SANTA CRUZ COUNTY BANK

2019 ANNUAL REPORT

Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

The Shareholders and Board of Directors
Santa Cruz County Bank
Santa Cruz, California

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe LLP

Crowe LLP

Sacramento, California
March 17, 2020

SANTA CRUZ COUNTY BANK

BALANCE SHEETS

December 31, 2019 and 2018

	2019	2018
ASSETS		
Cash and due from financial institutions	$ 19,330,532	$ 11,552,290
Federal funds sold	30,700,190	5,370,193
Cash and cash equivalents	50,030,722	16,922,483
Interest-bearing deposits in other financial institutions	135,786,000	95,205,000
Debt Securities available for sale	52,344,896	26,272,050
Debt Securities held to maturity (fair value 2019-$15,444,362; 2018-$21,794,111)	15,078,677	21,612,885
Loans held for sale	23,800,497	19,202,395
Loans, net of allowance of $10,296,230 in 2019; $9,836,731 in 2018	723,419,023	461,342,303
Federal Home Loan Bank stock, at cost	3,420,200	2,179,800
Bankers Bank stock, at cost	456,215	170,000
Premises and equipment, net	7,647,742	3,096,039
Goodwill	25,761,654	-
Core deposit intangible asset, net	3,569,000	-
Bank owned life insurance	13,785,945	8,529,211
Deferred income tax	3,962,451	3,887,065
Accrued interest receivable	3,220,560	2,398,284
Right-of-use assets	4,942,681	-
Other assets	3,757,106	1,590,842
TOTAL ASSETS	$ 1,070,983,369	$ 662,408,357
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest bearing	$ 345,604,709	$ 259,724,984
Interest bearing	558,743,313	324,400,825
Total deposits	904,348,022	584,125,809
Accrued interest payable	193,330	157,970
Lease liabilities	5,057,206	-
Other liabilities	10,286,443	9,601,576
Total liabilities	919,885,001	593,885,355
Commitments and Contingencies - See Note 17		
Shareholders' equity		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued or outstanding	-	-
Common stock, no par value; 30,000,000 shares authorized; 3,849,841 and 2,448,594 shares issued at December 31, 2019 and 2018 respectively	94,834,188	24,313,164
Additional paid-in capital	12,558,094	12,083,645
Retained earnings	43,704,318	32,335,096
Accumulated other comprehensive income (loss)	1,768	(208,903)
Total shareholders' equity	151,098,368	68,523,002
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,070,983,369	$ 662,408,357

SANTA CRUZ COUNTY BANK
STATEMENTS OF INCOME
Years ended December 31,

	2019	2018
Interest and dividend income		
Loans, including fees	$ 32,891,233	$ 27,264,058
Interest-bearing deposits in other financial institutions	2,547,132	1,736,710
Taxable securities	1,023,405	800,917
Tax-exempt securities	246,337	304,081
Dividends on FHLB and PCBB and TIB stock	192,373	195,201
Federal funds sold	472,807	309,238
Total interest and dividend income	37,373,287	30,610,205
Interest expense		
Deposits	2,187,596	1,332,816
Federal Home Loan Bank advances	210	237
Federal Funds purchased	387	336
Total interest expense	2,188,193	1,333,389
Net interest income	35,185,094	29,276,816
Provision for loan losses	450,000	687,500
Net interest income after provision for loan losses	34,735,094	28,589,316
Noninterest income		
Service charges on deposits	602,711	573,231
Net gains on sales of loans	782,418	722,493
Loan servicing fees	612,460	652,004
Loss on disposal of fixed assets	(1,773)	-
Other	1,450,739	1,274,265
Total noninterest income	3,446,555	3,221,993
Noninterest expense		
Salaries and employee benefits	10,795,030	9,108,649
Occupancy	1,312,189	1,336,964
Furniture and equipment	999,464	682,312
Marketing and business development	546,499	465,769
Data and item processing	910,127	738,646
Federal deposit insurance	196,547	264,241
Provision for (reduction of) off balance sheet commitments	(9,614)	42,832
Amortization of core deposit intangibles	138,000	-
Acquisition expenses	3,341,558	-
Other	2,523,888	3,305,425
Total noninterest expense	20,753,688	15,944,838
Income before income taxes	17,427,961	15,866,471
Income tax expense	5,152,711	4,486,385
Net income	$ 12,275,250	$ 11,380,086
Earnings per share:		
Basic	$ 4.51	$ 4.68
Diluted	$ 4.47	$ 4.61

