AMERICAN RIVIERA
BANK

2019 Annual Report

AMERICAN RIVIERA BANK

A Message to our Shareholders, Customers and Community

2019 was another year of significant growth at American Riviera Bank with total assets increasing over $100 million for the second year in a row, and record net income of $6.4 million. In May 2019, we opened our full service branch in San Luis Obispo with great reception from the community. We are building market share in San Luis Obispo County, with our Paso Robles branch reaching profitability after just one year of operations. High-touch service with a focus on relationships, flexibility and local decision-making has firmly established **American Riviera Bank as the Central Coast's community bank!**

For the ninth year in a row, your bank achieved double-digit loan growth without sacrificing credit quality. Net loans increased 14% due to continued synergies between commercial, Small Business Administration, and residential lending as well as our expansion into Paso Robles and San Luis Obispo. We provide construction loans, mortgages, home equity lines, commercial real estate loans, business loans and lines of credit, agricultural loans, and SBA loans. At year-end 2019, your bank had no loans that were 90 or more days past due, only $284 thousand on non-accrual status, and no other real estate owned.

Our deposit base continues to expand with 21% growth from the prior year, representing an increase of $108 million in total deposits. In 2019, non-interest bearing deposits increased 28%, and comprised 35% of total deposits at 2019 year-end. With interest bearing checking included this percentage increases to 49%. This high mix 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 changing rate environment. Mobile phone deposit and bill pay functionality in combination with available ATM fee waivers for withdrawals made at other banks allow our customers to bank with us no matter where they live or travel.

In the first quarter of 2019, we raised $8.5 million of new common equity at a price which represented a premium to book value. Our existing capital base, retained earnings, and this new equity will continue to support our expansion plan while providing extra security during uncertain times. Your bank achieved a 2019 return on equity of 9%, which was retained in order to increase book value and support growth. Tangible book value per share at December 31, 2019 increased 13% from the prior year-end.

We would be remiss to not comment on the challenges our community is facing in 2020. In the first quarter, the bank continued to experience strong loan and deposit growth with a 4% increase for both loans outstanding and deposits. At the end of March, the full impact of the COVID-19 crisis was not yet being felt in our community or in our customer base, however, we did choose to increase provisioning for loan loss reserve. In April, Congress passed the CARES Act and our existing status as a Preferred SBA lender allowed us to move quickly and deploy an automated Paycheck Protection Program loan application portal. As we write this letter, we are documenting and funding over 420 loans from the first round of CARES Act funding and plan to submit many more loans if additional funding is added. Our PPP loans represent almost $100 million of much needed small business relief and could save over 13,000 jobs in our community. We have also been working closely with existing loan clients negatively affected by COVID-19, and have provided temporary payment deferrals as needed.

We are very thankful for the loyalty of our clients and our team of dedicated bankers. No matter what the future brings, you should know that your bank is well capitalized and the combination of capital, retained earnings and loan loss reserve stands at over $82 million at December 31, 2019. We are confident that we have the team and balance sheet strength to successfully navigate this crisis. American Riviera Bank will support our community through a full recovery and restoration while maintaining and growing franchise value for our shareholders. Stay healthy and safe!

Lawrence Koppelman, Board Chair

Jeff DeVine, President and CEO

AMERICAN RIVIERA
BANK

FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2019 AND 2018
AND FOR THE YEARS THEN ENDED

Page

American Riviera Bank:

Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of American Riviera Bank, which comprise the balance sheets as of December 31, 2019 and 2018, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of American Riviera Bank as of December 31, 2019 and 2018, 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.

Crowe LLP

Crowe LLP

Sacramento, California
March 18, 2020

AMERICAN RIVIERA BANK

BALANCE SHEETS

December 31, 2019 and 2018

(Dollar amounts in thousands except share amounts)

	2019	2018
ASSETS		
Cash and due from banks	$ 11,531	$ 10,580
Interest-bearing deposits in other financial institutions	54,941	30,691
Available-for-sale investment securities	43,329	45,952
Equity securities	74	57
Loans	578,458	508,397
Allowance for loan losses	(6,366)	(5,542)
Net loans	572,092	502,855
Bank premises and equipment, net	6,878	5,299
Operating lease right-of-use asset	7,661	-
Cash surrender value of bank owned life insurance	7,286	7,056
Stock in other banks	3,222	2,636
Goodwill	4,800	4,800
Other intangibles, net	537	716
Accrued interest receivable and other assets	6,584	5,898
Total assets	$ 718,935	$ 616,540
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing deposits	$ 216,671	$ 169,549
Interest-bearing demand deposits	87,906	73,652
Savings deposits	16,330	15,773
Money market deposits	222,115	177,791
Time deposits	78,140	76,542
Total deposits	621,162	513,307
Short term Federal Home Loan Bank borrowings	10,000	40,000
Operating lease liability	8,078	-
Accrued interest payable and other liabilities	3,552	2,346
Total liabilities	642,792	555,653
Shareholders' equity:		
Preferred stock – no par value; 5,000,000 shares authorized, none issued	-	-
Common stock – no par value; 10,000,000 shares authorized; 5,033,348 and 4,461,068 shares issued and outstanding in 2019 and 2018, respectively	55,034	46,477
Retained earnings	21,224	14,831
Accumulated other comprehensive loss, net of taxes	(115)	(421)
Total shareholders' equity	76,143	60,887
Total liabilities and shareholders' equity	$ 718,935	$ 616,540

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

AMERICAN RIVIERA BANK

STATEMENTS OF INCOME

For the Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands except per share data)

	2019	2018
Interest income:		
Interest and fees on loans	$ 28,725	$ 24,674
Interest on available-for-sale investment securities	1,025	999
Interest on Federal funds sold	1	12
Interest on deposits in other financial institutions	984	601
Total interest income	30,735	26,286
Interest expense:		
Interest on savings deposits	58	48
Interest on money market deposits	1,819	762
Interest on interest-bearing demand deposits	222	158
Interest on time deposits	1,873	926
Total interest expense on deposits	3,972	1,894
Interest expense from borrowings	277	199
Total interest expense	4,249	2,093
Net interest income before provision for loan losses	26,486	24,193
Provision for loan losses	806	1,294
Net interest income after provision for loan losses	25,680	22,899
Non-interest income:		
Service charges commissions and fees	2,168	1,528
Broker fees	358	244
Gain on sale of investment securities	126	-
Gain on sale of loans	139	-
Total non-interest income	2,791	1,772
Non-interest expense:		
Salaries and employee benefits	11,922	9,694
Occupancy and equipment	2,358	1,806
Loss on sale of fixtures, furniture and equipment	-	12
Other	5,292	4,823
Total non-interest expense	19,572	16,335
Income before provision for taxes	8,899	8,336
Provision for taxes	2,506	2,446
Net income	$ 6,393	$ 5,890
Earnings per share, basic and diluted	$ 1.31	$ 1.33

