AMERICAN RIVIERA BANCORP

2023 Annual Report

AMERICAN RIVIERA BANCORP

A Message to our Shareholders, Clients, and Community

We are pleased to report that American Riviera Bancorp (OTCQX: ARBV) reported net income of $10.5 million or $1.82 per share for 2023. Our return on average assets of 0.82% and return on average equity of 11.02% were respectable. As a result of retained earnings as well as improved market value of our bond portfolio, tangible book value per share of $16.59 at December 31, 2023 has increased $2.16 or 15.0% from the prior year-end.

2023 profitability declined $3.0 million from the record level reported last year. In 2022, we benefited from excess liquidity that remained in the economy and on our balance sheet despite the Federal Reserve's initiation of target rate increases. In 2023, the effects of the Fed's aggressive rate hikes began to take hold which caused a shift in interest-bearing depositor behavior. Most banks experienced reduced deposits as some clients decided to invest their excess cash in non-FDIC insured, external investment products. In 2023, we retained our relationship clients by paying out over $7.1 million more in deposit interest than 2022.

The higher rate environment also softened loan demand. However, our ability to deliver the full complement of construction loans, mortgages, home equity lines, commercial real estate loans, business loans and lines of credit, agricultural loans, and SBA loans allowed the Bank to grow loans by $38.7 million or 4.3% in 2023. Your Bank now has almost $950 million in loans to local businesses, real estate investors, and homeowners just like you on the Central Coast of California. Credit quality remains strong with no other real estate owned, no loans 90 days or more past due, and only $0.6 million or 0.06% of total loans on non-accrual status as of December 31, 2023.

Your Bank is committed to strengthening ties within our community. In February 2023, we expanded into Santa Maria with a new branch. Santa Maria is the most populous city in Santa Barbara County. Increased business and construction activity, as well as the Vandenberg Space Force Base, have positioned Santa Maria for sustained economic growth. As a community bank, we are proud to support that growth and expand our branch footprint for our clients.

In April 2023, our dedication was recognized by the FDIC. Your Bank received the highest rating of "Outstanding" on our Community Reinvestment Act evaluation underscoring strong lending performance and ongoing efforts to support community development in Santa Barbara and San Luis Obispo counties. Our team members' commitment to service plays an important role, collectively contributing over 3,300 volunteer hours to the communities we serve. Over half our workforce proudly serves on local nonprofit boards. We are happy to report that we allocated more than 3.5% of our net profit toward local sponsorships and donations at a time when other banks may have been cutting back amidst consolidations and a challenging rate environment.

We ended the year by investing in a significant core system and online banking upgrade which will allow us to deliver advanced banking technology to better serve our clients. In 2024, we will launch debit card controls and alerts, consumer Zelle® transfer functionality, and high-volume cash management services for our business clients all made possible by our technology investment.

Healthy earnings have also been retained to support current and future growth, with American Riviera Bank Tier I Risk-Based Capital of $134.6 million or 12.6%, and Total Risk-Based Capital of $146.8 million or 13.8%, as of December 31, 2023, which exceed regulatory guidelines for well-capitalized institutions.

We are thankful for the loyalty of our clients and our team of dedicated bankers, who make **American Riviera Bank the Central Coast's community bank**!

Thank you for your support,

Darren Caesar, Board Chair

Jeff DeVine, President and CEO

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AMERICAN RIVIERA BANCORP

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2023 AND 2022
AND FOR THE YEARS THEN ENDED

Page

American Riviera Bancorp:

Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of American Riviera Bancorp, which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of American Riviera Bancorp as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, American Riviera Bancorp's internal control over financial reporting as of December 31, 2023, based on criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 20, 2024 expressed an unmodified opinion.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, American Riviera Bancorp changed its method for accounting for credit losses effective January 1, 2023, due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, Financial Instruments - Credit Losses (ASC 326). Our opinion is not modified with respect to this matter.

Basis for Opinion

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

(Continued)

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Crowe LLP

Crowe LLP

Sacramento, California
March 20, 2024

AMERICAN RIVIERA BANCORP

CONSOLIDATED BALANCE SHEETS

December 31, 2023 and 2022

(Dollar amounts in thousands except share amounts)

	2023	2022
ASSETS		
Cash and due from banks	$ 11,986	$ 12,096
Interest-bearing deposits in other financial institutions	7,697	49,704
Available-for-sale investment securities	207,114	223,189
Held-to-maturity investment securities, net of allowance for credit losses of $7 and zero ($40,808 and $38,569, fair value respectively)	41,326	41,293
Equity securities	157	92
Loans, net of deferred fees	946,411	907,685
Allowance for credit losses	(11,648)	(10,626)
Net Loans	934,763	897,059
Premises and equipment, net	8,801	5,752
Operating lease right-of-use asset	5,193	6,595
Cash surrender value of bank owned life insurance	11,738	9,863
Stock in other banks	6,699	5,300
Goodwill	4,800	4,800
Other intangibles, net	129	147
Accrued interest receivable and other assets	24,633	26,678
Total Assets	$ 1,265,036	$ 1,282,568
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing demand deposits	$ 443,070	$ 478,519
Interest-bearing demand deposits	123,686	176,088
Savings deposits	93,617	78,171
Money market deposits	305,524	377,911
Time deposits	83,786	52,839
Total Deposits	1,049,682	1,163,528
Other borrowings	85,000	-
Subordinated notes	18,000	18,000
Operating lease liability	6,218	7,069
Accrued interest payable and other liabilities	5,496	6,875
Total Liabilities	1,164,396	1,195,472
Shareholders' Equity:		
Preferred stock - no par value; 10,000,000 shares as of 2023 and 2022, respectively authorized, none issued	-	-
Common stock - no par value; 50,000,000 shares authorized as of 2023 and 2022, respectively; 5,768,697 and 5,692,161 shares issued and outstanding in 2023 and 2022, respectively	67,296	66,346
Retained earnings	54,270	44,672
Accumulated other comprehensive (loss), net of taxes	(20,926)	(23,922)
Total Shareholders' Equity	$ 100,640	$ 87,096
Total Liabilities and Shareholders' Equity	$ 1,265,036	$ 1,282,568

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

AMERICAN RIVIERA BANCORP

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2023 and 2022
(Dollar amounts in thousands except per share data)

	2023	2022
Interest income:		
Interest and fees on loans	$ 47,686	$ 40,517
Interest on investment securities	6,940	5,212
Interest on deposits in other financial institutions	1,055	3,049
Total interest income	55,681	48,778
Interest expense:		
Interest on interest-bearing demand deposits	388	107
Interest on savings deposits	1,185	101
Interest on money market deposits	4,730	1,058
Interest on time deposits	2,185	96
Total interest expense on deposits	8,488	1,362
Interest expense on borrowings	2,907	570
Total interest expense	11,395	1,932
Net interest income before provision for credit losses	44,286	46,846
Provision for credit losses	171	1,147
Net interest income after provision for credit losses	44,115	45,699
Non-interest income:		
Service charges, commissions, and fees	2,219	2,467
Other non-interest income	784	436
(Loss) on sale of furniture, fixtures, & equipment	(68)	-
(Loss) on sale of investment securities	(544)	(89)
Gain on sale of loans	85	533
Total non-interest income	2,476	3,347
Non-interest expense:		
Salaries and employee benefits	18,966	18,300
Occupancy and equipment	3,542	3,155
Other non-interest expense	9,579	8,834
Total non-interest expense	32,087	30,289
Income before provision for taxes	14,504	18,757
Provision for taxes	3,991	5,263
Net Income	$ 10,513	$ 13,494
Earnings per share, basic and diluted	$ 1.82	$ 2.38

