	0.96
Issued	-	-	-
Forfeited or expired	-	-	-
Exercised	(11,730)	11.41	0.96
Options outstanding at December 31, 2021	-	$ -	-
Issued	-	-	-
Exercised	-	-	-
Options exercisable at December 31, 2022	-	$ -	-

14. SHARE-BASED PAYMENT *(continued)*

Non-Qualified Stock Option Awards *(continued)*

Information related to the stock option plan during each year follows *(Dollars in thousands)*:

	2022	2021
Intrinsic value of options exercised	$ -	$ 104
Cash received from options exercised	-	105
Tax benefit realized from option exercise	-	22

As of December 31, 2022, and 2021, there was no unrecognized compensation related to non-qualified stock option awards. There were zero options granted and zero intrinsic value related to non-qualified stock option awards at December 31, 2022. During 2021, 11,730 stock options were exercised, of which 2,548 were conducted by cashless exercises, resulting in 1,491 shares being forfeited and 1,057 shares being issued. The remaining 9,182 stock options exercised were paid for in cash, resulting in proceeds of $105,000.

Employee Incentive Stock Option Awards

There were no employee incentive stock option awards granted or outstanding for the years ended December 31, 2022, and 2021. Therefore, there were no related share-based compensation expenses recorded nor any unrecognized compensation cost related to unvested stock option awards to employees for each of the years ended December 31, 2022, and 2021.

Restricted Common Stock Awards

The Plan provides for the issuance of shares to directors and officers. Compensation expense for employee awards and director fee expense for director grants is recognized over the vesting period of the awards based on the fair value of the stock at grant date. The fair value of the stock was determined using most recent market data. Restricted common stock shares to employees typically vest over a four to five-year period and immediately for directors.

A summary of changes in the Company’s unvested shares for the year is as follows:

Unvested Shares	**Shares**	**Weighted Average Grant Date Fair Value**
Unvested shares at January 1, 2022	177,248	$ 15.55
Granted	69,949	18.26
Vested	(53,726)	16.18
Forfeited	(9,908)	17.38
Unvested shares at December 31, 2022	183,563	$ 16.42

14. SHARE-BASED PAYMENT *(continued)*

In 2022, the Bank granted 61,117 shares of restricted common stock to selected officers, which had a fair market value between $15.58 and $18.86 per share on the date of grant. These restricted common stock awards generally vest over a four-year period from the date of the grant.

In 2022, the Bank granted a total of 8,832 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value of $16.76 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $148,000 was recorded for the year ended December 31, 2022.

In 2021, the Bank granted 56,253 shares of restricted common stock to selected officers, which had a fair market value between $16.15 and $20.05 per share on the date of grant. These restricted common stock awards generally vest over a four-year period from the date of the grant.

In 2021, the Bank granted a total of 7,232 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value of $19.35 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $140,000 was recorded for the year ended December 31, 2021.

As of December 31, 2022, there were 183,563 shares of restricted stock that were unvested and expected to vest. Compensation cost and directors' fees charged against income for restricted stock awards was $1.0 million and $0.9 million for the years ended December 31, 2022, and 2021. There was an excess tax benefit recognized for restricted stock awards in the amount of $118,000 and $166,000, respectively for the years ended December 31, 2022, and 2021. At December 31, 2022, and 2021, the total compensation cost related to unvested restricted common stock not yet recognized was $1.8 million and $1.6 million. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted-average remaining period of approximately four years and will be adjusted for subsequent changes in estimated forfeitures. The fair value attributable to restricted stock awards vested for the year ended December 31, 2022, and 2021, was $0.9 million and $0.6 million, respectively.

15. SHAREHOLDERS' EQUITY

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2022, $32.7 million were free of such restrictions.

The Company declared a 10% stock dividend on October 27, 2022, payable on November 24, 2022, to shareholders of record as of the close of business on November 10, 2022. Cash was paid in lieu of fractional shares based on the closing price on the record date. Restricted stock awards and the related price per share amounts reflected in the respective tables have been restated to give retroactive effect to the 10% stock dividend declared in November 2022.

Earnings per share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the years ended December 31, 2022, and 2021 is as follows:

	Net Income	Weighted Average Number of Shares Outstanding	Earnings per share
December 31, 2022			
Basic earnings per share	$ 13,494,000	5,669,489	$ 2.38
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	13,494,000	5,669,489	2.38
December 31, 2021			
Basic earnings per share	11,829,000	5,651,190	$ 2.09
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	$ 11,829,000	5,651,190	2.09

Shares of common stock issuable under stock options for which the exercise prices are greater than average market prices are not included in the computation of diluted earnings per share due to their antidilutive effect. There were no options or restricted shares excluded from the computation of diluted earnings per share for the years ended December 31, 2022, and 2021, respectively.