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

AMERICAN RIVIERA BANK

STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Net income	$ 6,393	$ 5,890
Other comprehensive income (loss):		
Unrealized gain (loss) on investment securities:		
Unrealized holding gains (losses) arising during the period	433	(381)
Other comprehensive income (loss) before tax	433	(381)
Tax effect	(127)	111
Total other comprehensive income (loss)	306	(270)
Comprehensive income	$ 6,699	$ 5,620

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

AMERICAN RIVIERA BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2019 and 2018

(Dollar amounts in thousands except share amounts)

	Common Stock		Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (loss) (Net of Taxes)	Total Shareholders' Equity
	Shares	Amount			
Balance, January 1, 2018	4,402,841	$ 45,895	$ 8,915	$ (125)	$ 54,685
Net income			5,890		5,890
AOCI Reclassification due to Tax cut and jobs act			26	(26)	-
Other comprehensive loss				(270)	(270)
Exercise of stock options, net shares issued	51,360	356			356
Restricted stock awards granted	26,125				
Restricted stock awards forfeited	(8,341)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(10,917)	(208)			(208)
Share-based compensation expense		434			434
Balance, December 31, 2018	4,461,068	$ 46,477	$ 14,831	$ (421)	$ 60,887
Net income			6,393		6,393
Other comprehensive gain				306	306
Exercise of stock options, net shares issued	8,112	12			12
Restricted stock awards granted	109,914				
Restricted stock awards forfeited	(4,622)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(13,346)	(235)			(235)
Share-based compensation expense		736			736
Issuance of common shares	472,222	8,044			8,044
Balance, December 31, 2019	5,033,348	$ 55,034	$ 21,224	$ (115)	$ 76,143

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

AMERICAN RIVIERA BANK

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Cash flows from operating activities:		
Net income	$ 6,393	$ 5,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	806	1,294
Depreciation and amortization	1,041	808
Loss on sale of equipment	-	12
Change in cash surrender value of BOLI	(202)	52
Net decrease in deferred tax asset	188	38
Increase in deferred loan origination fees, net of costs	309	125
Net amortization of investment security premiums and discounts	357	329
Net realized gain on sales of investment securities	(126)	-
Net gain on sale of loans	(139)	-
Share-based compensation expense	736	434
(Gain) Loss on equity securities	(17)	10
Lessee improvement allowances	196	-
Increase in accrued interest receivable and other assets	(813)	(119)
Increase in accrued interest payable and other liabilities	1,162	687
Net cash provided by operating activities	9,891	9,560
Cash flows from investing activities:		
(Increase) Decrease in interest-bearing deposits in other financial institutions	(24,250)	1,262
Increase in loans, net	(70,352)	(94,369)
Proceeds from principal payments of available-for-sale investment securities	5,913	3,580
Purchase of available-for-sale investment securities	(21,545)	(16,775)
Sales of available-for-sale investment securities	14,657	-
Maturities of available-for-sale investment securities	3,800	-
Purchase of Federal Home Loan Bank stock	(586)	(606)
Purchase of premises and equipment	(2,253)	(1,857)
Net cash used in investing activities	(94,616)	(108,765)
Cash flows from financing activities:		
Increase in demand, interest bearing and savings deposits, net	106,256	23,440
Increase in time deposits, net	1,599	41,111
Net increase (decrease) in borrowings	(30,000)	30,000
Proceeds from issuance of common stock	8,044	-
Restricted shares surrendered to pay taxes	(235)	(208)
Proceeds from exercise of stock options, including tax benefit	12	356
Net cash provided by financing activities	85,676	94,699
Increase (Decrease) in cash and cash equivalents	951	(4,506)
Cash and cash equivalents at beginning of year	10,580	15,086
Cash and cash equivalents at end of year	$ 11,531	$ 10,580

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

AMERICAN RIVIERA BANK

STATEMENTS OF CASH FLOWS *(continued)*

For the Years Ended December 31, 2019 and 2018
(Dollar amounts in thousands)

	2019	2018
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest expense	$ 3,035	$ 1,796
Income taxes	$ 2,585	$ 1,635
Supplemental noncash disclosures:		
Liability arising from obtaining right-of-use assets upon adoption of lease standard	$ 4,441	$ -
Liabilities arising from obtaining right-of-use assets after adoption	$ 4,831	$ -

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

American Riviera Bank (“we” or “management” or the "Bank") opened for business on July 18, 2006 in Santa Barbara, California. As a state-chartered non-member bank, the Bank is subject to regulation by the California Department of Business Oversight (the "DBO"), and the Federal Deposit Insurance Corporation (the "FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits. The Bank is a full service community bank, focused on serving the lending and deposit needs of businesses and consumers in our community.

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

Subsequent Event

We have reviewed all events occurring from December 31, 2019 through March 18, 2020, 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.

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.

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

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 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 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. At December 31, 2019 all securities are classified as available-for-sale with the exception of $74,000 of equity securities and there were no transfers between categories.

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 Bank 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 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 Bank 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 Bank will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

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

Investment Securities *(continued)*

On January 1, 2018, the Bank adopted the new accounting standard for Financial Instruments (ASU 2016-01), which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The adoption of this guidance had no material impact on the Bank's financial position, results of operations or cash flows.

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 90 days delinquent unless the loan is well-secured and in process of collection in accordance with the Bank's policy. Consumer and other loans are typically charged off no later than 90 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. Payments received are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on non-accrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. 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 6 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 Bank 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.

Purchase Credit Impaired Loans

The Bank 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,

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

Purchase Credit Impaired Loans *(continued)*

losses are recognized by an increase in the allowance for loan losses. The Bank 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 Bank 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 Bank 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.

A restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Bank 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

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

Allowance for Loan Losses *(continued)*

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 Bank 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 by portfolio segment since 2009, historical losses of the Bank's peers since 2009, internal asset classifications, and qualitative factors to include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio as a whole.

The Bank determines a separate allowance for each portfolio segment. These portfolio segments include commercial, real estate - commercial, real estate - residential (including home equity loans), construction, and consumer and other. 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 Bank's overall allowance, which is included in the balance sheets and available for all loss exposures.

The Bank 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 $500,000 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 Bank and the Bank's regulators. During the Bank'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 - Represents credits that satisfactorily meet all of the Bank's underwriting criteria, and provide adequate protection for the Bank through the paying capacity of the borrower and/or the margin (value) and marketability (liquidity) of the collateral.

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 - Substandard loans are 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

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

Allowance for Loan Losses *(continued)*

jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified Doubtful have 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 - Loans classified Loss are 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 generally possess a lower inherent risk of loss than real estate portfolio segments because these 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.