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

AMERICAN RIVIERA BANCORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2023 and 2022
(Dollar amounts in thousands)

	2023	2022
Net income	$ 10,513	$ 13,494
Other comprehensive income (loss):		
Change in debt securities available-for-sale:		
Loss on sale of securities included in net income	544	-
Unrealized holding gains (losses) arising during the period	3,030	(33,299)
Reclassification of the unrealized loss at the time of transfer to held-to-maturity	-	7,037
Income tax effect	(721)	7,763
Unrealized gains (losses) on available-for-sale debt securities	2,853	(18,499)
Change in debt securities held-to-maturity:		
Reclassification of the unrealized loss at the time of transfer from available-for-sale	-	(7,037)
Amortization of unrealized loss on securities transferred from available-for-sale	496	365
Income tax effect	(353)	1,972
Changes from securities held-to-maturity	143	(4,700)
Total other comprehensive income (loss)	2,996	(23,199)
Comprehensive (loss) income	$ 13,509	$ (9,705)

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

AMERICAN RIVIERA BANCORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2023 and 2022
(Dollar amounts in thousands except share amounts)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive Income (loss) (Net of taxes)	Total Shareholders' Equity
	Shares	Amount			
Balance, January 1, 2022	5,134,993	$ 56,564	$ 40,432	$ (723)	$ 96,273
Net income			13,494		13,494
Other comprehensive (loss)				(23,199)	(23,199)
Restricted stock awards granted	69,949				
Restricted stock awards forfeited	(9,908)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(16,544)	(344)			(344)
Share-based compensation expense		1,020			1,020
10% stock dividend, fractional shares paid in cash	513,671	9,106	(9,254)		(148)
Balance, December 31, 2022	5,692,161	$ 66,346	$ 44,672	$ (23,922)	$ 87,096
Cumulative change in accounting principle (Note 1)			$ (915)		$ (915)
Balance at January 1, 2023 (as adjusted for change in accounting principle)	5,692,161	$ 66,346	$ 43,757	$ (23,922)	$ 86,181
Net income			10,513		10,513
Other comprehensive income				2,996	2,996
Restricted stock awards granted	103,447				
Restricted stock awards forfeited	(7,215)				
Shares surrendered:					
To pay taxes on vesting of restricted stock	(19,696)	(376)			(376)
Share-based compensation expense		1,326			1,326
Balance, December 31, 2023	5,768,697	$ 67,296	$ 54,270	$ (20,926)	$ 100,640

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

AMERICAN RIVIERA BANCORP

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2023 and 2022
(Dollar amounts in thousands)

	2023	2022
Cash flows from operating activities:		
Net income	$ 10,513	$ 13,494
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	171	1,147
Depreciation and amortization	1,757	1,216
Change in cash surrender value of BOLI	(275)	(222)
Deferred income tax benefit	632	(733)
(Decrease) in deferred loan origination fees, net of costs	(207)	(855)
Net amortization of investment security premiums and discounts	1,175	1,531
Net realized loss (gain) on sales of investment securities	544	89
Net loss on sale of disposed assets	68	3
Net (loss) gain on sale of loans	(85)	(533)
Share-based compensation expense	1,326	1,020
Loss (gain) on equity securities	(65)	28
Decrease (increase) in accrued interest receivable and other assets	585	(6,312)
Increase (decrease) in accrued interest payable and other liabilities	(1,380)	3,669
Net cash provided by operating activities	14,759	13,542
Cash flows from investing activities:		
Change in interest-bearing deposits in other financial institutions	42,007	234,223
Increase in loans, net	(38,424)	(112,716)
Proceeds from principal payments of available-for-sale investment securities	15,630	17,979
Purchase of available-for-sale investment securities	(14,619)	(129,482)
Sales of available-for-sale investment securities	15,597	3,890
Calls and maturities of available-for-sale investment securities	2,000	-
Purchase of Federal Home Loan Bank stock	(1,399)	(1,012)
Purchase of BOLI	(1,600)	(1,000)
Purchase of premises and equipment	(4,839)	(605)
Net cash provided by in investing activities	14,353	11,277
Cash flows from financing activities:		
(Decrease) in demand, interest-bearing, and savings deposits, net	(144,794)	(62,175)
Increase in time deposits, net	30,498	23,612
Increase in borrowings	85,000	-
Increase in subordinated debt	-	18,000
Restricted shares surrendered to pay taxes	(376)	(344)
Proceeds from exercise of stock options, including tax benefit	-	-
Net cash (used) by financing activities	(29,222)	(20,907)
(Decrease) increase in cash and cash equivalents	(110)	3,912
Cash and cash equivalents at beginning of year	12,096	8,184
Cash and cash equivalents at end of year	$ 11,986	$ 12,096
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest expense	$ 10,855	$ 1,643
Income taxes	$ 2,775	$ 3,625

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

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

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

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

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

Subsequent Events

No material subsequent events have occurred from December 31, 2023, through March 20, 2024, the date the financial statements were available to be issued.

Use of Estimates

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

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

<u>Cash Flows</u>

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.

<u>Interest-Bearing Deposits in Other Financial Institutions</u>

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

<u>Debt Securities</u>

Investment securities are classified into the following categories:

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

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

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated.

<u>Allowance for Credit Losses – Available-for-sale Securities</u>

For available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be

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

collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as credit loss expense (or reversal). Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on available-for-sale debt securities totaled $1.1 million at December 31, 2023 and is excluded from the estimate of credit losses.

Allowance for Credit Losses – Held-to-maturity Securities

Management measures expected credit losses on held-to-maturity debt securities on a collective basis by major security type. Accrued interest receivable on held-to-maturity debt securities totaled $0.6 million at December 31, 2023 and 2022, and is excluded from the estimate of credit losses.

The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts.

Management classifies the held-to-maturity portfolio into the following major security types: Mortgage-backed: Residential and Municipal.

Nearly all of the mortgage-backed: residential and municipal securities held by the Company are issued by U.S. government entities and agencies. These securities are either explicitly or implicitly guaranteed by the US government, are highly rated by major rating agencies, and have a long history of no credit losses.

Equity Securities

Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment.

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

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 credit losses. Interest is accrued daily based upon outstanding loan balances. Interest income on construction, real estate-commercial, real estate-residential and commercial loans is discontinued, and the loan is moved to non-accrual status at the time the loan is ninety days delinquent, unless the loan is well-secured and in process of collection in accordance with the Company's policy. Consumer and other loans are typically charged off no later than ninety days past due. For all classes of loans, past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of interest or principal is considered doubtful.

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

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

Allowance for Credit Losses - Loans

The allowance for credit losses ("ACL") is a valuation account that is deducted from the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged-off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off.