15. SHAREHOLDERS' EQUITY *(continued)*

Regulatory Capital

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer for 2022 is 2.5%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. The Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. As of December 31, 2022, and 2021, the most recent regulatory notifications categorized the Bank as "well-capitalized" under the regulatory framework. There are no conditions or events since that notification that management believes have changed the Bank's category.

As of December 31, 2022, and 2021, total average assets for leverage capital purposes were $1,391.6 million and $1,271.0 million, respectively, and total risk-weighted assets were $1,037.7 million and $834.0 million, respectively.

15. SHAREHOLDERS' EQUITY (continued)

Capital ratios as of December 31, 2022, and 2021 are as follows *(Dollars in thousands)*:

	2022		2021	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
American Riviera Bank	$ 122,938	8.8%	$ 91,921	7.2%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 69,885	5.0%	$ 63,527	5.0%
Minimum regulatory requirement	$ 41,275	4.0%	$ 33,560	4.0%
Common Equity Tier I Ratio				
American Riviera Bank	$ 122,938	11.9%	$ 91,921	11.0%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 67,072	6.5%	$ 54,210	6.5%
Minimum regulatory requirement	$ 46,434	4.5%	$ 37,530	4.5%
Tier 1 Risk-Based Capital Ratio				
American Riviera Bank	$ 122,938	11.9%	$ 91,921	11.0%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 82,550	8.0%	$ 66,720	8.0%
Minimum regulatory requirement	$ 61,912	6.0%	$ 50,040	6.0%
Total Risk-Based Capital Ratio				
American Riviera Bank	$ 133,722	13.0%	$ 101,468	12.1%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 103,187	10.0%	$ 83,401	10.0%
Minimum regulatory requirement	$ 82,550	8.0%	$ 66,720	8.0%

The Company operates under the Small Bank Holding Company Policy Statement and therefore is not currently subject to generally applicable capital adequacy requirements.

16. REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income. The following table presents the Company's sources of non-interest income for the twelve months ended December 31, 2022, and 2021. The other category totaling $2.4 million and $2.8 million for the years ended December 31, 2022, and 2021, respectively, is not within the scope of ASC 606.

Non-interest income for the years ended December 31, 2022, and 2021 consisted of the following *(Dollars in thousands)*:

	2022	**2021**
Service charges on deposits	$ 902	$ 719
Overdraft Fees	65	44
Other	2,380	2,822
Total	$ 3,347	$ 3,585

A description of the Bank's revenue stream accounted for under ASC 606 is as follows:

The Bank earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Bank fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period which the Bank satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

17. EMPLOYEE BENEFIT PLANS

<u>Profit Sharing Plan</u>

In 2006, the Bank adopted the American Riviera Bank 401(k) Profit Sharing Plan and Trust (the "401k Plan"). All employees 21 years of age or older are immediately eligible to participate in the 401k Plan. Eligible employees may elect to make tax deferred contributions up to the maximum amount allowed by law. The Bank makes "safe harbor" matching contributions, and the Bank may make additional profit-sharing contributions to the 401k Plan at the discretion of the Board of Directors. "Safe harbor" Bank contributions vest immediately for all employees. The Company contributed $0.5 million and $0.4 million in the form of employer matching contributions to the 401k Plan during the years ended December 31, 2022, and 2021, respectively.

18. OTHER EXPENSES

Other expenses for the years ended December 31, 2022, and 2021, consisted of the following *(Dollars in thousands)*:

	2022	2021
Data processing	$ 1,552	$ 1,308
Advertising and marketing	1,007	786
Professional fees	929	660
Regulatory assessments	772	761
Director Fees	391	360
Software	810	638
Insurance	156	99
Other	3,217	2,470
Total other expenses	$ 8,834	$ 7,082

19. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including executive officers and directors. The following is a summary of the aggregate activity involving related parties *(Dollars in thousands):*

Loans

Balance, January 1, 2022	$ -
Disbursements	48
Amounts repaid	(48)
Balance, December 31, 2022	$ -

As of December 31, 2022, total undisbursed commitments to related parties were $70,000.

As of December 31, 2022, and 2021, there were no loans to related parties that exceeded 10% of the Bank's total loans.

20. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company invested in qualified affordable housing projects in 2022. At December 31, 2022, the balance of the investment for qualified affordable housing projects was $2.4 million. These balances are reflected in the accrued interest receivable and other assets line on the consolidated balance sheets. Total unfunded commitments related to the investments in qualified affordable housing projects totaled $2.4 million at December 31, 2022. These balances are reflected in the accrued interest payable and other liabilities line on the consolidated balance sheets. The Company expects to fulfill these commitments during the year ending 2039.

During the year ended December 31, 2022, the Company recognized amortization expense of $29,000, which was included within income tax expense on the consolidated statements of income.

Additionally, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of $28,000.

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