Real estate - commercial – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. 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.

Real estate - residential (single family residential real estate and home equity lines of credit) – 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. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. 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 – 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 time lines. 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.

Consumer and other – Consumer and other 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 its 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 DBO, 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 Bank 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 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 Bank 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 Bank 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 $86,000 and $62,000 for the years ended December 31, 2019 and 2018, respectively. Late fees and ancillary fees related to loan servicing are not material.

Bank Premises and Equipment

Bank 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 Bank 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"). 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 Famer 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 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 Bank has purchased life insurance policies on certain key executives. Bank owned life insurance 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 Bank’s acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2019 and 2018 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 Bank’s ability to generate net earnings after the acquisitions and is not deductible for tax purposes. 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 Bank 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 Bank below its carrying amount. No such events or circumstances arose during the fourth quarter of 2019, so goodwill was not required to be retested. Goodwill is the only intangible asset with an indefinite life on the Bank’s balance sheet.

Intangible Assets

The intangible assets at December 31, 2019 and 2018 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. Management evaluates the remaining useful lives annually on October 31 to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required.

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

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 bases 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 “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, 2019 and 2018 are more likely than not to be fully realized and 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 Bank. The treasury stock method is applied to determine the dilutive effect of stock options and unvested restricted stock in computing diluted earnings per share.

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

Share-Based Payments

The Bank 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 Bank'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 Bank has not paid dividends to date. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized.

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 Bank’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 Bank 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 Bank 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.

Retirement Plans

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

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

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 items. 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.

Adoption of New Accounting Standards

Leases
On January 1, 2019, the Bank adopted ASU No. 2016-02 “Leases (Topic 842)” and subsequent amendments thereto, which requires the Bank to recognize most leases on the balance sheet. We adopted the standard under a modified retrospective approach as of the date of adoption and elected to apply several of the available practical expedients, including:

- Carry over of historical lease determination and lease classification conclusions
- Carry over of historical initial direct cost balances for existing leases

Adoption of the leasing standard resulted in the recognition of operating right-of-use assets of $4,252,000, and operating lease liabilities of $4,441,000 as of January 1, 2019. These amounts were determined based on the present value of remaining minimum lease payments, discounted using the Bank’s incremental borrowing rate as of the date of adoption. There was no material impact to the timing of expense or income recognition in the Bank’s Income Statements. Prior periods were not restated and continue to be presented under legacy GAAP. Disclosures about the Bank’s leasing activities are presented in Note 7 – Leases.

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 Bank has the ability to access as of the measurement date.

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 Bank'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.

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

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 Bank for deposits with similar remaining maturities, resulting in a Level 2 classification.

(c) Investment Securities

Fair values for available-for-sale 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, is based on the exit price notion set forth by ASU 2016-01 effective January 1, 2018 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.

(e) FHLB and TIB Stock

It is not practical to determine the fair value of FHLB or TIB stock due to restrictions placed on its transferability.

(f) Equity Securities

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

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

(g) 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.

(h) 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.

(i) Other Borrowings

The fair values of the Bank'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.

(j) 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.

(k) 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)*

Fair Value Hierarchy *(continued)*

The estimated carrying and fair values of the Bank's financial instruments at December 31, 2019 and 2018 are as follows *(Dollars in thousands)*:

	2019				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash & due from banks	$ 11,531	$ 11,531	$ -	$ -	$ 11,531
Federal funds sold	-	-	-	-	-
Interest-bearing deposits In other financial institutions	54,941	-	55,074	-	55,074
Investment securities	43,329	-	43,329	-	43,329
Equity securities	74	74	-	-	74
Loans, gross	579,033	-	-	577,630	577,630
FHLB stock	3,160	-	-	-	N/A
TIB stock	62	-	-	-	N/A
Accrued interest receivable	2,212	-	226	1,986	2,212
Financial liabilities:					
Deposits	$ 621,162	$ -	$ 620,708	$ -	$ 620,708
Accrued interest payable	1,686	-	1,686	-	1,686
Federal Home Loan Bank Borrowings	10,000	-	10,000	-	10,000

	2018				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash & due from banks	$ 10,580	$ 10,580	$ -	$ -	$ 10,580
Federal funds sold	-	-	-	-	-
Interest-bearing deposits In other financial institutions	30,691	-	30,700	-	30,700
Investment securities	45,952	-	45,952	-	45,952
Equity securities	57	57	-	-	57
Loans, gross	508,663	-	-	485,747	485,747
FHLB stock	2,574	-	-	-	N/A
TIB stock	62	-	-	-	N/A
Accrued interest receivable	2,037	-	208	1,829	2,037
Financial liabilities:					
Deposits	$ 513,307	$ -	$ 513,880	$ -	$ 513,880
Accrued interest payable	472	-	472	-	472
Federal Home Loan Bank Borrowings	40,000	-	40,000	-	40,000

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 Bank'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 2019. The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2019 and 2018:

Recurring Basis

The following tables present information about the Bank's assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018 *(Dollars in thousands):*

	2019			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 11,648	$ -	$ 11,648	$ -
State and political subdivision	6,679	-	6,679	-
Residential mortgage-backed securities	21,995	-	21,995	-
Corporate debt	3,007	-	3,007	-
Equity Securities	74	-	74	-
Total assets measured at fair value on a recurring basis	$ 43,403	$ -	$ 43,403	$ -

	2018			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 31,259	$ -	$ 31,259	$ -
Residential mortgage-backed securities	11,714	-	11,714	-
Corporate debt	2,979	-	2,979	-
Equity Securities	57	-	57	-
Total assets measured at fair value on a recurring basis	$ 46,009	$ -	$ 46,009	$ -

During the years ended December 31, 2019 and 2018, there were no transfers in or out of Levels 1 or 2.

2. FAIR VALUE MEASUREMENTS *(continued)*

Non-recurring Basis

The Bank 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, 2019 and 2018 *(Dollars in thousands):*

	2019				
Description	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans					
Residential	$ 425	$ -	$ -	$ 425	$ -
Commercial	331	-	-	331	45
Consumer and other	-	-	-	-	(13)
Total impaired loans	756	-	-	756	32
Total assets measured at fair value on a non-recurring basis	$ 756	$ -	$ -	$ 756	$ 32

	2018				
Description	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans					
Residential	$ 425	$ -	$ -	$ 425	$ -
Commercial	459	-	-	459	(205)
Total impaired loans	884	-	-	884	(205)
Total assets measured at fair value on a non-recurring basis	$ 884	$ -	$ -	$ 884	$ (205)

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $809,000, with a valuation allowance of $53,000 at December 31, 2019, resulting in $53,000 of additional provision for loan losses for the year ended December 31, 2019. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $1,028,000, with a valuation allowance of $144,000 at December 31, 2018, resulting in $144,000 of additional provision for loan losses for the year ended December 31, 2018.