Management estimates the ACL balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Pools of loans with similar risk characteristics are collectively evaluated while loans that no longer share risk characteristics with loan pools are evaluated individually. The Company measures the ACL using a discounted cash flow methodology, which utilizes pool-level assumptions and cash flow projections on an individual loan basis, which then aggregates at the portfolio segment level and is supplemented by a qualitative reserve that is applied to each portfolio segment level.

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

Allowance for Credit Losses - Loans *(continued)*

The Company has identified the following portfolio segments to measure the allowance for credit losses. Below is a description and the risk characteristics of each segment:

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.

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

Real Estate - residential - 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.

Construction – Construction and land loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and 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.

The Company’s ACL model incorporates assumptions for prepayments rates, probability of default (“PD”) and loss given default (“LGD”) to project each loan’s cash flow throughout its entire life cycle. An initial reserve amount is determined based on the difference between the amortized cost basis of each loan and the present value of all future cash flows. Assumptions for prepayment rates are based on actual prepayment experience over a trailing time frame. PD is forecasted using a regression model that incorporates the Company’s own data, benchmark data, and certain economic variables as inputs. The LGD is derived from PD using the Frye-Jacobs index provided by the Company’s third-party model provider.

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

Allowance for Credit Losses - Loans *(continued)*

Reasonable and supportable forecasts are used to predict current and future economic conditions. Management elected to use a four-quarter forecast period followed by a straight-line reversion period. After twelve quarters of forecast plus reversion period, the probability of default is assumed to remain unchanged for the remaining life of the loan. The Company uses a single key macroeconomic variable from the Federal Open Market Committee's Summary of Economic Projections within the economic forecast scenarios.

In addition to the quantitative assumptions, management considers the need for qualitative adjustments to the ACL. Such adjustments may be related to and include, but are not limited to factors such as: changes in lending policies; changes in the nature and volume of the portfolio; staff experience; changes in the volume and trends in classified loans, delinquencies and nonaccruals; concentration risk; trends in underlying collateral value; external factors such as competition, legal and regulatory; changes in the quality of the loan review system; and general economic conditions.

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

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

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

Substandard – A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.

Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. It is characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

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

Allowance for Credit Losses - Loans *(continued)*

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.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines that foreclosure is probable the collateral-dependent practical expedient has been elected, and expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for discounted selling costs as appropriate. When the discounted cash flow method is used to determine the allowance for credit losses, management adjusts the effective interest rate used to discount expected cash flows to incorporate expected prepayments.

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.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The Company also maintains a separate reserve for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit unless that obligation is unconditionally cancellable by the Company. The allowance for credit losses on off-balance sheet credit exposures is adjusted through credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. Historical losses, economic conditions, and reasonable and supportable forecasts all influence the reserve estimate.

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

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.

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

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

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

Servicing fees totaled $0.3 million for the years ended December 31, 2023, and 2022. Late fees and ancillary fees related to loan servicing are not material.

Premises and Equipment

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

When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Company evaluates premises and equipment for

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

Premises and Equipment *(continued)*

financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

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.

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

Investment in Federal Agricultural Mortgage Corporation ("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.

Bank Owned Life Insurance

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

Goodwill

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2023, and 2022 represents the excess of the cost of the acquired bank over the net of the amounts assigned to assets acquired and liabilities assumed in the transaction accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

The Company has selected October 31 as the date to perform the annual impairment test. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment. Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2023, so goodwill was not required to be retested. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

Intangible Assets

The intangible assets at December 31, 2023, and 2022, represent the net carrying value of servicing rights associated with SBA loans that are serviced by the Company for the SBA and other institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2023, and 2022, the net carrying value of servicing rights associated with these loans was $129,000 and $147,000, respectively.

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

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax 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 "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, 2023, and 2022, were more likely than not to be fully realized, therefore no valuation allowance was recorded.

Accounting for Uncertainty in Income Taxes

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

Earnings Per Share

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

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

Share-Based Payments

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

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions. Expected volatility is based on the historical volatility of the Company's common stock over a

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

Share-Based Payments *(continued)*

preceding period commensurate with the expected term of the option. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant with substantially the same term as the expected term of the option. Expected dividend yield was not considered in the option pricing formula since the Company has not paid cash dividends to date. In addition to these assumptions, management makes estimates regarding pre-vesting forfeitures that will impact total compensation expense recognized.

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

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

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

Comprehensive Income

Comprehensive income includes net income and unrealized gains and losses on available-for-sale investment securities which are also recognized as a separate component of shareholders' equity. During 2022, $43.0 million of the Company's AFS securities were moved to HTM classification. The transfer occurred at fair value. The related unrealized loss of $7.0 million was included in other comprehensive income, to be amortized out of other comprehensive income with an offsetting entry to interest income as a yield adjustment through earnings over the remaining term of the securities. No gain or loss was recorded at the time of transfer.

Equity

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

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

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.

Adoption of New Accounting Standards

On January 1 2023, the Company adopted ASU 2016-13 Financial Instruments - Credit Losses (ASC 326): Measurement of Credit Losses on Financial Instruments, as amended, which replaces the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (“CECL”) methodology. The measurement of expected credit losses under the CECL methodology is applicable to 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 (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor in accordance with Topic 842 on leases. In addition, ASC 326 made changes to the accounting for available-for-sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale debt securities management does not intend to sell or believes that it is more likely than not they will be required to sell.

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost, and off-balance-sheet (“OBS”) credit exposures. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. For the cumulative effect of adopting ASC 326, the Company recorded an additional $839,000 in Allowance for Credit Losses - Loans, $449,000 in Allowance for Credit Losses on Off-Balance Sheet Credit Exposures and $12,000 in Allowance for Credit Losses – Securities. Net of taxes, these adjustments resulted in a net decrease to retained earnings of $915,000, as of January 1, 2023.

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

Adoption of New Accounting Standards *(continued)*

In addition to ASC 326, ASU 2022-02 was adopted for loan modifications that replaced troubled debt restructurings ("TDRs"). This update eliminated the recognition and measurement guidance for TDRs by creditors in ASC 310-40. This update also enhances disclosure requirements for certain loan restructurings by creditors when a borrower is experiencing financial difficulty. Specifically, rather than applying the recognition and measurement guidance for TDRs, an entity will apply the loan refinancing and restructuring guidance to determine whether a modification or other form of restructuring results in a new loan or a continuation of an existing loan. Additionally, the amendments in this ASU require a public business entity to disclose current-period gross write-offs by year of origination for financing receivables and net investments in leases in the existing vintage disclosures. The Company adopted ASU 2022-2 as of January 1, 2023, using the modified retrospective transition approach. The adoption did not have a material impact on the Company's financial statements.

Reclassifications

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

2. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

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

Level 1 – Quoted market prices (unadjusted) for identical instruments traded in active exchange markets that the Company has the ability to access as of the measurement date.

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

Level 3 – Model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use in pricing the asset or liability.

Valuation techniques include management judgment and estimation, which may be significant.

2. FAIR VALUE MEASUREMENTS *(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 Company for deposits with similar remaining maturities, resulting in a Level 2 classification.

