AMERICAN RIVIERA
BANK

2021 Annual Report

AMERICAN RIVIERA BANK

A Message to our Shareholders, Clients, and Community

We are proud to report that American Riviera Bank served an important role in providing economic stability to Santa Barbara and San Luis Obispo counties while also enhancing shareholder value with a continued commitment to relationship growth, credit quality, and strong earnings throughout the prolonged COVID-19 pandemic. Your Bank produced tremendous SBA Paycheck Protection Program (PPP) loan volume and double digit growth in both deposits and non-PPP loans in 2021. Total assets increased to $1.3 billion and the Bank reported record net income of $11.8 million. **American Riviera Bank is truly the Central Coast's community bank**, as evidenced by our growth, and due to our ability to quickly respond to the needs of our clients, provide high-touch service from experienced bankers, remain flexible, and keep decision-making local.

For the eleventh year in a row, your Bank achieved double-digit core loan growth excluding PPP, reporting an increase of $112 million or 17%, without sacrificing credit quality. Our ability to deliver construction loans, mortgages, home equity lines, commercial real estate loans, business loans and lines of credit, agricultural loans, and SBA loans ensures that we can meet the diverse needs of our clients. At year end, the Bank had no other real estate owned, no loans 90 days or more past due, and only $2.9 million or 0.38% of total loans excluding PPP on non-accrual status, which are well supported by collateral. As a Preferred SBA lender, we continued to leverage our automated PPP loan application portal. In 2021, we funded an additional $72 million of PPP loans which provided much needed small business relief.

Our deposit base continues to expand rapidly with 38% growth from the prior year, representing an increase of $330 million in total deposits. In 2021, non-interest-bearing demand deposits increased 41%, and comprised 39% of total deposits at December 31, 2021. Including interest-bearing checking accounts, our transaction accounts represent 54% of total deposits at December 31, 2021. Deposit inflows from our clients have been the driving factor in the total assets of the Bank increasing $335 million, or 34%, since December 31, 2020, to a total of $1.3 billion at December 31, 2021. The high mix of transaction account balances is indicative of our relationship oriented deposit base which adds to franchise value and is meaningful to maintaining margins in a rising rate environment.

Your Bank achieved record earnings with $2.30 earnings per share, representing a 59% increase from the prior year, and a return on average equity of 13.02%. We continue to retain earnings to support current and future growth, reporting total capital of over $96 million at December 31, 2021 and a Tier 1 Capital Ratio of 11%, comfortably above the regulatory guideline of 8% for well capitalized institutions. Additionally, our tangible book value per share increased 15% from the prior year, reaching $17.92 at December 31, 2021.

We are very thankful for the loyalty of our clients and our team of dedicated bankers. We are confident that we have the team, balance sheet strength, and innovation to thrive despite changing economic cycles. American Riviera Bank will continue to support our community while growing franchise value for our shareholders.

Thank you for your support,

Lawrence Koppelman, Board Chair

Jeff DeVine, President and CEO

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AMERICAN RIVIERA
BANK

FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2021 AND 2020
AND FOR THE YEARS THEN ENDED

Page

American Riviera Bank:

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

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

Opinion

We have audited the financial statements of American Riviera Bank, which comprise the balance sheets as of December 31, 2021 and 2020, 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 the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of American Riviera Bank as of December 31, 2021 and 2020, 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.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit 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 American Riviera Bank's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about American Riviera Bank's ability to continue as a going concern for a reasonable period of time.

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

Crowe LLP

Crowe LLP

Sacramento, California
March 18, 2022

AMERICAN RIVIERA BANK

BALANCE SHEETS

December 31, 2021 and 2020
(Dollar amounts in thousands except share amounts)

	2021	2020
ASSETS		
Cash and due from banks	$ 8,184	$ 8,647
Interest-bearing deposits in other financial institutions	283,927	121,085
Available-for-sale investment securities	191,423	86,877
Equity securities	120	65
Loans	793,490	726,067
Allowance for loan losses	(9,383)	(8,467)
Net Loans	784,107	717,600
Bank premise and equipment, net	5,916	6,458
Operating lease right-of-use asset	4,513	6,012
Cash surrender value of bank owned life insurance	8,641	8,407
Stock in other banks	4,288	3,375
Goodwill	4,800	4,800
Other intangibles, net	179	358
Accrued interest receivable and other assets	10,442	7,939
Total Assets	$ 1,306,540	$ 971,623
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing demand deposits	$ 470,763	$ 332,995
Interest-bearing demand deposits	181,546	128,266
Savings deposits	87,139	54,075
Money market deposits	433,416	319,117
Time deposits	29,226	37,644
Total Deposits	1,202,090	872,097
Federal Home Loan Bank borrowings	-	5,000
Operating lease liability	4,972	6,481
Accrued interest payable and other liabilities	3,205	3,126
Total Liabilities	1,210,267	886,704
Shareholders' Equity:		
Preferred stock - no par value; 5,000,000 shares authorized, none issued	-	-
Common stock - no par value; 10,000,000 shares authorized; 5,134,993 and 5,083,648 shares issued and outstanding in 2021 and 2020, respectively	56,564	55,738
Retained earnings	40,432	28,603
Accumulated other comprehensive gain (loss), net of taxes	(723)	578
Total Shareholders' Equity	96,273	84,919
Total Liabilities and Shareholders' Equity	$ 1,306,540	$ 971,623

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

AMERICAN RIVIERA BANK

STATEMENTS OF INCOME

For the Years Ended December 31, 2021 and 2020
(Dollar amounts in thousands except per share data)