2. FAIR VALUE MEASUREMENTS *(continued)*

Non-recurring Basis *(continued)*

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 as prescribed by topic 310 is not 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 Bank. 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 Bank uses the contract price less actual cost of sale as that price is determined to be market value.

The Bank had no OREO as of December 31, 2019 and 2018. There were no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2019 and 2018.

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2019 and 2018 consisted of the following *(Dollars in thousands):*

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 11,840	$ -	$ (192)	$ 11,648
State and political subdivision	6,731	-	(52)	6,679
Residential mortgage-backed securities	21,918	188	(111)	21,995
Corporate debt	3,004	3	-	3,007
	$ 43,493	$ 191	$ (355)	$ 43,329

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 31,693	$ -	$ (434)	$ 31,259
Residential mortgage-backed securities	11,846	6	(138)	11,714
Corporate debt	3,010	-	(31)	2,979
	$ 46,549	$ 6	$ (603)	$ 45,952

Net unrealized losses on available-for-sale investment securities totaling $164,000 were recorded net of $48,000 in tax assets as accumulated other comprehensive income within shareholders' equity at December 31, 2019. Net unrealized losses on available for sale investment securities totaling $597,000 were recorded net of $177,000 in tax assets as accumulated other comprehensive income within shareholders' equity at December 31, 2018.

The following table summarizes the securities sold and called for the year ended December 31, 2019 *(Dollars in thousands)*:

	2019	
	Proceeds	Gross Gains
Sales	$ 12,657	$ 126
Calls	2,000	-
	$ 14,657	$ 126

There were no securities sold or called for the year ended December 31, 2018.

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES *(continued)*

The following tables summarize securities with unrealized losses at December 31, 2019 and December 31, 2018, aggregated by major security type and length of time in a continuous unrealized loss position *(Dollars in thousands):*

	2019					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
U.S. government agencies	$ -	$ -	$ 11,648	$ (192)	$ 11,648	$ (192)
State and Political Subdivision	6,132	(52)	-	-	6,132	(52)
Residential Mortgage-backed securities	13,189	(102)	385	(9)	13,574	(111)
Corporate Debt	-	-	-	-	-	-
Total available-for-sale	$ 19,321	$ (154)	$12,033	$ (201)	$ 31,354	$ (355)

	2018					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
U.S. government agencies	$ 5,017	$ (49)	$ 26,242	$ (385)	$ 31,259	$ (434)
Residential Mortgage-backed securities	7,946	(85)	796	(53)	8,742	(138)
Corporate Debt	1,986	(23)	993	(8)	2,979	(31)
Total available-for-sale	$14,949	$ (157)	$ 28,031	$ (446)	$ 42,980	$ (603)

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES *(continued)*

Unrealized losses on all securities have not been recognized into income because the issuer's bonds are of high credit quality, management does not intend to sell and 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 amortized cost and estimated fair value of investment securities at December 31, 2019 and 2018 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 *(Dollars in thousands):*

	2019		2018	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$ 3,004	$ 3,007	$ 3,797	$ 3,764
One to three years	-	-	6,015	5,941
Three years through five years	-	-	9,014	8,904
After 5 years	6,731	6,679	-	-
	9,735	9,686	18,826	$ 18,609
Investment securities not due at a single maturity date:				
Residential mortgage-backed securities and small business administration securities	33,758	33,643	27,723	27,343
	$ 43,493	$ 43,329	$ 46,549	$ 45,952

4. LOANS

Outstanding loans at December 31, 2019 and 2018 are summarized below *(Dollars in thousands)*:

	2019	**2018**
Commercial	$ 85,717	$ 81,944
Real estate – commercial	331,037	281,354
Real estate – residential	114,094	110,171
Construction	47,744	34,763
Consumer and other	441	431
	579,033	508,663
Deferred loan origination fees, net of costs	(575)	(266)
Allowance for loan losses	(6,366)	(5,542)
	$ 572,092	$ 502,855

4. LOANS *(continued)*

The table above includes loans acquired at fair value on January 1, 2016 with outstanding balances of $22,899,000 as of December 31, 2019.

The Bank deferred $546,000 and $531,000 in salaries and employee benefits as loan origination costs for the years ended December 31, 2019 and 2018, respectively.

Loans with a fair value of approximately $147,821,000 and $90,080,000 were pledged to secure borrowing arrangements as of December 31, 2019 and 2018, respectively (Note 12).

Loan Servicing

The Bank services SBA loans for the SBA as well as institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2019 and 2018 the Bank was servicing approximately $7.5 million and $6.4 million in SBA loans previously sold. The net carrying value of servicing rights associated with these loans was approximately $33,000 and $17,000 as of December 31, 2019 and 2018, respectively. The carrying value approximated the fair value at December 31, 2019 and 2018.

5. ALLOWANCE FOR LOAN LOSSES

The following tables present the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2019 and 2018 *(Dollars in thousands):*

December 31, 2019	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 1,341	$ 2,416	$ 838	$ 949	$ (2)	$ -	$ 5,542
Provision(benefit) for loan losses	(219)	891	(128)	234	28	-	806
Loans charged-off	(57)	-	-	-	(8)	-	(65)
Recoveries	83	-	-	-	-	-	83
Ending balance allowance	$ 1,148	$ 3,307	$ 710	$ 1,183	$ 18	$ -	$ 6,366

December 31, 2018	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 1,041	$ 2,028	$ 553	$ 618	$ 17	$ 3	$ 4,260
Provision(benefit) for loan losses	317	388	280	331	(19)	(3)	1,294
Loans charged-off	(44)	-	-	-	-	-	(44)
Recoveries	27	-	5	-	-	-	32
Ending balance allowance	$ 1,341	$ 2,416	$ 838	$ 949	$ (2)	$ -	$ 5,542

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows the allocation of the allowance for loan losses at December 31, 2019 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	$ 1,148	$ 3,307	$ 710	$ 1,183	$ 18	$ -	$ 6,366
Ending balance: individually evaluated for impairment	$ 40	$ -	$ -	$ -	$ 13	$ -	$ 53
Ending balance: collectively evaluated for impairment	$ 1,108	$ 3,307	$ 710	$ 1,183	$ 5	$ -	$ 6,313
Loans							
Ending balance	$ 85,717	$ 331,037	$ 114,094	$ 47,744	$ 441	$ -	$ 579,033
Ending balance: individually evaluated for impairment	$ 40	$ -	$ 425	$ -	$ 13	$ -	$ 478
Ending balance: collectively evaluated for impairment	$ 85,677	$ 331,037	$ 113,669	$ 47,744	$ 428	$ -	$ 578,555