(c) Investment Securities

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

(d) Loans

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

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

(e) Equity Securities

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

(f) Deposits

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

(g) Borrowings

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

(h) Other Borrowings

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

(i) Accrued Interest Receivable/Payable

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

(j) Off-balance Sheet Instruments

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

2. FAIR VALUE MEASUREMENTS *(continued)*

The estimated carrying and fair values of the Company's financial instruments at December 31, 2023, and 2022 are as follows *(Dollars in thousands)*:

	2023				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and due from banks	$ 11,986	$ 11,986	$ -	$ -	$ 11,986
Interest-bearing deposits in other financial institutions	7,697	-	7,812	-	7,812
Investment securities available-for-sale	207,114	-	207,114	-	207,114
Investment securities held-to-maturity	41,326	-	40,808	-	40,808
Equity securities	157	157	-	-	157
Loans, net	934,763	-	-	885,598	885,598
Accrued interest receivable	5,119	-	1,622	3,497	5,119
Financial liabilities:					
Deposits	$ 1,049,682	$ -	$ 912,219	$ -	$ 912,219
Accrued interest payable	565	-	565	-	565
Other borrowings	85,000	-	85,039	-	85,039
Subordinated debt	18,000	-	14,746	-	14,746

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

2. FAIR VALUE MEASUREMENTS *(continued)*

Fair Value Hierarchy *(continued)*

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

Assets and Liabilities Recorded at Fair Value

There were no changes in the valuation techniques used during 2023. The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2023, and 2022:

Recurring Basis

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2023, and 2022 *(Dollars in thousands):*

	2023			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 17,697	$ -	$ 17,697	$ -
State and political subdivision	44,440	-	44,440	-
Residential mortgage-backed securities	136,623	-	136,623	-
Corporate debt	8,354	-	8,354	-
Equity Securities	157	-	157	-
Total assets measured at fair value on a recurring basis	$ 207,271	$ -	$ 207,271	$ -

	2022			
Description	Fair Value	Level 1	Level 2	Level 3
Available-for-sale investment securities				
Debt securities:				
U.S. government agencies	$ 22,609	$ -	$ 22,609	$ -
State and political subdivision	51,183	-	51,183	-
Residential mortgage-backed securities	138,221	-	138,221	-
Corporate debt	11,176	-	11,176	-
Equity Securities	92	-	92	-
Total assets measured at fair value on a recurring basis	$ 223,281	$ -	$ 223,281	$ -

During the years ended December 31, 2023, and 2022, there were no transfers in or out of Levels 1 or 2.

2. FAIR VALUE MEASUREMENTS *(continued)*

Non-recurring Basis

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

These include assets that are measured at the lower of cost or fair value that were recognized at fair value, which was below cost as of December 31, 2023 and 2022 *(Dollars in thousands):*

2023				
Description	Fair Value	Level 1	Level 2	Level 3
Collateral-dependent loans				
Commercial	$ 97	$ -	$ -	$ 97
Total assets measured at fair value on a non-recurring basis	$ 97	$ -	$ -	$ 97

2022				
Description	Fair Value	Level 1	Level 2	Level 3
Impaired loans				
Commercial	$ 16	$ -	$ -	$ 16
Total assets measured at fair value on a non-recurring basis	$ 16	$ -	$ -	$ 16

Individually evaluated loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $97,000, with an allowance for credit loss of zero at December 31, 2023. Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of $604,000, with a valuation allowance of $588,000 at December 31, 2022, resulting in $588,000 of additional provision for loan losses for the year ended December 31, 2022.

2. FAIR VALUE MEASUREMENTS *(continued)*

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

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

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2023 and 2022 consisted of the following *(Dollars in thousands):*

	2023				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Allowance for Credit Losses
Securities Available for Sale					
U.S. government agencies mortgage-backed securities	$ 18,520	$ 9	$ (832)	$ 17,697	$ -
State and political subdivision	47,910	126	(3,596)	44,440	-
Residential mortgage-backed securities	153,699	175	(17,251)	136,623	-
Corporate Debt	10,700	-	(2,347)	8,354	-
Total Available for Sale	$ 230,829	$ 310	$ (24,026)	$ 207,114	$ -
	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Estimated Fair Value	Allowance for Credit Losses
Securities Held to Maturity					
U.S. government agencies mortgage-backed securities	$ -	$ -	$ -	$ -	$ -
State and political subdivision	38,757	220	(464)	38,520	7
Residential mortgage-backed securities	2,569	-	(281)	2,288	-
Corporate Debt	-	-	-	-	-
Total Held to Maturity	41,326	220	(745)	40,808	7
Total Investment Securities	**$ 272,155**	**$ 530**	**$ (24,771)**	**$ 247,922**	**$ 7**

3. INVESTMENT SECURITIES *(continued)*

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

Net unrealized gains on investment securities totaling $3.0 million were recorded net of tax for $2.4 million as accumulated other comprehensive income within shareholders' equity at December 31, 2023. Net unrealized losses on investment securities totaling $33.3 million were recorded net of tax for $23.2 million as accumulated other comprehensive income within shareholders' equity at December 31, 2022.

3. INVESTMENT SECURITIES *(continued)*

The following table summarizes the securities sold and called for the year ended December 31, 2023 and 2022 *(Dollars in thousands)*:

	2023		
	Proceeds	Gross Gains	Gross Losses
Sales	$ 15,597	$ 16	$ (560)
Calls	2,000	-	-
Total	$ 17,597	$ 16	$ (560)

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

The following tables summarizes investment securities available-for-sale in an unrealized loss position for which an allowance for credit losses has not been recorded at December 31, 2023, aggregated by major security type and length of time in a continuous unrealized loss position *(Dollars in thousands):*

	2023					
	Less Than 12 Months		12 months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities Available for Sale						
U.S. government agencies	$ -	$ -	$ 15,363	$ (832)	$ 15,363	$ (832)
State and Political Subdivision	-	-	38,683	(3,596)	38,683	(3,596)
Residential Mortgage-backed securities	5,436	(41)	113,053	(17,210)	118,489	(17,251)
Corporate Debt	357	(143)	7,997	(2,204)	8,354	(2,347)
Total Available for Sale	$ 5,793	$ (184)	$ 175,096	$ (23,842)	$ 180,889	$ (24,026)

3. INVESTMENT SECURITIES *(continued)*

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

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

3. INVESTMENT SECURITIES *(continued)*

Unrealized losses on available for sale securities have not been recognized into income because the issuer's securities are of high credit quality, management does not intend to sell, it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity. The Company has adequate liquidity and the ability and intent to hold these securities to maturity, resulting in full recovery of the indicated unrealized loss. Accordingly, none of the unrealized losses on the securities are related to credit issues.

As of December 31, 2023, the Company's available-for-sale security portfolio consisted of 164 securities, 148 of which were in an unrealized loss position. At December 31, 2023, 98% of the mortgage-backed securities held by the Company were issued by U.S. government-sponsored entities and agencies. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be provisioned for credit loss at December 31, 2023.

The Company's available-for-sale mortgage-backed securities portfolio includes non-agency collateralized mortgage obligations with a fair value of $3.6 million which had unrealized losses of approximately $514,000 at December 31, 2023. These non-agency mortgage-backed securities were rated AAA at purchase. The Company believes there is no provision for credit loss and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The issuers continue to make timely principal and interest payments on the bonds.