	2021	2020
Interest income:		
Interest and fees on loans	$ 37,972	$ 33,219
Interest on available-for-sale investment securities	1,674	1,149
Interest on deposits in other financial institutions	391	400
Total interest income	40,037	34,768
Interest expense:		
Interest on savings deposits	64	90
Interest on money market deposits	698	917
Interest on interest-bearing demand deposits	86	197
Interest on time deposits	100	787
Total interest expense on deposits	948	1,991
Interest expense on borrowings:	-	123
Total interest expense	948	2,114
Net interest income before provision for loan losses	39,089	32,654
Provision for loan losses	338	2,120
Net interest income after provision for loan losses	38,751	30,534
Non-interest income:		
Service charges, commissions and fees	2,511	1,853
Broker fees	620	539
Gain on sale of investment securities	8	154
Gain on sale of loans	446	322
Total non-interest income	3,585	2,868
Non-interest expense:		
Salaries and employee benefits	16,007	14,398
Occupancy and equipment	2,872	2,750
Other non-interest expense	7,082	5,913
Total non-interest expense	25,961	23,061
Income before provision for taxes	16,375	10,341
Provision for taxes	4,546	2,963
Net income	$ 11,829	$ 7,378
Earnings per share, basic and diluted	$ 2.30	$ 1.45

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

AMERICAN RIVIERA BANK

STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2021 and 2020

(Dollar amounts in thousands)

	2021	2020
Net income	$ 11,829	$ 7,378
Other comprehensive income (loss):		
Unrealized gain (loss) on investment securities:		
Unrealized holding gains (losses) arising during the period	(1,848)	985
Other comprehensive income (loss) before tax	(1,848)	985
Tax effect	547	(292)
Total other comprehensive income (loss)	(1,301)	693
Comprehensive income	$ 10,528	$ 8,071

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

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AMERICAN RIVIERA BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2021 and 2020
(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, 2020	5,033,348	$ 55,033	$ 21,225	$ (115)	$ 76,143
Net income			7,378		7,378
Other comprehensive gain				693	693
Exercise of stock options, net shares issued	15,670	29			29
Restricted stock awards granted	47,344				
Restricted stock awards forfeited	(3,736)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(8,978)	(152)			(152)
Share-based compensation expense		828			828
Balance, December 31, 2020	5,083,648	55,738	28,603	578	84,919
Net income			11,829		11,829
Other comprehensive gain (loss)				(1,301)	(1,301)
Exercise of stock options, net shares issued	11,730	105			105
Restricted stock awards granted	63,485				
Restricted stock awards forfeited	(13,667)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(10,203)	(150)			(150)
Share-based compensation expense		871			871
Balance, December 31, 2021	5,134,993	$ 56,564	$ 40,432	$ (723)	$ 96,273

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

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AMERICAN RIVIERA BANK

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2021 and 2020
(Dollar amounts in thousands)

	2021	2020
Cash flows from operating activities:		
Net income	$ 11,829	$ 7,378
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	338	2,120
Depreciation and amortization	1,600	1,187
Change in cash surrender value of BOLI	(225)	(93)
Deferred income tax benefit	(722)	(547)
(Decrease) increase in deferred loan origination fees, net of costs	(274)	2,284
Net amortization of investment security premiums and discounts	1,216	717
Net realized gain on sales of investment securities	(8)	(154)
Net gain on sale of loans	(446)	(322)
Share-based compensation expense	871	828
(Gain) Loss on equity securities	(55)	9
Lessee improvement allowances	(49)	65
Increase in accrued interest receivable and other assets	(1,575)	(1,106)
Increase (decrease) in accrued interest payable and other liabilities	81	(669)
Net cash provided by operating activities	12,581	11,697
Cash flows from investing activities:		
Increase in interest-bearing deposits in other financial institutions	(162,843)	(66,144)
Increase in loans, net	(66,064)	(149,575)
Proceeds from principal payments of available-for-sale investment securities	13,868	10,570
Purchase of available-for-sale investment securities	(126,429)	(68,129)
Sales of available-for-sale investment securities	3,996	14,432
Calls and maturities of available-for-sale investment securities	1,011	-
Purchase of Federal Home Loan Bank stock	(913)	(153)
Purchase of BOLI	-	(1,028)
Purchase of premises and equipment	(563)	(366)
Net cash used in investing activities	(337,936)	(260,393)
Cash flows from financing activities:		
Increase in demand, interest bearing and savings deposits, net	338,355	291,432
Decrease in time deposits, net	(8,418)	(40,497)
Decrease in borrowings, net	(5,000)	(5,000)
Restricted shares surrendered to pay taxes	(150)	(152)
Proceeds from exercise of stock options, including tax benefit	105	29
Net cash provided by financing activities	324,892	245,812
Decrease in cash and cash equivalents	(463)	(2,884)
Cash and cash equivalents at beginning of year	8,647	11,531
Cash and cash equivalents at end of year	$ 8,184	$ 8,647
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest expense	$ 1,105	$ 3,615
Income taxes	$ 4,885	$ 3,480

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

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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 Financial Protection and Innovation ("DFPI"), 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 Events

We have reviewed all events occurring from December 31, 2021 through March 16, 2022, the date the financial statements were available to be issued. On February 10, 2022, following shareholder and regulatory approval, a holding company reorganization was finalized and American Riviera Bank became a wholly-owned subsidiary of American Riviera Bancorp (the "Company"). In February 2022, the Company completed a private placement of $18.0 million in fixed-to-floating rate subordinated notes due March 1, 2032, to certain qualified buyers and accredited investors. The Company intends to use the net proceeds for general corporate purposes, the maintenance of required regulatory capital at the Bank, and to support the Company's and Bank's future growth.