The following table shows the allocation of the allowance for loan losses at December 31, 2018 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	$ 1,341	$ 2,416	$ 838	$ 949	$ (2)	$ -	$ 5,542
Ending balance: individually evaluated for impairment	$ 144	$ -	$ -	$ -	$ -	$ -	$ 144
Ending balance: collectively evaluated for impairment	$ 1,197	$ 2,416	$ 838	$ 949	$ (2)	$ 3	$ 5,398
Loans							
Ending balance	$ 81,944	$ 281,354	$ 110,171	$ 34,763	$ 431	$ -	$ 508,663
Ending balance: individually evaluated for impairment	$ 459	$ -	$ 425	$ -	$ -	$ -	$ 884
Ending balance: collectively evaluated for impairment	$ 81,485	$ 281,354	$ 109,746	$ 34,763	$ 431	$ -	$ 507,779

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2019 (*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	$ 82,782	$ 329,636	$ 113,570	$ 47,744	$ 428	$ 574,160
Special Mention	793	-	-	-	-	793
Substandard	2,142	1,401	524	-	13	4,080
Total	$ 85,717	$ 331,037	$ 114,094	$ 47,744	$ 441	$ 579,033

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2018 (*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	$ 79,747	$ 278,861	$ 109,691	$ 34,763	$ 431	$ 503,493
Special Mention	1,052	2,493	55	-	-	3,600
Substandard	1,145	-	425	-	-	1,570
Total	$ 81,944	$ 281,354	$ 110,171	$ 34,763	$ 431	$ 508,663

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2019 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 284	$ 284	$ 85,433	$ 85,717
Real Estate – Commercial	-	-	-	-	331,037	331,037
Real Estate – Residential	-	-	-	-	114,094	114,094
Construction	-	-	-	-	47,744	47,744
Consumer and Other	-	-	-	-	441	441
Total	$ -	$ -	$ 284	$ 284	$ 578,749	$ 579,033

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2018 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ 170	$ -	$ 349	$ 519	$ 81,425	$ 81,944
Real Estate – Commercial	-	-	-	-	281,354	281,354
Real Estate – Residential	-	-	-	-	110,171	110,171
Construction	-	-	-	-	34,763	34,763
Consumer and Other	13	-	-	13	418	431
Total	$ 183	$ -	$ 349	$ 532	$ 508,131	$ 508,663

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

During the years ended December 31, 2019 and 2018, the Bank had $86,000 and $90,000 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, 2019 (*Dollars in thousands*):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without an allowance recorded:					
Real Estate - Residential	$ 425	$ 425	$ -	$ 425	$ 29
With an allowance recorded:					
Commercial	40	40	40	62	38
Consumer and Other	13	13	13	7	1
Total:					
Commercial	40	40	40	62	38
Real Estate - Residential	425	425	-	425	29
Construction	-	-	-	-	-
Consumer and Other	13	13	13	7	1
	$ 478	$ 478	$ 53	$ 494	$ 68

The following table shows information related to impaired loans at and for the year ended December 31, 2018 (*Dollars in thousands*):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without an allowance recorded:					
Commercial	$ 138	$ 138	$ -	$ 350	$ 48
Real Estate - Residential	425	425	-	425	27
With an allowance recorded:					
Commercial	321	321	144	522	46
Total:					
Commercial	459	459	144	872	94
Real Estate - Residential	425	425	-	425	27
Construction	-	-	-	-	-
Consumer and Other	-	-	-	-	-
	$ 884	$ 884	$ 144	$ 1,297	$ 121

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.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

For the years ended December 31, 2019 and 2018, the Bank did not recognize any income on a cash basis.

Troubled Debt Restructurings

Included in impaired loans at December 31, 2019 are two loans in the amount of $53,000 that are considered to be troubled debt restructurings. Included in impaired loans at December 31, 2018 is one loan in the amount of $85,000 that is considered to be a troubled debt restructuring. The Bank has allocated $53,000 and $85,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2019 and 2018, respectively.

The Bank has not committed to lend any additional funds to customers with outstanding loans that are classified as troubled debt restructurings as of December 31, 2019.

The Bank had $13,000 and $124,000 of troubled debt restructurings during the years ending December 31, 2019 and 2018, respectively.

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2019:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Consumer and Other	1	$13,000	$13,000

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2018:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial	1	$124,000	$124,000

The troubled debt restructurings described above increased the allowance for loan losses by $13,000 and $85,000 and resulted in $0 charge offs during the years ending December 31, 2019 and 2018.

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, 2019 and 2018.

A loan is considered to be in payment default typically 90 days from the contractual due date.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

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 Bank's internal underwriting policy.

6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following at December 31, 2019 and 2018 *(Dollars in thousands)*:

	2019	2018
Furniture, fixtures and equipment	$ 2,809	$ 2,384
Leasehold improvements	4,770	2,943
Building	1,224	1,224
Building Improvements	1,585	1,585
Land	774	774
	11,162	8,910
Less accumulated depreciation and amortization	(4,284)	(3,611)
	$ 6,878	$ 5,299

Depreciation and amortization included in occupancy and equipment expense totaled $673,000 and $450,000 for the years ending December 31, 2019 and 2018, respectively.

7. LEASES

The Bank enters into leases in the normal course of business primarily for full service branches and lending centers. The Bank's leases have remaining terms ranging from 2 to 10 years, some of which include renewal options to extend the lease for up to 20 years.

The Bank leases its headquarters, branch facilities (except Paso Robles which is owned by the Bank) and lending offices under non-cancelable operating leases. The lease for the headquarters and Santa Barbara branch expires on June 30, 2020 and the Bank intends to exercise the remaining five year renewal option on this lease. 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 7%. The lease for the Montecito branch expires on April 30, 2028 and has one ten year renewal option. The lease includes rent adjustments every 3 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, 2022 and has two five year renewal options. The lease includes annual scheduled rent increases of fixed amounts. The lease for the Residential Lending Department expires on October 31, 2022 and has two five year renewal options. The lease includes an annual rent adjustment of 3%. 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 Bank also received a $40,000 tenant improvement allowance as part of the lease agreement.

7. LEASES *(continued)*

The Bank entered into two separate leases in 2018 for a full service branch and a loan production office in San Luis Obispo. The lease for the full service branch commenced on June 1, 2019 and expires in May 2029. The lease includes an annual rent adjustment of 3% and has four 5 year renewal options. The Bank received a lessee improvement allowance of $100,000 as part of the lease agreement. The lease for the loan production office commenced on June 1, 2019 and expires in May 2029. The lease includes an annual rent adjustment of 3% and has four 5 year renewal options. The Bank received a lessee improvement allowance of $146,000 as part of the lease agreement.