The Company's portfolio of available-for-sale debt securities includes 38 municipal securities with a market value of $44.4 million which had unrealized losses of $3.5 million at December 31, 2023. The Company monitors certain credit characteristics of each municipal security issuer as necessary, and these issuers appear to be able to service all outstanding debt. The Company believes there is no provision for credit loss and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

The Company's available-for-sale corporate debt securities portfolio includes 9 securities with a market value of $8.4 million which had unrealized losses of $2.3 million at December 31, 2023. The Company monitors certain credit characteristics of each corporate issuer on a quarterly basis and these issuers appear to be able to service all outstanding debt. The Company believes there is no provision for credit loss and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

3. INVESTMENT SECURITIES *(continued)*

The following table presents the activity in the allowance for credit losses for debt securities held-to-maturity by major security type for the year ended December 31, 2023 *(Dollars in thousands):*

December 31, 2023	Mortgage-backed Residential	Municipal
Allowance for credit losses:		
Beginning balance	$ -	$ -
Impact of adopting ASC 326	-	11
Reversal of Provision	-	(3)
Total ending allowance balance	$ -	$ 7

The amortized cost and estimated fair value of investment securities at December 31, 2023 and 2022 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately *(Dollars in thousands):*

	2023		2022	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Securities available-for-sale				
Due in one year or less	$ 16,083	$ 15,907	$ -	$ -
After one through five years	33,052	29,858	38,875	37,270
After five years through ten years	38,488	35,393	43,640	39,960
After ten years	33,466	31,006	11,011	7,739
Residential Mortgage-backed securities	143,206	125,956	156,952	138,220
Total	230,829	207,114	250,478	223,189
Securities held-to-maturity				
Due in one year or less	$ -	$ -	$ -	$ -
After one year through five years	-	-	-	-
After five years through ten years	-	-	-	-
After ten years	38,757	38,520	38,753	36,346
Residential Mortgage-backed securities	2,569	2,288	2,540	2,223
Total	41,326	40,808	41,293	38,569
Total	$ 272,155	$ 247,922	$ 291,772	$ 261,758

4. LOANS

Outstanding loans at December 31, 2023 and 2022 are summarized below *(Dollars in thousands)*:

	2023	2022
Commercial	$ 81,367	$ 89,423
Real estate – commercial	642,285	607,565
Real estate – residential	168,356	169,214
Construction	55,840	43,020
Consumer and other	98	193
Total gross loans	947,946	909,415
Deferred loan origination fees, net of costs	(1,535)	(1,730)
Allowance for credit losses	(11,648)	(10,626)
Loans, net	$ 934,763	$ 897,059

The table above includes loans acquired at fair value on January 1, 2016, with outstanding balances of $6.5 million and $7.5 million as of December 31, 2023, and 2022, respectively.

The Company deferred $1.0 million and $0.6 million in salaries and employee benefits as loan origination costs for the years ended December 31, 2023, and 2022, respectively.

Loans with a fair value of approximately $387.0 million and $204.2 million were pledged to secure borrowing arrangements as of December 31, 2023, and 2022, respectively (see Note 12).

Loan Servicing

The Company services SBA loans for the SBA and other institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2023, and 2022, the Bank was servicing approximately $12.9 million and $10.3 million in SBA loans previously sold. The net carrying value of servicing rights associated with these loans was $129,000 and $147,000 as of December 31, 2023, and 2022, respectively. The carrying value approximated the fair value at December 31, 2023, and 2022.

5. ALLOWANCE FOR CREDIT LOSSES

The following tables present the activity in the allowance for credit losses by portfolio segment for the years ending December 31, 2023 and 2022 *(Dollars in thousands):*

December 31, 2023	Commercial	Real Estate – Commercial	Real Estate – Residential	Construction	Consumer and Other	Total
Allowance for credit losses:						
Beginning balance prior to adoption of ASC 326	$ 1,430	$ 7,245	$ 1,555	$ 392	$ 4	$ 10,626
Impact of adopting ASC 326	529	(151)	(68)	528	1	839
Credit loss expense	41	92	17	26	(5)	171
Charge-offs	-	-	-	-	2	2
Recoveries	10	-	-	-	-	10
Ending balance	$ 2,010	$ 7,186	$ 1,504	$ 946	$ 2	$ 11,648

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

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

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

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

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

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

The following table shows an aging analysis of the loan portfolio by the time past due at December 31, 2023 (*Dollars in thousands*):

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due	Current	Total
Commercial	$ -	$ -	$ 594	$ 594	$ 80,773	$ 81,367
Real Estate – Commercial	78	-	-	78	642,207	642,285
Real Estate – Residential	-	-	-	-	168,356	168,356
Construction	-	-	-	-	55,840	55,840
Consumer and Other	-	-	-	-	98	98
Total	$ 78	$ -	$ 594	$ 672	$ 947,274	$ 947,946

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

The following table present the amortized cost basis of loans on nonaccrual status and loans past due over 89 days still accruing as of December 31, 2023 (*Dollars in thousands*):

	Nonaccrual With No Allowance for Credit Loss	Nonaccrual	Loans past Due Over 89 Days Still Accruing
Commercial	$ 594	$ 594	$ -
Total	594	594	-

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

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

During the years ended December 31, 2023 and 2022, the Company had $0.2 million and $0.3 million of interest income foregone from loans on non-accrual status.

The following table presents the amortized cost basis of collateral-dependent loans by class of loans as of December 31, 2023 (*Dollars in thousands*):

	Third position lien on residential real estate
Commercial	$ 594
Total	594

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

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

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

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, 2023 and 2022, the Company did not recognize any income on a cash basis of accounting.

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

	Term Loans Amortized Cost Basis by Origination Year								
	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
As of December 31, 2023									
Commercial:									
Risk rating									
Pass	$ 15,402	$ 17,492	$ 6,752	$ 4,854	$ 1,116	$ 11,708	$ 19,418	$ -	$ 76,742
Special mention	-	382	-	-	-	-	-	-	382
Substandard	-	539	688	205	34	-	2,777	-	4,243
Doubtful	-	-	-	-	-	-	-	-	-
Total commercial loans	15,402	18,414	7,440	5,058	1,149	11,708	22,195	-	81,367
Commercial:									
Current period gross write offs	-	-	-	-	-	-	-	-	-
Current period recoveries	-	-	-	-	-	10	-	-	10
Current period net write offs	-	-	-	-	-	(10)	-	-	(10)
Real Estate - Commercial:									
Risk rating									
Pass	$ 87,133	$ 185,059	$ 161,757	$ 99,329	$ 41,045	$ 60,986	$ 1,055	$ -	$ 636,364
Special mention	-	-	-	-	-	-	1	-	1
Substandard	-	-	5,919	-	-	-	-	-	5,919
Doubtful	-	-	-	-	-	-	1	-	1
Total Real Estate - Commercial	87,133	185,059	167,676	99,329	41,045	60,986	1,057	-	642,285
Real Estate - Commercial:									
Current period gross write offs	-	-	-	-	-	-	-	-	-