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.

The global pandemic resulting from the outbreak of the coronavirus ("COVID-19") has substantially and negatively impacted the United States economy, created significant volatility and disruption in financial markets, and materially increased unemployment levels. In addition, the pandemic has resulted in temporary closures of businesses and the institution of social distancing and sheltering in place requirements in most states and communities. The Bank has, and could, continue to experience adverse effects as a result of the COVID-19 pandemic. It is at least reasonably possible that information which was available to the Bank at the date of the financial statements will change in the near term

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Use of Estimates *(continued)*

due to the COVID-19 pandemic and that the effect of the change could be material to the financial statements. The extent to which the COVID-19 pandemic will continue to impact the Bank's estimates and assumptions continues to be uncertain.

Cash Flows

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

Interest-Bearing Deposits in Other Financial Institutions

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

Investment Securities

Investment securities are classified into the following categories:

- Available-for-sale 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, 2021, all securities are classified as available-for-sale with the exception of $120,000 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

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

Investment Securities *(continued)*

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.

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 principal until principal is completely repaid then to earned but unpaid interest. 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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

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, 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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Allowance for Loan Losses *(continued)*

A restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the 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 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 based on the previous 40 quarters' average; historical losses of the Bank's peers based on the previous 40 quarters' average, 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 defined by FFIEC call report code instructions. These portfolio segments include loans secured by real estate, loans to finance agricultural production, commercial and industrial loans, and loans to individuals. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the 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 $750,000 or more, to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the 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 – A Pass loan represents a credit that satisfactorily meets all of the Bank's underwriting criteria, and provides 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

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

Allowance for Loan Losses *(continued)*

classified and do not expose an institution to sufficient risk to warrant adverse classification.

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

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

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

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

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

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

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

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

Allowance for Loan Losses *(continued)*

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

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

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

Reserve for Off-Balance Sheet Credit Exposures

The 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 Small Business Administration (“SBA”) loans are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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 $0.2 million and $0.1 million for the years ended December 31, 2021 and 2020, 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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Leases

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

Other Real Estate Owned

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

Investment in Federal Home Loan Bank Stock

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

Investment in The Independent Bankers Bank Stock

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

Investment in Farmer Mac Stock

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

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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 ("BOLI") is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2021 and 2020 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. 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 goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2021, 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, 2021 and 2020, 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.

Income Taxes

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

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Income Taxes *(continued)*

"more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon our analysis of available evidence, we have determined that all of our deferred income tax assets as of December 31, 2021 and 2020, were more likely than not to be fully realized, therefore no valuation allowance was recorded.

Accounting for Uncertainty in Income Taxes

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

Earnings Per Share

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

Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options and unvested restricted stock awards, result in the issuance of common stock which share in the earnings of the 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.

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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Share-Based Payments *(continued)*

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

Restricted stock awards are grants of shares of the 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.

Fair Value of Financial Instruments

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

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters at this time that will have a material effect on the financial statements.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

Reclassifications

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

New Accounting Standards That Have Not Yet Been Adopted

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

2. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the 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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

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

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

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

(a) Cash and Cash Equivalents

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

(b) Interest-bearing Deposits in Other Financial Institutions

Fair values for interest-bearing deposits in other financial institutions are estimated using discounted cash flow analyses using interest rates offered at each reporting date by the 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 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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

The estimated carrying and fair values of the Bank's financial instruments at December 31, 2021 and 2020 are as follows *(Dollars in thousands)*:

	2021				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 8,184	$ 8,184	$ -	$ -	$ 8,184
Interest-bearing deposits in other financial institutions	283,927	-	283,922	-	283,922
Investment securities	191,423	-	191,423	-	191,423
Equity securities	120	120	-	-	120
Loans, gross	796,075	-	-	784,073	784,073
FHLB stock	4,226	-	-	-	-
TIB stock	62	-	-	-	-
Accrued interest receivable	4,087	-	1,052	3,035	4,087
Financial liabilities:					
Deposits	$ 1,202,090	$ -	$ 1,109,413	$ -	$ 1,109,413
Accrued interest payable	28	-	28	-	28

	2020				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 8,647	$ 8,647	$ -	$ -	$ 8,647
Interest-bearing deposits in other financial institutions	121,085	-	121,156	-	121,156
Investment securities	86,877	-	86,877	-	86,877
Equity securities	65	65	-	-	65
Loans, gross	728,926	-	-	726,691	726,691
FHLB stock	3,313	-	-	-	-
TIB stock	62	-	-	-	-
Accrued interest receivable	3,307	-	499	2,808	3,307
Financial liabilities:					
Deposits	$ 872,097	$ -	$ 872,039	$ -	$ 872,039
Accrued interest payable	185	-	185	-	185
Borrowings	5,000	-	5,000	-	5,000

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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 2021. 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, 2021 and 2020:

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, 2021 and 2020 *(Dollars in thousands):*

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

	2020			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 9,778	$ -	$ 9,778	$ -
State and political subdivision	38,852	-	38,852	-
Residential mortgage-backed securities	35,220	-	35,220	-
Corporate debt	3,027	-	3,027	-
Equity Securities	65	-	65	-
Total assets measured at fair value on a recurring basis	$ 86,942	$ -	$ 86,942	$ -