SANTA CRUZ COUNTY BANK
STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31,

	2019	2018
Net income	$ 12,275,250	$ 11,380,086
Other comprehensive income:		
Unrealized losses on available for sale securities:		
Unrealized holding losses arising during the period	(24,659)	(91,389)
Reclassification adjustment for losses included in net income	-	-
Tax effect	7,289	27,015
Net of tax	(17,370)	(64,374)
Unrealized frozen gains on securities transferred to held to maturity		
Amortization of unrealized frozen gain during the period	33,577	24,761
Reclassification adjustment for losses included in net income	-	-
Tax effect	(9,927)	(7,318)
Net of tax	23,650	17,443
Defined benefit pension plans:		
Actuarial net gain arising during the period	261,770	66,078
Reclassification adjustment for amortization of prior service cost and net gain/loss included in net periodic pension cost	28,408	(161,199)
Tax effect	(85,787)	28,121
Net of tax	204,391	(67,000)
Total other comprehensive income (loss)	210,671	(113,931)
Comprehensive income	$ 12,485,921	$ 11,266,155

SANTA CRUZ COUNTY BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years ended December 31,

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2017	2,422,924	$ 24,115,128	$ 11,635,536	$ 21,966,055	$ (436,171)	$ 57,280,548
Net income				11,380,086		11,380,086
Other comprehensive loss					(113,931)	(113,931)
Cash dividends declared ($0.275 per share)				(669,846)		(669,846)
Stock-based compensation			448,109			448,109
Exercise of stock options	17,445	198,036				198,036
Restricted stock awards granted	8,225					
Amortization of minimum pension liability adj. split dollar liability				(341,199)	341,199	-
Balance at December 31, 2018	2,448,594	$ 24,313,164	$ 12,083,645	$ 32,335,096	$ (208,903)	$ 68,523,002
Net income				12,275,250		12,275,250
Other comprehensive income					210,671	210,671
Stock issued for acquisition	1,394,443	70,424,788				70,424,788
Cash dividends declared ($0.30 per share)				(839,357)		(839,357)
Stock-based compensation			474,449			474,449
Exercise of stock options	5,904	96,236				96,236
Restricted Stock awards granted	900					
Cumulative Effect of Right of Use Asset				(66,671)		(66,671)
Balance at December 31, 2019	3,849,841	$ 94,834,188	$ 12,558,094	$ 43,704,318	$ 1,768	$ 151,098,368