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

	Term Loans Amortized Cost Basis by Origination Year								
	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Real Estate - Commercial:									
Current period recoveries	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current period net write offs	-	-	-	-	-	-	-	-	-
Real Estate - Residential:									
Risk rating									
Pass	$ 18,287	$ 61,791	$ 39,284	$ 20,281	$ 5,526	$ 8,209	$ 14,979	$ -	$ 168,356
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Total Real Estate - Residential	18,287	61,791	39,284	20,281	5,526	8,209	14,979	-	168,356
Real Estate - Residential:									
Current period gross write offs	-	-	-	-	-	-	-	-	-
Current period recoveries	-	-	-	-	-	-	-	-	-
Current period net write offs	-	-	-	-	-	-	-	-	-
Construction:									
Risk rating									
Pass	$ 31,038	$ 23,309	$ 1,024	$ -	$ -	$ 469	$ -	$ -	$ 55,840
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Total Construction	31,038	23,309	1,024	-	-	469	-	-	55,840

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

	Term Loans Amortized Cost Basis by Origination Year								
	2023	2022	2021	2020	2019	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Construction:									
Current period gross write offs	-	-	-	-	-	-	-	-	-
Current period recoveries	-	-	-	-	-	-	-	-	-
Current period net write offs	-	-	-	-	-	-	-	-	-
Consumer and other:									
Risk rating									
Pass	$ 21	$ -	$ -	$ -	$ -	$ -	$ 77	$ -	$ 98
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Total Consumer and other	21	-	-	-	-	-	77	-	98
Consumer and other:									
Current period gross write offs	-	-	-	-	2	-	-	-	2
Current period recoveries	-	-	-	-	-	-	-	-	-
Current period net write offs	-	-	-	-	2	-	-	-	2
Total loans:	$ 151,880	$ 288,573	$ 215,424	$ 124,669	$ 47,720	$ 81,372	$ 38,308	$ -	$ 947,946
Current period gross write offs	-	-	-	-	2	-	-	-	2
Current period recoveries	-	-	-	-	-	10	-	-	10
Current period net write offs	-	-	-	-	2	(10)	-	-	(8)

5. ALLOWANCE FOR CREDIT LOSSES *(continued)*

Loan Modifications

The Company did not make any loan modifications during the year ended December 31, 2023.

Troubled Debt Restructurings

Included in impaired loans at December 31, 2022, were four loans totaling $604,000 which were considered to be troubled debt restructurings. The Company had allocated $588,000 of specific reserves to these loans that have been modified in troubled debt restructurings as of December 31, 2022. The Company allocated $497,000 of specific reserves to these loans that have been modified as of December 31, 2023.

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

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Loan Modifications:			
Commercial	2	$ 570	$ 570

During 2021, a single borrower with two commercial loans presented in the table above, qualified for modifications under the CARES Act. Subsequently in 2022, another modification was provided to the same borrower, which was determined to be a troubled debt restructuring. Both loans were fully reserved as of December 31, 2023 and 2022. The troubled debt restructurings described above, increased the allowance for loan losses by $497,000 and $570,000, and resulted in zero charge-offs during the years ending December 31, 2023, and 2022.

There were no loans modified for which there was a payment default within twelve months following the modification during the years ending December 31, 2023, and 2022.

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

6. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31, 2023 and 2022 *(Dollars in thousands)*:

	2023	2022
Furniture fixtures and equipment	$ 4,386	$ 3,208
Leasehold improvements	7,644	4,962
Construction in progress	-	588
Building	1,224	1,224
Building improvements	1,576	1,593
Land	774	774
Total bank premises and equipment	15,604	12,349
Accumulated Depreciation and amortization	(6,803)	(6,597)
Premises and equipment, net	$ 8,801	$ 5,752

Depreciation and amortization included in occupancy and equipment expense totaled $0.9 million and $0.8 million for the years ending December 31, 2023 and 2022.

7. LEASES

The Company enters into leases in the normal course of business primarily for full-service branches and lending centers. The Company's leases have remaining terms ranging from 2 to 9 years, some of which include renewal options to extend the lease for up to 20 years. The Company leases its headquarters, branch facilities (except Paso Robles which is owned by the Company) and lending offices under non-cancelable operating leases.

During 2023, the Company consolidated its administration and commercial lending offices from downtown Santa Barbara and commenced rent for its new headquarters in uptown Santa Barbara. The initial lease term is for ten years. The lease has two five-year renewal options and includes an annual rent adjustment of 3%. The Company also received a $450,000 tenant improvement allowance as part of the lease agreement.

The lease for the Santa Maria branch expires on December 31, 2026, and has one four-year renewal option. The lease includes annual rent adjustments of 4%.

The lease for the Santa Barbara branch expires on June 30, 2025, and includes two five-year renewal options. 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%.

7. LEASES *(continued)*

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

The leases for the full-service branch and loan production office in San Luis Obispo expires in May 2029. The lease include annual rent adjustments of 3% and have four five-year renewal options.

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

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

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

As of December 31, 2023 and 2022, all of the Company's leases are classified as operating leases. Right-of-use assets were $5.2 million and $6.6 million and lease liabilities were $6.2 million and $7.1 million as of December 31, 2023, and 2022, respectively.

Rental expense, net of sublease income, included in occupancy and equipment expense totaled $1.5 million and $1.4 million for the years ended December 31, 2023, and 2022, respectively.

7. LEASES *(continued)*

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2023, are as follows *(Dollars in thousands)*:

Year Ending December 31,	Operating Lease
2024	$ 1,415
2025	1,227
2026	1,025
2027	932
2028	743
Thereafter	1,783
Total undiscounted lease payments	7,126
Less: imputed interest	(908)
Net lease liabilities	$ 6,218

Supplemental Lease Information

	December 31, 2023	December 31, 2022
Operating lease weighted average remaining lease term (years)	6	7
Operating lease weighted average discount rate	2.92%	2.54%

8. OTHER REAL ESTATE OWNED

At December 31, 2023 and December 31, 2022, the Company had no properties acquired through foreclosure or deed-in-lieu.

9. GOODWILL AND INTANGIBLE ASSETS

Business combinations involving the Company's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2023 and 2022 was $4.8 million. Total goodwill at December 31, 2023 and 2022 represented the excess of the cost of BSB over the net of the amounts assigned to assets acquired and liabilities assumed in the transactions accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisitions. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least annually for impairment.

Goodwill is also tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the goodwill below its carrying amount. No such events or circumstances arose during the fourth quarter of 2023, so goodwill was not required to be retested.

The intangible assets at December 31, 2023, and 2022, represent the net carrying value of servicing rights associated with SBA loans that are serviced by the Company for the SBA and other institutional investors that have purchased government guaranteed portions of certain loans. At December 31, 2023, and 2022, the net carrying value of servicing rights associated with these loans was $129,000 and $147,000, respectively.

10. TIME DEPOSITS

Time deposits as of December 31, 2023, have the following maturities by year *(Dollars in thousands)*:

Maturity Year	Amount
2024	$ 79,169
2025	4,615
2026	0
2027	2
2028	0
Total	$ 83,786

Time deposits with balances of more than $250,000 totaled $36.7 million and $22.9 million at December 31, 2023, and 2022, respectively.