During the years ended December 31, 2021 and 2020, there were no transfers in or out of Levels 1 or 2.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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, 2021 and 2020 *(Dollars in thousands):*

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

	2020				
Description	Fair Value	Level 1	Level 2	Level 3	Total Gains (Losses)
Impaired loans					
Commercial	$ 521	$ -	$ -	$ 521	$ (297)
Consumer and other	-	-	-	-	4
Total impaired loans	521	-	-	521	(293)
Total assets measured at fair value on a non-recurring basis	$ 521	$ -	$ -	$ 521	$ (293)

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $44,000, with a valuation allowance of $36,000 at December 31, 2021, resulting in $36,000 of additional provision for loan losses for the year ended December 31, 2021. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $0.8 million, with a valuation allowance of $0.3 million at December 31, 2020, resulting in $0.3 million of additional provision for loan losses for the year ended December 31, 2020.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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 is not considered a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate.

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

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

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the appraisal management group engaged by the 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, 2021 and 2020. There were no liabilities measured at fair value on a recurring or non-recurring basis at December 31, 2021 and 2020.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

3. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2021 and 2020 consisted of the following *(Dollars in thousands):*

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

	2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 9,897	$ -	$ (119)	$ 9,778
State and political subdivision	38,081	786	(15)	38,852
Residential mortgage-backed securities	35,063	281	(124)	35,220
Corporate Debt	3,015	12	-	3,027
Total	$ 86,056	$ 1,079	$ (258)	$ 86,877

Net unrealized losses on available-for-sale investment securities totaling $1.0 million were recorded net of tax for $0.7 million as accumulated other comprehensive income within shareholders' equity at December 31, 2021. Net unrealized gains on available-for-sale investment securities totaling $0.8 million were recorded net of tax for $0.2 million as accumulated other comprehensive income within shareholders' equity at December 31, 2020.

The following table summarizes the securities sold and called for the year ended December 31, 2021 and 2020 *(Dollars in thousands)*:

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

	2020		
	Proceeds	Gross Gains	Gross Losses
Sales	$ 11,431	$ 263	$ (109)
Calls	3,001	-	-
Total	$ 14,432	$ 263	$ (109)

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

The following tables summarize securities with unrealized losses at December 31, 2021, and December 31, 2020, aggregated by major security type and length of time in a continuous unrealized loss position *(Dollars in thousands):*

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

	2020					
	Less Than 12 Months		12 months of Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
U.S. government agencies	$ -	$ -	$ 9,778	$ (119)	$ 9,778	$ (119)
State and Political Subdivision	10,385	(15)	-	-	10,385	(15)
Residential Mortgage backed securities	20,653	(124)	-	-	20,653	(124)
Corporate Debt	-	-	-	-	-	-
Total available for sale	$ 31,038	$ (139)	$ 9,778	$ (119)	$ 40,816	$ (258)

Unrealized losses on all securities have not been recognized into income because the issuer’s securities are of high credit quality, management does not intend to sell, it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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

The amortized cost and estimated fair value of investment securities at December 31, 2021 and 2020 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):*

	2021		2020	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	$ -	$ -	$ 1,000	$ 1,010
One to three years	2,510	2,482	-	-
Three years through five years	991	978	2,015	2,017
After five years	92,564	93,098	38,081	38,852
Total	96,065	96,558	41,096	41,879
Investment securities not due at a single maturity date:				
Residential mortgage-backed securities and small business administration securities	96,385	94,865	44,960	44,998
Total	$ 192,450	$ 191,423	$ 86,056	$ 86,877

4. LOANS

Outstanding loans at December 31, 2021 and 2020 are summarized below *(Dollars in thousands)*:

	2021	**2020**
Commercial	$ 133,830	$ 176,234
Real estate – commercial	504,986	402,118
Real estate – residential	126,577	124,916
Construction	29,981	25,330
Consumer and other	701	328
Total gross loans	796,075	728,926
Deferred loan origination fees, net of costs	(2,585)	(2,859)
Allowance for loan losses	(9,383)	(8,467)
Loans, net	$ 784,107	$ 717,600

The table above includes loans acquired at fair value on January 1, 2016 with outstanding balances of $11.0 million and $17.3 million as of December 31, 2021 and 2020, respectively.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

4. LOANS *(continued)*

The Bank deferred $0.7 million and $0.6 million in salaries and employee benefits as loan origination costs for the years ended December 31, 2021 and 2020, respectively.

Loans with a fair value of approximately $216.6 million and $178.3 million were pledged to secure borrowing arrangements as of December 31, 2021 and 2020, respectively (see Note 12).

Loan Servicing

The Bank services SBA loans for the SBA and other institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2021 and 2020, the Bank was servicing approximately $10.3 million and $7.5 million in SBA loans previously sold. The net carrying value of servicing rights associated with these loans was approximately $76,000 and $33,000 as of December 31, 2021 and 2020, respectively. The carrying value approximated the fair value at December 31, 2021 and 2020.