SANTA CRUZ COUNTY BANK

STATEMENTS OF CASH FLOWS

Years ended December 31,

	2019	2018
Cash flows from operating activities		
Net income	$ 12,275,250	$ 11,380,086
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	450,000	687,500
Depreciation and amortization of premises and equipment	609,992	395,873
Amortization of core deposit intangible	138,000	-
Net amortization of securities	329,498	471,153
Net amortization (accretion) of loans	(574,202)	(473,651)
Deferred income tax benefit	(225,053)	(119,944)
Net gain on sale of loans	(782,418)	(722,493)
Stock-based compensation expense	474,449	448,109
Earnings on bank owned life insurance	(283,975)	(195,867)
Originations of loans held for sale	(25,391,714)	(24,508,376)
Proceeds from loans held for sale	11,641,182	10,907,089
Net loss on sale/disposal of assets	1,773	12,665
(Reversal of) provision for unfunded loan commitments	(9,614)	42,832
Non cash lease expense	47,854	-
Deferred benefit expense	368,599	494,134
Increase in deferred loan fees, net of costs	331,051	58,653
Increase in accrued interest receivable	(822,276)	(296,628)
Decrease in other assets	3,059,741	222,594
Increase in accrued interest payable	35,360	50,449
Decrease in other liabilities	(512,530)	(947,281)
Net cash from operating activities	1,160,967	(2,093,103)
Cash flows from investing activities		
Net cash and cash equivalents acquired in acquisition	55,286,309	-
Net change in Interest-bearing deposits in other financial institutions	(20,981,000)	(6,677,000)
Available for sale securities:		
Sales	12,363,815	-
Maturities, prepayments and calls	13,200,000	3,000,000
Purchases	(43,606,520)	(11,885,543)
Principal repayments on securities available for sale	4,242,657	586,506
Held to maturity securities:		
Maturities, prepayments and calls	3,615,000	5,015,000
Principal repayments on securities held to maturity	2,733,685	1,732,607
Loan originations and payments, net	(29,851,578)	(20,386,496)
Purchases of premises and equipment	(435,873)	(2,746,329)
Purchase of bank owned life insurance	-	(2,250,000)
Purchases of Federal Home Loan Bank stock	(155,800)	(63,600)
Proceeds from sale of assets	-	1,250
Net cash from investing activities	(3,589,305)	(33,673,605)
Cash flows from financing activities		
Increase in deposits	36,279,698	21,466,862
Cash dividends paid	(839,357)	(669,846)
Proceeds from exercise of stock options, including tax benefit	96,236	198,036
Net cash from financing activities	35,536,577	20,995,052
Net change in cash and cash equivalents	33,108,239	(14,771,656)
Beginning cash and cash equivalents	16,922,483	31,694,139
Ending cash and cash equivalents	$ 50,030,722	$ 16,922,483
Supplemental cash flow information		
Interest paid	$ 2,152,236	$ 1,282,940
Income taxes paid	$ 6,400,000	$ 4,650,000
Supplemental noncash disclosures		
Transfer from loans held for sale to portfolio loans	$ 8,026,849	$ 13,337,433
Common stock issued in acquisition	$ 70,424,788	$ -
Operating lease right of use assets recognized	$ 4,836,176	$ -
Operating lease liabilities recognized	$ 4,903,172	$ -

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: Santa Cruz County Bank, referred to as "the Bank", is a California state chartered bank which offers a full range of commercial and personal banking services to residents and businesses in Santa Cruz County and contiguous counties, through its seven full service offices located in Aptos, Capitola, Cupertino, Santa Cruz, Scotts Valley, and Watsonville. The Bank was incorporated on September 10, 2003 as Santa Cruz County Bank (In Organization) and commenced banking operations on February 3, 2004 (Inception), upon receipt of final regulatory approval. The Bank is subject to regulations and undergoes periodic examinations by the California Department of Business Oversight ("CDBO") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits.

The majority of the Bank's business is conducted with customers located in Santa Cruz County and adjacent counties. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial, multi-family, agriculture, loans supported by single-family residential real estate, municipal loans, government guaranteed loans, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Bank products are also supported by various government guarantee programs. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

Subsequent Events: The Bank has evaluated subsequent events for recognition and disclosure from December 31, 2019 through March 17, 2020, which is the date the financial statements were available to be issued.

Use of Estimates: The preparation of financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: For purposes of reporting cash flows, cash and cash equivalents include cash, deposits with other financial institutions with maturities fewer than 90 days, and federal funds sold. Federal funds are sold for a one day period and are highly liquid investments. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions, and federal funds purchased.

Interest-Bearing Deposits in Other Financial Institutions: Interestbearing deposits in other financial institutions mature within three years and are carried at cost.