The Bank includes lease extension and termination options in the lease term, if, after considering relevant economic factors, it is reasonably certain the Bank will exercise the option. In addition, the Bank has elected to account for any non-lease components in its real estate leases as part of the associated lease component. The Bank has also elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the Bank'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 Bank 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 Bank's incremental borrowing rate is based on the US Treasury rate, adjusted for the lease term and other factors.

As of December 31, 2019, all of the Bank's leases are classified as operating leases. Right-of-use assets were $7,661,000 and lease liabilities were $8,078,000 as of December 31, 2019.

Rental expense, net of sublease income, included in occupancy and equipment expense totaled $991,000 and $774,000 for the years ended December 31, 2019 and 2018, 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, 2019 are as follows *(Dollars in thousands)*:

Year Ending December 31,	Operating Lease
2020	$ 1,489
2021	1,533
2022	1,474
2023	1,008
2024	983
Thereafter	2,229
Total undiscounted lease payments	8,716
Less: imputed interest	(638)
Net lease liabilities	$ 8,078

The Bank subleases certain excess space. The sublease expires on October 31, 2022 and has no renewal options. The lease includes an annual rent adjustment of 3%. Future minimum lease receivables are as follows *(Dollars in thousands)*:

Year Ending December 31,	Operating Lease
2020	$ 168
2021	173
2022	148
Thereafter	-
	$ 489

Supplemental Lease Information

	December 31, 2019
Operating lease weighted average remaining lease term (years)	7
Operating lease weighted average discount rate	2.07

8. OTHER REAL ESTATE OWNED

At December 31, 2019 and December 31, 2018 the Bank had no properties acquired through foreclosure or deed in lieu.

9. GOODWILL AND INTANGIBLE ASSETS

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2019 and 2018 was $4.8 million. Total goodwill at December 31, 2019 and 2018 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 Bank's ability to generate net earnings after the acquisitions and is not deductible for tax purposes. 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 Bank 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 Bank below its carrying amount. No such events or circumstances arose during the fourth quarter of 2019, so goodwill was not required to be retested.

The intangible assets at December 31, 2019 and 2018 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. The carrying value of intangible assets at December 31, 2019 was $1,250,000, net of accumulated amortization of $713,000. Management evaluates the remaining useful lives annually to determine whether events or circumstances warrant a revision to the remaining periods of amortization. Based on the evaluation, no changes to the remaining useful lives was required. Management performed an annual impairment test on core deposit intangibles on October 31, 2019 and determined that no impairment existed. Amortization expense recognized was $179,000 for 2019 and $178,000 for 2018.

The following table summarizes the Bank's estimated core deposit intangible amortization expense for each of the next three years *(Dollars in thousands)*:

Year Ending December 31,	Estimated Core Deposit Intangible Amortization
2020	179
2021	179
2022	179
	$ 537

10. TIME DEPOSITS

Time deposits as of December 31, 2019 have the following maturities by year *(Dollars in thousands)*:

2020	$	68,855
2021		9,143
2022		124
Thereafter		18
	$	78,140

Time deposits of $250 thousand or more were $37,048,000 and $26,749,000 at December 31, 2019 and 2018, respectively.

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2019 and 2018 consisted of the following *(Dollars in thousands)*:

	2019	2018
Current:		
Federal	$ 1,697	$ 1,566
State	997	918
	2,694	2,484
Deferred:		
Federal	(105)	(11)
State	(83)	(27)
	(188)	(38)
Provision for income taxes	$ 2,506	$ 2,446

Effective tax rates differ from the federal statutory rate of 21% applied to income before income taxes due to the following:

	2019	2018
Federal statutory rate times financial statement income	$ 1,869	$ 1,751
Effect of:		
State income taxes, net of federal tax benefit	722	712
Share-based compensation	(73)	(46)
Other, net	(12)	29
Total	$ 2,506	$ 2,446

11. INCOME TAXES *(continued)*

Deferred tax assets (liabilities) at December 31, 2019 and 2018 consisted of the following and are recorded on the balance sheet with accrued interest receivable and other assets *(Dollars in thousands)*:

	2019	2018
Deferred tax assets:		
Organization costs	$ 74	$ 126
Lease liability	2,388	-
Allowance for loan losses	1,586	1,258
Accrued expenses	494	502
Share-based compensation	265	212
Unrealized loss on available-for-sale investment securities	48	177
Net operating loss carryforward	580	716
Fair value adjustments	123	196
Other	265	235
Deferred tax assets	5,823	3,422
Deferred tax liabilities:		
Deferred loan costs	(458)	(437)
Right-of-use asset	(2,265)	-
Premises and equipment	(302)	(257)
Prepaid expenses	(48)	(40)
Other	(6)	(3)
Total deferred tax liabilities	(3,079)	(737)
Net deferred tax asset	$ 2,744	$ 2,685

As of December 31, 2019 and 2018 management performed an evaluation of the Bank's net deferred tax asset and determined that it was more likely than not that the Bank would be able to utilize its net deferred tax asset. Therefore, no valuation allowance is necessary for 2019.

The Bank files income tax returns in the United States and California jurisdictions. The Bank is no longer subject to examination by federal taxing authorities for tax years prior to 2016 and is no longer subject to examination by California taxing authorities for tax years prior to 2015. There are currently no pending federal or state income tax examinations by tax authorities.

The Bank has no uncertain tax positions and has not accrued for any interest or penalties as of December 31, 2019 or 2018. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

As of December 31, 2019, the Bank has net operating losses ("NOLs") available to carry-forward for federal tax purposes totaling $2.8 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 Bank 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

11. INCOME TAXES *(continued)*

approximately $0.5 million for federal purposes. The Bank does not, however, believe that the annual limitation will impact the ultimate deductibility of these NOL carry-forwards.

12. BORROWING ARRANGEMENTS

The Bank has unsecured Federal funds lines of credit with four of its correspondent banks under which it can borrow up to $37,000,000 in the aggregate. There were $0 in borrowings outstanding under these arrangements as of December 31, 2019 and 2018.

In addition, the Bank 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, 2019, amounts pledged and available under such limits at the FHLB were approximately $71,847,000 and $51,847,000, respectively. At December 31, 2018, amounts pledged and available under such limits at the FHLB were approximately $72,806,000 and $68,335,000, respectively. As of December 31, 2019 and 2018, the Bank had FHLB borrowings outstanding of $10,000,000 and $40,000,000 respectively. FHLB borrowings mature in August 2020. As of December 31, 2019 the Bank had a $10,000,000 letter of credit secured with the Federal Home Loan Bank to secure local agency deposits.

The Bank has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Bank 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, 2019 or 2018, and the Bank had $7,356,000 of readily available borrowing capacity at December 31, 2019 based on currently pledged loans.