SBA Paycheck Protection Program Loans

The Bank participated in the SBA Paycheck Protection Program (“PPP”) which are federally guaranteed loans intended to provide loans to small businesses to pay their employees, rent, mortgage interest and utilities. The loans may be forgiven upon certain conditions being met including the borrower providing payroll documentation evidencing compliance with the program. The Bank began accepting PPP applications in April 2020 and originated $118.4 million of PPP loans during the year. The Bank originated an additional $72.0 million of PPP loans during 2021. The Bank had $39.9 million and $84.4 million in PPP loans outstanding as of December 31, 2021 and 2020, respectively. The Bank recognized $4.6 million and $3.1 million as interest and fees on PPP loans in the Statements of Income for the years ended December 31, 2021 and 2020, respectively. Deferred processing fees outstanding were $2.0 million at December 31, 2021. Processing fees were deferred and are recognized over the contractual life of the loan, and accelerated at forgiveness.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ending December 31, 2021 and 2020 *(Dollars in thousands):*

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

December 31, 2020	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Allowance for loan losses:						
Beginning balance	$ 1,148	$ 3,307	$ 710	$ 1,183	$ 18	$ 6,366
Provision(benefit)	1,196	1,586	207	(863)	(6)	2,120
Charge-offs	(89)	-	-	-	(1)	(90)
Recoveries	71	-	-	-	-	71
Ending balance	$ 2,326	$ 4,893	$ 917	$ 320	$ 11	$ 8,467

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

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

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

The following table shows the allocation of the allowance for loan losses at December 31, 2020 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	$ 2,326	$ 4,893	$ 917	$ 320	$ 11	$ -	$ 8,467
Ending balance: individually evaluated for impairment	297	-	-	-	10	-	307
Ending balance: collectively evaluated for impairment	$ 2,029	$ 4,893	$ 917	$ 320	$ 1	$ -	$ 8,160
Loans							
Ending balance	$ 176,234	$ 402,118	$ 124,916	$ 25,330	$ 328	$ -	$ 728,926
Ending balance: individually evaluated for impairment	1,223	2,986	425	-	10	-	4,644
Ending balance: collectively evaluated for impairment	$ 175,011	$ 399,132	$ 124,491	$ 25,330	$ 318	$ -	$ 724,282

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

Credit Exposure

Credit Risk Profile by Internally Assigned Grade

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

The following table shows the loan portfolio allocated by management's internal risk ratings at December 31, 2020 (*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	$ 168,321	$ 389,078	$ 124,392	$ 25,330	$ 328	$ 707,449
Special Mention	4,436	8,728	-	-	-	13,164
Substandard	3,477	4,312	524	-	-	8,313
Total	$ 176,234	$ 402,118	$ 124,916	$ 25,330	$ 328	$ 728,926

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

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

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

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2020 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 450	$ 450	$ 175,784	$ 176,234
Real Estate – Commercial	-	-	2,986	2,986	399,132	402,118
Real Estate – Residential	-	-	-	-	124,916	124,916
Construction	-	-	-	-	25,330	25,330
Consumer and Other	-	-	10	10	318	328
Total	$ -	$ -	$ 3,446	$ 3,446	$ 725,162	$ 728,598

During the years ended December 31, 2021 and 2020, the Bank had $0.3 million and $0.1 million of interest income foregone from loans on non-accrual status.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

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

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

The following table shows information related to impaired loans at and for the year ended December 31, 2020 (*Dollars in thousands*):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Without an allowance recorded:					
Commercial	$ 405	$ 405	$ -	$ 350	$ 19
Real Estate – Residential	425	425	-	425	24
Real Estate – Commercial	2,986	2,986	-	2,986	87
With an allowance recorded:					
Commercial	818	818	297	860	68
Consumer and Other	10	10	10	12	-
Total:					
Commercial	1,223	1,223	297	1,210	87
Real Estate – Residential	425	425	-	425	24
Real Estate – Commercial	2,986	2,986	-	2,986	87
Consumer and Other	10	10	10	12	-
Total impaired loans	$ 4,644	$ 4,644	$ 307	$ 4,633	$ 198

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

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

For the years ended December 31, 2021 and 2020, the Bank did not recognize any income on a cash basis.

Troubled Debt Restructurings

Included in impaired loans at December 31, 2021 and 2020, are three loans totaling $265,000 and $384,000, respectively, which are considered to be troubled debt restructurings. The Bank has allocated $36,000 and $45,000 of specific reserves to these loans that have been modified in troubled debt restructurings as of December 31, 2021 and 2020, 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, 2021.

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

The following table presents loans by class modified as troubled debt restructurings that occurred during the year ending December 31, 2020 (*Dollars in thousands*):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial	2	$ 374	$ 374

The troubled debt restructurings described above, increased the allowance for loan losses by $36,000 and $35,000, and resulted in zero charge-offs during the years ending December 31, 2021 and 2020.

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, 2021 and 2020.

The Bank provided loan principal and interest payment deferrals to certain borrowers impacted by COVID-19 who were current in their payments at the inception of the Bank's loan modification program. As of December 31, 2021 and 2020, the Bank had no loans on principal and interest deferral. The Bank had nine loans with outstanding balances totaling $13.7 million as of December 31, 2021 and eight loans with outstanding balances totaling $8.3 million as of December 31, 2020 on principal only deferral.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

5. ALLOWANCE FOR LOAN LOSSES *(continued)*

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

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

6. BANK PREMISES AND EQUIPMENT

Bank premises and equipment consisted of the following at December 31, 2021 and 2020 *(Dollars in thousands)*:

	2021	2020
Furniture fixtures and equipment	$ 3,198	$ 3,013
Leasehold improvements	4,962	4,932
Building	1,224	1,224
Building improvements	1,593	1,585
Land	774	774
Total bank premises and equipment	11,751	11,528
Accumulated Depreciation and amortization	(5,835)	(5,070)
Bank premises and equipment, net	$ 5,916	$ 6,458

Depreciation and amortization included in occupancy and equipment expense totaled $0.8 million and $0.8 million for the years ending December 31, 2021 and 2020, respectively.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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 9 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. During 2020, the Bank exercised its five year renewal option for its headquarters and Santa Barbara branch and amended the lease to include two additional five-year renewal options. The Bank also received a tenant improvement allowance of $65,000 as part of the amended lease agreement. The lease includes an annual rent adjustment based on changes in the Consumer Price Index (CPI) with a floor of 3% and a cap of 8%. The lease for the Montecito branch expires on April 30, 2028, and has one ten-year renewal option. The lease includes rent adjustments every three years based on changes in the Consumer Price Index (CPI) with a floor of 2% and a cap of 5%. The lease for the Goleta branch expires on August 31, 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 and Administrative office 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.