11. INCOME TAXES

The provision for income taxes for the years ended December 31, 2023, and 2022 consisted of the following *(Dollars in thousands)*:

	2023	2022
Current:		
Federal	$ 1,782	$ 3,634
State	1,577	2,362
Total	3,359	5,996
Deferred:		
Federal	681	(425)
State	(49)	(308)
Total	632	(733)
Provision for income taxes	$ 3,991	$ 5,263

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

	2023	2022
Federal statutory rate times financial statement income	$ 3,046	$ 3,939
Effect of:		
State income taxes, net of federal tax benefit	1,207	1,623
Share-based compensation	(74)	(25)
Tax-exempt interest	(290)	(308)
Other, net	102	34
Total	$ 3,991	$ 5,263

11. INCOME TAXES *(continued)*

Deferred tax assets (liabilities) at December 31, 2023, and 2022 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)*:

	2023	2022
Deferred tax assets:		
Lease liability	$ 1,838	$ 2,090
Allowance for loan losses	3,443	3,141
Accrued expenses	956	1,012
Share-based compensation	498	428
Unrealized loss on available-for-sale investment securities	8,746	10,039
Net operating loss carryforward	181	281
Fair value adjustments	-	16
State taxes	394	492
Other	308	206
Total deferred tax assets	$ 16,364	$ 17,705
Deferred tax liabilities:		
Deferred loan costs	(686)	(666)
Right-of-use asset	(1,535)	(1,950)
Premises and equipment	(859)	(311)
Prepaid expenses	(33)	(28)
Other	(64)	(19)
Total deferred tax liabilities	(3,177)	(2,974)
Net deferred tax asset	$ 13,187	$ 14,731

As of December 31, 2023 and 2022, management performed an evaluation of the Company's net deferred tax asset and determined that it was more likely than not that the Company would be able to utilize its net deferred tax asset. Therefore, no valuation allowance is necessary for 2023.

The Company files income tax returns in the United States and California jurisdictions. The Company is no longer subject to examination by federal taxing authorities for tax years prior to 2020 and is no longer subject to examination by California taxing authorities for tax years prior to 2019. There are currently no pending federal or state income tax examinations by tax authorities.

11. INCOME TAXES *(continued)*

The Company has no uncertain tax positions and has not accrued for any interest or penalties as of December 31, 2023 or 2022. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

As of December 31, 2023, the Company has net operating losses ("NOLs") available to carry-forward for federal tax purposes totaling $0.9 million. Federal NOL carry-forwards will expire at various dates from 2029 to 2035, if unused. All federal NOLs were acquired in the BSB acquisition in 2016. The utilization of these NOL carry-forwards by the Company for federal tax purposes is subject to Internal Revenue Code Sec. 382 with limitations placed on the amount of NOLs that can be utilized annually. The annual 382 limitation is approximately $0.5 million for federal purposes. The Company does not, however, believe that the annual limitation will impact the ultimate deductibility of these NOL carry-forwards.

12. BORROWING ARRANGEMENTS

The Company has unsecured Federal funds lines of credit with five of its correspondent banks under which it can borrow up to $125.0 million in the aggregate. There were zero borrowings outstanding under these arrangements as of December 31, 2023, and 2022.

In addition, the Company has an arrangement with the Federal Home Loan Bank ("FHLB") under which it may borrow an amount not to exceed 25% of total assets which must be fully secured by qualifying loans or investment securities. At December 31, 2023, amounts pledged and available under such limits at the FHLB were approximately $276.5 million and $201.5 million, respectively.

At year-end, advances from the FHLB were as follows *(Dollars in thousands)*:

	2023	2022
Maturities 2024 through 2026, fixed rate at rates from 4.00% to 5.64%, averaging 5.41%	$ 75,000	$ -
Total	$ 75,000	$ -

Principal payments over the next five years are as follows *(Dollars in thousands)*:

2024	$ 65,000
2025	-
2026	10,000
2027	-
2028	-

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company has pledged certain loans and investment securities to secure borrowings. The borrowing capacity under the agreement varies depending on the amount and type of loans and investment securities pledged. There were no borrowings outstanding under the agreement at December 31, 2023, or 2022,

12. BORROWING ARRANGEMENTS *(continued)*

and the Company had $42.9 million of readily available borrowing capacity at December 31, 2023, based on currently pledged loans and investment securities.

The Company has one secured line of credit with The Independent Bankers Bank of $10.0 million dollars. As of December 31, 2023, the balance on the line of credit was $10.0 million dollars. The note is at a fixed rate of 3.85% until May 1, 2027, at which time the rate will adjust annually to Wall Street Prime, with a floor of 3.25%.

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

13. COMMITMENTS AND CONTINGENCIES

Financial Instruments With Off-Balance Sheet Risk

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

	December 31,	
	2023	2022
Commitments to extend credit	$ 187,570	$ 174,911
Standby letters of credit	$ 3,619	$ 3,892

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

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

The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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

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, 2023 and 2022. The Company recognizes these fees as revenue over the term of the commitment.

As of December 31, 2023, unsecured commercial loan commitments represent approximately 56% 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 10% of total commitments and have fixed and variable rates. Agricultural production represents approximately 2% of total commitments and generally have variable rates. The remaining 2% of loan commitments represent other consumer loans, which are collateralized and uncollateralized and generally have variable interest rates.

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

Concentrations of Credit Risk

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

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

13. COMMITMENTS AND CONTINGENCIES *(continued)*

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

At December 31, 2023, a concentration representing approximately 439% of the Bank's TC and 638% of the Company's TE was in Real Estate – Commercial loans. These loans include both owner-occupied and non-owner-occupied commercial real estate loans and are within a variety of types. Residential real estate loans also represented a concentration of approximately 115% of the Bank's TC and 167% of the Company's TE. These loans include owner occupied and non-owner occupied adjustable residential real estate loans, variable home equity lines and fixed rate, short term non-revolving credits.

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

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

Concentrations in Deposit and Loan Relationships

As of December 31, 2023 and 2022, the Company did not have any deposit customers that exceed 5% of total deposits.

As of December 31, 2023 and 2022, the Company did not have any loan customers that exceed 10% of total loans.

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, 2023, the Bank had $15.4 million of uninsured deposits.

14. SHARE-BASED PAYMENTS

On December 31, 2023, the Company had one share-based compensation plan, which is described below. The Plan does not provide for the settlement of awards in cash and new shares are issued upon option exercise or grant of restricted stock.

On September 2, 2015, the Company adopted the American Riviera Bank 2015 Omnibus Stock Incentive Plan ("Plan") which has been approved by its shareholders and permits the grant of equity compensation in the form of Options, Restricted Stock Awards,

14. SHARE-BASED PAYMENTS *(continued)*

Performance Awards, and Restricted Stock Units for up to 1,091,782 shares of the Company's common stock. The remaining shares available for issuance are reduced by shares reserved and shares outstanding under the 2015 Plan, leaving 194,060 available for issuance under the Plan at December 31, 2023. In connection with the Bancorp reorganization in February 2022, the Plan became an equity incentive plan of the Company and all outstanding award agreements of Bank shares became shares of the Company with the same terms, conditions, and restrictions.