13. COMMITMENTS AND CONTINGENCIES

Financial Instruments With Off-Balance Sheet Risk

The Bank 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, 2019	December 31, 2018
Commitments to extend credit	$ 123,349	$ 101,719
Standby letters of credit	$ 451	$ 1,125

The Bank'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 Bank uses the same credit policies in making commitments as it does for loans included on the balance sheets.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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

Commitments to extend credit are agreements to lend to a customer 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 Bank evaluates each customer's creditworthiness on a case-by-case basis.

The amount of collateral obtained, if deemed necessary by the Bank 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, 2019 and 2018.

The Bank recognizes these fees as revenue over the term of the commitment or when the commitment is used.

As of December 31, 2019, unsecured commercial loan commitments represent approximately 48% 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 9% of total commitments. Home equity lines of credit, which are collateralized and generally have variable interest rates, represent approximately 20% of total commitments. Secured construction loan commitments represent approximately 18% of total commitments and have primarily fixed rates. Agricultural production represents approximately 3% of total commitments. The remaining 2% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

As of December 31, 2018, unsecured commercial loan commitments represent approximately 43% 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 10% of total commitments. Home equity lines of credit, which are collateralized and generally have variable interest rates, represent approximately 24% of total commitments. Secured construction loan commitments represent approximately 16% of total commitments and have primarily fixed rates. Agricultural production represents approximately 4% of total commitments. The remaining 3% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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 I capital and reserves.

The Bank 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 125% of the Bank's total capital ("TC").

At December 31, 2019, a concentration representing approximately 441% 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 152% 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.

At December 31, 2018, a concentration representing approximately 460% 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 181% 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 Bank's primary market area could have an adverse impact on the collectability of these loans.

Concentrations in Deposit and Loan Relationships

As of December 31, 2019 and 2018, the Bank did not have any deposit customers that exceed 5% of total deposits.

As of December 31, 2019 and 2018 the Bank did not have any loan customers that exceed 10% of total loans.

Federal Reserve Requirements

Banks are required to maintain reserves with the Federal Reserve Bank of San Francisco (the "FRB") equal to a percentage of their reservable deposits. As of December 31, 2019, the Bank was required to maintain $16,008,000 in reserves with the FRB.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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, 2019, the Bank had $33,255,000 of uninsured deposits.

14. SHARE-BASED PAYMENT

On December 31, 2019, the Bank had two share-based compensation plans, which are described below. The Plans do 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 Bank 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 Bank's common stock. The remaining shares available for issuance are reduced by shares reserved under the 2009 Plan and shares outstanding under the 2015 Plan, leaving 385,577 available for issuance under the Plan at December 31, 2019.

In October 2009, the Bank adopted the American Riviera Bank 2009 Omnibus Stock Incentive Plan (“2009 Plan”) for which no shares remain reserved for issuance for options already granted to employees and directors under incentive and nonstatutory agreements and no shares of restricted stock awards are outstanding to be vested. While outstanding arrangements to issue shares under these plans, including options, continue in force until their expiration, no new options or awards will be granted under this plan.

There were 109,914 and 26,125 restricted shares granted in 2019 and 2018, 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 Bank'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 vest over a three 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. In 2016, in connection with the merger with BSB, replacement stock options were granted to certain current and previous officers and directors to replace options previously granted and fully vested under the BSB Omnibus Stock Plan.

14. SHARE-BASED PAYMENT *(continued)*

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, 2019 and 2018. A summary of the award activity under the Plan for the years ended December 31, 2019 and 2018 is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at January 1, 2018	16,829	$ 11.40	
Issued	-	$ -	
Exercised	-	$ -	
Options outstanding at December 31, 2018	16,829	$ 11.40	2.63
Issued	-	$ -	
Exercised	-	$ -	
Options exercisable at December 31, 2019	16,829	$ 11.40	1.63

As of December 31, 2019 and 2018, there was no unrecognized compensation related to non-qualified stock option awards. There was $141,000 intrinsic value related to non-qualified stock option awards at December 31, 2019. During 2019 and 2018, none of the 16,829 stock options were exercised by cashless exercises.

Employee Incentive Stock Option Awards

There were no employee incentive stock option awards granted for the years ended December 31, 2019 and 2018. In 2016, in connection with the merger with BSB, 65,287 replacement stock options were granted to certain employees 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 recorded for each of the years ended December 31, 2019 and 2018.

14. SHARE-BASED PAYMENT *(continued)*

Employee Incentive Stock Option Awards *(continued)*

A summary of the award activity under the Plan for the years ended December 31, 2019 and 2018 are presented below*:*

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at January 1, 2018	110,101	$ 9.23	1.90
Exercised	(51,360)	$ 6.94	
Options outstanding at December 31, 2018	58,741	$ 11.23	1.96
Exercised	(19,092)	$ 10.84	
Options vested and expected to vest	39,649	$ 11.41	1.00
Options exercisable at December 31, 2019	39,649	$ 11.41	1.00

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

	2019	2018
Intrinsic value of options exercised	$ 132	$ 614
Cash received from options exercised	12	356
Tax benefit realized from option exercise	32	-

As of December 31, 2019 and 2018, there was no unrecognized compensation cost related to non-vested stock option awards to employees. The aggregate intrinsic value of outstanding employee incentive stock options was $333,000 and $389,000 at December 31, 2019 and 2018, respectively. During 2019, 19,092 stock options were exercised of which 17,092 were conducted by cashless exercises, resulting in 10,980 shares being forfeited and 6,112 shares being issued. The remaining 2,000 stock options exercised were paid for in cash resulting in proceeds of $12,000. During 2018, 51,360 stock options were exercised all of which were paid for in cash resulting in proceeds of $356,000.

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 issue date. The fair value of the stock was determined using most recent market data. Restricted common stock shares to employees typically vest over a three to five year period and immediately for directors.

14. SHARE-BASED PAYMENT *(continued)*

Restricted Common Stock Awards *(continued)*

A summary of changes in the Bank's nonvested shares for the year is as follows:

Non Vested Shares	Shares	Weighted Average Grant Date Fair Value
Non vested shares at January 1, 2019	80,018	$ 14.20
Granted	109,914	17.86
Vested	(52,353)	13.17
Forfeited	(4,622)	15.75
Non vested shares at December 31, 2019	132,957	$ 17.58

In 2019, the Bank granted 102,680 shares of restricted common stock to selected officers, which had a fair market value between $17.50 and $19.90 per share on the date of grant. These restricted common stock awards vest over a two to five year period from the date of the grant

In 2019, the Bank granted a total of 7,234 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value between $17.50 and $18.40 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $132,500 was recorded for the year ended December 31, 2019.

In 2018, the Bank granted 22,579 shares of restricted common stock to selected officers, which had a fair market value between $17.10 and $19.50 per share on the date of grant. These restricted common stock awards vest 25% after Year 1, 25% after Year 2, 25% after Year 3 and 25% after Year 4.