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

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

7. LEASES *(continued)*

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, 2021 and 2020, all of the Bank's leases are classified as operating leases. Right-of-use assets were $4.5 million and $6.0 million and lease liabilities were $5.0 million and $6.5 million as of December 31, 2021 and 2020, respectively.

Rental expense, net of sublease income, included in occupancy and equipment expense totaled $1.2 million and $1.1 million for the years ended December 31, 2021 and 2020, respectively.

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2021 are as follows *(Dollars in thousands)*:

Year Ending December 31,	Operating Lease
2022	$ 1,247
2023	927
2024	899
2025	699
2026	484
Thereafter	1,004
Total undiscounted lease payments	5,260
Less: imputed interest	(288)
Net lease liabilities	$ 4,972

Supplemental Lease Information

	December 31, 2021	December 31, 2020
Operating lease weighted average remaining lease term (years)	6	7
Operating lease weighted average discount rate	2.12	2.12

8. OTHER REAL ESTATE OWNED

At December 31, 2021 and December 31, 2020 the Bank had no properties acquired through foreclosure or deed in lieu.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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, 2021 and 2020 was $4.8 million. Total goodwill at December 31, 2021 and 2020 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. 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 goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2021, so goodwill was not required to be retested.

The intangible assets at December 31, 2021 and 2020, 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. At December 31, 2021, the gross carrying value of intangible assets was $1.3 million and accumulated amortization totaled $1.1 million. 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, 2021 and determined that no impairment existed. Amortization expense recognized was $0.2 million for 2021 and 2020.

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
2022	$ 179
Total	$ 179

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

10. TIME DEPOSITS

Time deposits as of December 31, 2021 have the following maturities by year *(Dollars in thousands)*:

Maturity Year	Amount
2022	$ 24,174
2023	4,320
2024	0
2025	732
Total	$ 29,226

Time deposits with balances of more than $250,000 totaled $15.6 million and $20.6 million at December 31, 2021 and 2020, respectively.

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2021 and 2020 consisted of the following *(Dollars in thousands)*:

	2021	2020
Current:		
Federal	$ 3,356	$ 2,073
State	1,912	1,437
Total	5,268	3,510
Deferred:		
Federal	(560)	(216)
State	(162)	(331)
Total	(722)	(547)
Provision for income taxes	$ 4,546	$ 2,963

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

	2021	2020
Federal statutory rate times financial statement income	$ 3,439	$ 2,172
Effect of:		
State income taxes, net of federal tax benefit	1,388	874
Share-based compensation	(24)	(34)
Tax-exempt interest	(245)	(69)
Other, net	(12)	20
Total	$ 4,546	$ 2,963

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

11. INCOME TAXES *(continued)*

Deferred tax assets (liabilities) at December 31, 2021 and 2020 consisted of the following and are recorded on the balance sheet with accrued interest receivable and other assets or accrued interest payable and other liabilities *(Dollars in thousands)*:

	2021	2020
Deferred tax assets:		
Organization costs	$ -	$ 22
Lease liability	1,470	1,916
Allowance for loan losses	2,774	2,334
Accrued expenses	869	685
Share-based compensation	418	314
Unrealized loss on available-for-sale investment securities	304	-
Net operating loss carryforward	307	480
Fair value adjustments	-	65
State taxes	422	306
Other	150	53
Total deferred tax assets	$ 6,714	$ 6,175
Deferred tax liabilities:		
Deferred loan costs	(515)	(479)
Right-of-use asset	(1,334)	(1,777)
Premises and equipment	(515)	(653)
Unrealized gain on available-for-sale investment securities	-	(243)
Fair value adjustments	(32)	-
Prepaid expenses	(41)	(20)
Other	(14)	(3)
Total deferred tax liabilities	(2,451)	(3,175)
Net deferred tax asset	$ 4,263	$ 3,000

As of December 31, 2021 and 2020, 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 2021.

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 2018 and is no longer subject to examination by California taxing authorities for tax years prior to 2017. There are currently no pending federal or state income tax examinations by tax authorities.

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

11. INCOME TAXES *(continued)*

The Bank has no uncertain tax positions and has not accrued for any interest or penalties as of December 31, 2021 or 2020. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

As of December 31, 2021, the Bank has net operating losses ("NOLs") available to carry-forward for federal tax purposes totaling $1.8 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 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 $37.0 million in the aggregate. There were zero borrowings outstanding under these arrangements as of December 31, 2021 and 2020.

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, 2021, amounts pledged and available under such limits at the FHLB were approximately $121.0 million and $101.0 million, respectively. As of December 31, 2021 and 2020, the Bank had FHLB borrowings outstanding of zero and $5.0 million, respectively. As of December 31, 2021 and 2020, the Bank is the obligor on a letter of credit issued by the FHLB to secure local agency deposits in the amount of $20.0 million and $12.0 million, respectively.