There were 103,447 and 69,949 restricted shares granted in 2023 and 2022, respectively. The Plan is designed to attract and retain employees and directors. The amount, frequency, and terms of share-based awards may vary based on competitive practices, the Company's operating results and government regulations. The Plan requires that the option or grant price may not be less than the fair market value of the stock at the date the award is granted, and that the exercise price per share must be paid in full or shares tendered for sale “net exercise” at the time the option is exercised. All of the options granted under the Plan have a 10-year term and have been issued with exercise prices at the fair market value of the underlying shares at the date of grant. The employee stock options, and restricted stock awards generally vest over a four to five-year period from the date of the grant. The Plan permits the use of vested, in-the-money stock options to be used as a cashless exercise.

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 on a straight-line basis over the vesting period of the awards based on the fair value of the stock at grant date. The fair value of the stock was determined using most recent market data. Restricted common stock shares to employees typically vest over a four to five-year period and immediately for directors.

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

Unvested Shares	Shares	Weighted Average Grant Date Fair Value
Unvested shares at January 1, 2023	183,563	$ 16.42
Granted	103,447	18.04
Vested	(65,295)	16.24
Forfeited	(7,215)	17.77
Unvested shares at December 31, 2023	214,500	$ 17.21

14. SHARE-BASED PAYMENTS *(continued)*

In 2023, the Bank granted 91,943 shares of restricted common stock to selected officers, which had a fair market value between $15.65 and $18.50 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 2023, the Bank granted a total of 11,504 shares of restricted common stock to the outside members of the Board of Directors, which had a fair market value of $15.30 per share on the date of grant. These restricted common stock awards vested immediately and the related expense of $176,000 was recorded for the year ended December 31, 2023.

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

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

As of December 31, 2023, there were 214,500 shares of restricted stock that were unvested and expected to vest. Compensation cost and directors' fees charged against income for restricted stock awards was $1.3 million and $1.0 million for the years ended December 31, 2023, and 2022. There was an excess tax benefit recognized for restricted stock awards in the amount of $74,000 and $118,000, respectively for the years ended December 31, 2023, and 2022. At December 31, 2023, and 2022, the total compensation cost related to unvested restricted common stock not yet recognized was $1.9 million and $1.8 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, 2023, and 2022, was $1.0 million and $0.9 million, respectively.

15. SHAREHOLDERS' EQUITY

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, 2023, and 2022 is as follows:

	Net Income	Weighted Average Number of Shares Outstanding	Earnings per share
December 31, 2023			
Basic earnings per share	$ 10,513,000	5,768,697	$ 1.82
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	10,513,000	5,768,697	1.82
December 31, 2022			
Basic earnings per share	$ 13,494,000	5,669,489	$ 2.38
Effect of dilutive stock options and restricted shares		-	
Diluted earnings per share	13,494,000	5,669,489	2.38

Shares of common stock issuable under stock options for which the exercise prices are greater than average market prices are not included in the computation of diluted earnings per share due to their antidilutive effect. There were no options or restricted shares excluded from the computation of diluted earnings per share for the years ended December 31, 2023, and 2022, respectively.

15. SHAREHOLDERS' EQUITY *(continued)*

Regulatory Capital

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer for 2023 is 2.5%. The net unrealized gain or loss on AFS securities is not included in computing regulatory capital. The Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. As of December 31, 2023, and 2022, 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, 2023, and 2022, total average assets for leverage capital purposes were $1,267.0 million and $1,391.6 million, respectively, and total risk-weighted assets were $1,065.9 million and $1,037.7 million, respectively.

15. SHAREHOLDERS' EQUITY (continued)

Capital ratios as of December 31, 2023, and 2022 are as follows *(Dollars in thousands)*:

	2023		2022	
	Amount	Ratio	Amount	Ratio
Leverage Ratio				
American Riviera Bank	$ 134,561	10.6%	$ 122,938	8.8%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 63,352	5.0%	$ 69,885	5.0%
Minimum regulatory requirement	$ 50,682	4.0%	$ 55,908	4.0%
Common Equity Tier I Ratio				
American Riviera Bank	$ 134,561	12.6%	$ 122,938	11.9%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 69,286	6.5%	$ 67,072	6.5%
Minimum regulatory requirement	$ 47,967	4.5%	$ 46,434	4.5%
Tier 1 Risk-Based Capital Ratio				
American Riviera Bank	$ 134,561	12.6%	$ 122,938	11.9%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 85,275	8.0%	$ 82,550	8.0%
Minimum regulatory requirement	$ 63,956	6.0%	$ 61,912	6.0%
Total Risk-Based Capital Ratio				
American Riviera Bank	$ 146,797	13.8%	$ 133,722	13.0%
Minimum for "Well-Capitalized" institution under prompt corrective action provisions	$ 106,593	10.0%	$ 103,187	10.0%
Minimum regulatory requirement	$ 85,275	8.0%	$ 82,550	8.0%

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

16. REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income. The following table presents the Company's sources of non-interest income for the twelve months ended December 31, 2023, and 2022. The other category totaling $1.3 million and $2.4 million for the years ended December 31, 2023, and 2022, respectively, is not within the scope of ASC 606.

Non-interest income for the years ended December 31, 2023, and 2022 consisted of the following *(Dollars in thousands)*:

	2023	2022
Service charges on deposits	$ 1,066	$ 902
Overdraft Fees	74	65
Other	1,336	2,380
Total	$ 2,476	$ 3,347

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 Company contributed $0.6 million and $0.5 million in the form of employer matching contributions to the 401k Plan during the years ended December 31, 2023, and 2022, respectively.

18. OTHER EXPENSES

Other expenses for the years ended December 31, 2023, and 2022, consisted of the following *(Dollars in thousands)*:

	2023		2022	
Data processing	$	2,396	$	1,552
Advertising and marketing		962		1,007
Professional fees		880		929
Regulatory assessments		705		772
Director Fees		437		391
Software		1,058		810
Insurance		188		156
Other		2,973		3,217
Total other expenses	$	9,579	$	8,834

19. RELATED PARTY TRANSACTIONS

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

Loans

Balance, January 1, 2023	$	-
Disbursements		67
Amounts repaid		(67)
Balance, December 31, 2023	$	-

As of December 31, 2023, total undisbursed commitments to related parties were $70,000.

As of December 31, 2023, and 2022, there were no loans to related parties that exceeded 10% of the Bank's total loans.

20. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company invested in qualified affordable housing projects in 2022. At December 31, 2023, the balance of the investment for qualified affordable housing projects was $2.3 million. These balances are reflected in the accrued interest receivable and other assets line on the consolidated balance sheets. Total unfunded commitments related to the investments in qualified affordable housing projects totaled $2.4 million at December 31, 2023. These balances are reflected in the accrued interest payable and other liabilities line on the consolidated balance sheets. The Company expects to fulfill these commitments during the year ending 2039.

During the years ended December 31, 2023, and 2022, the Company recognized amortization expense of $152,000 and $29,000, respectively, which was included within income tax expense on the consolidated statements of income.

Additionally, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of $40,000 and $28,000 in 2023 and 2022, respectively.

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