In 2018, the Bank granted a total of 3,546 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value of $19.05 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $67,500 was recorded for the year ended December 31, 2018.

As of December 31, 2019, there were 132,957 shares of restricted stock that are nonvested and expected to vest. Compensation cost and directors fees charged against income for restricted stock awards was $736,000 and $434,000 for the years ended December 31, 2019 and 2018, respectively. There was an excess tax benefit recognized for restricted stock awards in the amount of $71,000 and $65,000, respectively for the years ended December 31, 2019 and 2018. At December 31, 2019 and 2018, the total compensation cost related to nonvested restricted common stock not yet recognized was $1,823,000 and $669,000. 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 4.0 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, 2019 and 2018 was $795,000 and $582,000, 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, 2019, $15,819,000 were free of such restrictions.

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, 2019 and 2018 is as follows:

	Net Income	Weighted Average Number of Shares Outstanding	Common Share Amount
December 31, 2019			
Basic earnings per share	$6,393,000	4,886,531	$ 1.31
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	$ 6,393,000	4,886,531	1.31
December 31, 2018			
Basic earnings per share	$5,890,000	4,441,880	$ 1.33
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	$ 5,890,000	4,441,880	1.33

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. As a result, there were no options excluded from the computation of diluted earnings per share for the years ended December 31, 2019 and 2018, respectively.

Regulatory Capital

The Bank is subject to certain regulatory capital requirements administered by the FDIC. Failure to meet these minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

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. The final rules implementing Basel committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the

15. SHAREHOLDERS' EQUITY *(continued)*

Regulatory Capital *(continued)*

requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. 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 2019 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, 2019 and 2018, the most recent regulatory notifications categorized the Bank as "well capitalized" under the regulatory framework for prompt correction action. There are no conditions or events since that notification that management believes have changed the Bank's category.

As of December 31, 2019 and 2018, total average assets for leverage capital purposes were $705,771,000 and $600,171,000, respectively, and total risk weighted assets were $624,582,000 and $536,330,000, respectively.

Capital ratios as of December 31, 2019 and 2018 are as follows *(Dollars in thousands)*:

	2019		2018	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
American Riviera Bank	$ 70,889	10.0%	$ 55,250	9.2%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 35,289	5.0%	$ 30,009	5.0%
Minimum regulatory requirement	$ 28,231	4.0%	$ 24,007	4.0%
Common Equity Tier I Ratio				
American Riviera Bank	$ 70,889	11.35%	$ 55,250	10.3%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 40,598	6.5%	$ 34,861	6.5%
Minimum regulatory requirement	$ 28,106	4.5%	$ 24,135	4.5%
Tier 1 Risk-Based Capital Ratio				
American Riviera Bank	$ 70,889	11.3%	$ 55,250	10.3%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 49,967	8.0%	$ 42,906	8.0%
Minimum regulatory requirement	$ 37,475	6.0%	$ 32,180	6.0%
Total Risk-Based Capital Ratio				
American Riviera Bank	$ 77,424	12.4%	$ 60,941	11.4%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 62,458	10.0%	$ 53,633	10.0%
Minimum regulatory requirement	$ 49,967	8.0%	$ 42,906	8.0%

16. REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Bank's revenue from contracts with customers in the scope of ASC 606 is recognized within Non-Interest Income. The following table presents the Bank's sources of Non-Interest Income within the scope of ASC 606 for the twelve months ended December 31, 2019 and 2018. The Other category totaling $2,114 and $1,167 for the years ended December 31, 2019 and 2018, respectively, is not within the scope of ASC 606.

Non-Interest Income	**2019**	**2018**
Service charges on deposits	$ 479	$ 427
Overdraft fees	$ 198	$ 178
Other	$ 2,114	$ 1,167
	$ 2,791	$ 1,772

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

Profit Sharing Plan

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 Bank contributed $336,000 and $281,000 in the form of employer matching contributions to the 401k Plan during the years ended December 31, 2019 and 2018, respectively.

18. OTHER EXPENSES

Other expenses for the years ended December 31, 2019 and 2018 consisted of the following *(Dollars in thousands)*:

	2019	2018
Data processing	$ 825	$ 723
Advertising and marketing	847	680
Professional fees	610	545
Regulatory assessments	204	345
Director Fees	357	296
Software	319	273
Insurance	82	79
Other	2,048	1,882
	$ 5,292	$ 4,823

19. RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank 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, 2019	$ -
Disbursements	745
Amounts repaid	(289)
Re-classified related party balances	40
Balance, December 31, 2019	$ 496

As of December 31, 2019, total undisbursed commitments to related parties were $120,000.

As of December 31, 2019 and 2018, there were no loans to related parties that exceeded 10% of the Bank's total loans.

Deposits

As of December 31, 2019 and 2018, there were no deposits to related parties that exceeded 5% of the Bank's total deposits.

Other Related Party Transactions

A member of the Board of Directors is affiliated with the insurance brokerage company for the Bank's insurance coverage. Total amounts paid during 2019 and 2018 were $0 and $10,420, respectively. A member of the Board of Directors is affiliated with the accounting firm which provides fixed asset accounting services for the Bank. Total amounts paid during 2019 and 2018 were $9,889 and $8,075, respectively. A member of the Board of Directors is affiliated with a law firm which provides counsel for issues related to the Bank. Total amounts paid during 2019 and 2018 were $2,508 and $2,701, respectively. A member of the Board of Directors is affiliated with a wine company which provides wines for the Bank’s special events. Total amounts paid during 2019 and 2018 were $2,291 and $3,429 respectively. The Board of Directors of the Bank approved these transactions.

20. EQUITY OFFERING

On March 27, 2019 the Bank completed an equity offering of $8.5 million through the issuance of 472,222 shares of common stock at a price of $18.00 per share, at no par value. Expenses incurred related to this capital raise were $456,000 and were offset to common stock. The net proceeds of the capital raise will be used for general corporate purposes, including but not limited to, supporting organic growth and expansion opportunities in the Bank's Central Coast service area. These shares have the same voting and cash dividend rights as previously issued common stock.

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BANK

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Santa Barbara Commercial Lending Center
30 E. Figueroa Street, Suite 200, Santa Barbara, CA 93101

Residential Lending Office
18 E. Figueroa Street, Santa Barbara, CA 93101

Montecito Branch
525 San Ysidro Road, Montecito, CA 93108

Goleta Branch
5880 Calle Real, Goleta, CA 93117

San Luis Obispo Branch & Lending Center
1085 Higuera Street, San Luis Obispo, CA 93401

Paso Robles Branch
1601 Spring Street, Paso Robles, CA 93446