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, 2021 or 2020, and the Bank had $7.1 million of readily available borrowing capacity at December 31, 2021 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, 2021	December 31, 2020
Commitments to extend credit	$ 140,692	$ 121,032
Standby letters of credit	$ 2,339	$ 1,768

These statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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

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.

Commitments to extend credit are agreements to lend to a borrower as long as there is no violation of any covenant established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. These commitments are normally unfunded portions of previously approved lines of credit. The Bank evaluates each borrower'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, 2021 and 2020. The Bank recognizes these fees as revenue over the term of the commitment.

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

As of December 31, 2020, unsecured commercial loan commitments represent approximately 52% of total commitments and the majority of these commitments have variable interest rates. Other real estate loans, which are collateralized and generally have adjustable interest rates, represent approximately 5% of total commitments. Home equity lines of credit, which are collateralized and generally have variable interest rates, represent approximately 22% of total commitments. Secured construction loan commitments represent approximately 14% of total commitments and have primarily fixed rates. Agricultural production represents approximately 4% of total commitments and generally have variable rates.

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13. COMMITMENTS AND CONTINGENCIES *(continued)*

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

The remaining 3% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

Concentrations of Credit Risk

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

The 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 100% of the Bank’s total capital (“TC”).

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

At December 31, 2020, a concentration representing approximately 382% 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 142% 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, 2021 and 2020, the Bank did not have any deposit customers that exceed 5% of total deposits.

As of December 31, 2021 and 2020 the Bank did not have any loan customers that exceed 10% of total loans.

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13. COMMITMENTS AND CONTINGENCIES *(continued)*

Federal Reserve Requirements

Generally banks are required to maintain reserves with the Federal Reserve Bank of San Francisco (the "FRB") equal to a percentage of their reservable deposits. It was announced on March 15, 2020 that the Board of Governors of the Federal Reserve System reduced reserve requirement ratios to zero percent effective March 26, 2020, eliminating reserve requirements for all depository institutions. As such, as of December 31, 2021, the Bank was not required to maintain reserves with the FRB.

Correspondent Banking Agreements

The Bank maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. The Bank maintains funds in money market accounts at certain correspondent banks. As of December 31, 2021, the Bank had $35.8 million of uninsured deposits.

14. SHARE-BASED PAYMENT

On December 31, 2021, the Bank had one share-based compensation plan, which is described below. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise or grant of restricted stock.

On September 2, 2015, the 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 and shares outstanding under the 2015 Plan, leaving 297,143 available for issuance under the Plan at December 31, 2021.

In October 2009, the Bank adopted the American Riviera Bank 2009 Omnibus Stock Incentive Plan (“2009 Plan”). In accordance with the terms of the 2009 Plan, the plan was terminated on the tenth anniversary of the date upon which it was approved by the shareholders and no new options or awards were granted after that date. As of December 31, 2020, there were no shares remaining for issuance for stock options already granted and no shares of restricted stock awards outstanding to be vested.

There were 63,485 and 47,344 restricted shares granted in 2021 and 2020, 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 generally vest over a four to five-year period from the date

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14. SHARE-BASED PAYMENT *(continued)*

of the grant. The Plan permits the use of vested, in the money stock options to be used as a cashless exercise.

<u>Non-Qualified Stock Option Awards</u>

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, 2021 and 2020. A summary of the award activity under the Plan for the years ended December 31, 2021 and 2020 is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at January 1, 2020	16,829	$ 11.40	1.63
Issued	-	-	
Forfeited or expired	(266)	11.35	
Exercised	(4,833)	11.37	
Options outstanding at December 31, 2020	11,730	$ 11.41	0.96
Issued	-	-	
Exercised	(11,730)	11.41	
Options exercisable at December 31, 2021	-	$ -	-

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

	2021	2020
Intrinsic value of options exercised	$ 104	$ 21
Cash received from options exercised	105	29
Tax benefit realized from option exercise	22	2

As of December 31, 2021 and 2020, there was no unrecognized compensation related to non-qualified stock option awards. There was zero intrinsic value related to non-qualified stock option awards at December 31, 2021. During 2021, 11,730 stock options were exercised, of which 2,548 were conducted by cashless exercises, resulting in 1,491 shares being forfeited and 1,057 shares being issued. The remaining 9,182 stock options exercised were paid for in cash, resulting in proceeds of $105,000. During 2020, 4,833

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14. SHARE-BASED PAYMENT *(continued)*

stock options were exercised of which 2,306 were conducted by cashless exercises, resulting in 1,722 shares being forfeited and 584 shares being issued. The remaining 2,527 stock options exercised in 2020 were paid for in cash resulting in proceeds of $29,000.

Employee Incentive Stock Option Awards

There were no employee incentive stock option awards granted for the years ended December 31, 2021 and 2020. There was no related share-based compensation expense recorded for each of the years ended December 31, 2021 and 2020.

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

	2021	2020
Intrinsic value of options exercised	$ -	$ 210
Cash received from options exercised	-	-
Tax benefit realized from option exercise	-	42

As of December 31, 2021 and 2020, there was no unrecognized compensation cost related to unvested stock option awards to employees. There were no outstanding employee incentive stock options at December 31, 2021 and 2020, respectively. During 2020, 39,649 stock options were exercised all of which were conducted by cashless exercises, resulting in 27,090 shares being forfeited and 12,559 shares being issued.

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 four to five-year period and immediately for directors.

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

Unvested Shares	**Shares**	**Weighted Average Grant Date Fair Value**
Unvested shares at January 1, 2021	142,513	$ 17.46
Granted	63,485	17.24
Vested	(31,449)	17.98
Forfeited	(13,667)	17.74
Unvested shares at December 31, 2021	160,882	$ 17.25

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14. SHARE-BASED PAYMENT *(continued)*

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

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

In 2020, the Bank granted 36,816 shares of restricted common stock to selected officers, which had a fair market value between $11.75 and $19.90 per share on the date of grant. These restricted common stock awards vest over a four-year period from the date of the grant.

In 2020, the Bank granted a total of 10,528 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value of $13.30 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $140,000 was recorded for the year ended December 31, 2020.

As of December 31, 2021, there were 160,882 shares of restricted stock that were unvested and expected to vest. Compensation cost and directors fees charged against income for restricted stock awards was $0.8 million for the years ended December 31, 2021 and 2020. There was an excess tax benefit recognized for restricted stock awards in the amount of $166,000 and $3,000, respectively for the years ended December 31, 2021 and 2020. At December 31, 2021 and 2020, the total compensation cost related to unvested restricted common stock not yet recognized was $1.7 million and $1.9 million. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted-average remaining period of approximately four years and will be adjusted for subsequent changes in estimated forfeitures. The fair value attributable to restricted stock awards vested for the year ended December 31, 2021 and 2020, was $0.6 million and $0.5 million, respectively.

15. SHAREHOLDERS' EQUITY

Dividends

Upon declaration by the Board of Directors, all shareholders of record will be entitled to receive dividends. The California Financial Code restricts the total dividend payment of any state banking association in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. At December 31, 2021, $25.6 million were free of such restrictions.

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15. SHAREHOLDERS' EQUITY *(continued)*

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, 2021 and 2020 is as follows:

	Net Income	Weighted Average Number of Shares Outstanding	Earnings per share
December 31, 2021			
Basic earnings per share	$ 11,829,000	5,137,445	$ 2.30
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	11,829,000	5,137,445	2.30
December 31, 2020			
Basic earnings per share	7,378,000	5,057,168	1.45
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	$ 7,378,000	5,057,168	$ 1.45

Shares of common stock issuable under stock options for which the exercise prices are greater than average market prices are not included in the computation of diluted earnings per share due to their antidilutive effect. There were no options excluded from the computation of diluted earnings per share for the years ended December 31, 2021 and 2020, 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 of the 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 2021 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.

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15. SHAREHOLDERS' EQUITY (continued)

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, 2021 and 2020, the most recent regulatory notifications categorized the Bank as "well-capitalized" under the regulatory framework. There are no conditions or events since that notification that management believes have changed the Bank's category.

As of December 31, 2021 and 2020, total average assets for leverage capital purposes were $1,271.0 million and $969.9 million, respectively, and total risk-weighted assets were $834.0 million and $690.9 million, respectively.

Regulatory Capital *(continued)*

Capital ratios as of December 31, 2021 and 2020 are as follows *(Dollars in thousands)*:

	2021		2020	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
American Riviera Bank	$ 91,921	7.2%	$ 79,107	8.2%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 63,527	5.0%	$ 48,497	5.0%
Minimum regulatory requirement	$ 33,360	4.0%	$ 38,798	4.0%
Common Equity Tier I Ratio				
American Riviera Bank	$ 91,921	11.0%	$ 79,107	11.5%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 54,210	6.5%	$ 44,907	6.5%
Minimum regulatory requirement	$ 37,530	4.5%	$ 31,089	4.5%
Tier 1 Risk-Based Capital Ratio				
American Riviera Bank	$ 91,921	11.0%	$ 79,107	11.5%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 66,720	8.0%	$ 55,270	8.0%
Minimum regulatory requirement	$ 50,040	6.0%	$ 41,453	6.0%
Total Risk-Based Capital Ratio				
American Riviera Bank	$ 101,468	12.1%	$ 87,714	12.7%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 83,401	10.0%	$ 69,088	10.0%
Minimum regulatory requirement	$ 66,720	8.0%	$ 55,270	8.0%

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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 for the twelve months ended December 31, 2021 and 2020. The Other category totaling $2.8 million and $2.3 million for the years ended December 31, 2021 and 2020, respectively, is not within the scope of ASC 606.

Non-interest income for the years ended December 31, 2021 and 2020 consisted of the following *(Dollars in thousands)*:

	2021	2020
Service charges on deposits	$ 719	$ 516
Overdraft Fees	44	52
Other	2,822	2,300
Total	$ 3,585	$ 2,868

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 $0.4 million in the form of employer matching contributions to the 401k Plan during the years ended December 31, 2021 and 2020.

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18. OTHER EXPENSES

Other expenses for the years ended December 31, 2021 and 2020, consisted of the following *(Dollars in thousands)*:

	2021	2020
Data processing	$ 1,308	$ 984
Advertising and marketing	786	779
Professional fees	660	546
Regulatory assessments	761	453
Director Fees	360	362
Software	638	509
Insurance	99	92
Other	2,470	2,188
Total other expenses	$ 7,082	$ 5,913

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, 2021	$ 5
Disbursements	6
Amounts repaid	(11)
Re-classified related party balances	-
Balance, December 31, 2021	$ -

As of December 31, 2021, total undisbursed commitments to related parties were $69,000.

As of December 31, 2021 and 2020, there were no loans to related parties that exceeded 10% of the Bank's total loans.

Deposits

As of December 31, 2021 and 2020, there were no deposits to related parties that exceeded 5% of the Bank's total deposits.

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