Investment Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value with unrealized holding gains and losses reported in other comprehensive income, net of tax. At the time of purchase, the Bank designates securities as either held to maturity or available for sale based on its investment objectives, operational needs, and intent.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the settlement date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the magnitude and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses the intent and ability of the Bank to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Loans held for sale are generally sold with servicing rights retained. The carrying value of loans sold is reduced by the amount allocated to the servicing right. If the loans are sold with servicing retained, the fair value of the servicing asset or liability is recorded on the balance sheet. Gains and losses on the sold portion of the loans are recognized at the time of sale based on the difference between the sale proceeds and the carrying value of the related loans sold.

Loans Receivable: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal balances outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance daily and credited to income as it is earned. When a loan pays off or is sold, any unamortized balance of any related premiums, discounts, loan origination fees, and direct loan origination costs is recognized in income. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income over the expected life of the loan using a method that approximates the level yield method without anticipating prepayments.

Interest income on loans is generally discontinued and placed on non-accrual status at the time the loan is 90 days delinquent or when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful unless the loan is well-secured and in the process of collection. Past-due status is based on the contractual terms of the loan. A loan is moved to non-accrual status in accordance with the Bank's policy, typically after 90 days of non-payment. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Non-accrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest received on such loans is accounted for on the cash-basis method and recognized only to the extent that cash is received and where the future collection of principal is probable, until qualifying for return to accrual. Generally, loans will be restored to an accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Concentration of Credit Risk: Most of the Bank's business activity is with customers located within Santa Cruz County. Therefore, the Bank's exposure to credit risk is significantly affected by changes in the economy in the Santa Cruz County area.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable credit losses in the Bank's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses, which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Cash received on previously charged-off amounts is recorded as a recovery to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Generally, the Bank identifies loans to be reported as impaired when such loans are in non-accrual status or classified in part or in whole as either doubtful or loss. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Commercial and commercial real estate loans over $100,000 are individually evaluated for impairment. Typically, loans below $100,000 from all class types are excluded from individual impairment analysis. When a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Bank, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Troubled debt restructurings are individually evaluated for impairment and included in the separately identified impairment disclosures. TDRs are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a TDR is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral less estimated costs to sell. For TDRs that subsequently default, the Bank determines the amount of the allowance on that loan in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired. The Bank incorporates recent historical experience related to TDRs including the performance of TDRs that subsequently default into the calculation of the allowance by loan portfolio segment.

The general reserve component covers loans that are collectively evaluated for impairment. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. The general allowance component also includes loans that are not individually identified for impairment evaluation, such as commercial loans below the individual evaluation threshold, as well as those loans that are individually evaluated but are not considered impaired. The determination of the general reserve is based on estimates made by management, to include, but not limited to, consideration of historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on considerations of both the Bank's actual historical loss history and losses of the peer group in which the Bank operates over the most recent 12 years. This is supplemented with other economic factors based on the risks present for each portfolio segment and internal asset classifications. These qualitative factors include economic trends in the Bank's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Bank's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Bank maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, land and construction, commercial and industrial, agricultural land, real estate and production, and consumer loans (principally home equity loans). Portfolio classes are not distinguished from segments for reporting purposes. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Bank›s overall allowance, hence, is included on the balance sheet.

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

Commercial real estate – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Land and construction – Land and construction 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.

Commercial and industrial – Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural land, real estate and production – Agricultural real estate mortgage loans generally possess a lower inherent risk of loss than other real estate portfolio segments, including land and construction loans. Adverse economic developments may result in troubled loans. Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Bank and borrowers: commodity prices and weather conditions.

Consumer – Comprised of single-family residential real estate, home equity lines of credit and personal lines. The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators, FDIC and CDBO, 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 Bank maintains a separate allowance for off-balance sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for off-balance sheet commitments totaled $345,600 at December 31, 2019 and $176,914 at December 31, 2018, and is included in other liabilities on the balance sheet.

Federal Home Loan Bank Stock: The Bank, as a member of the Federal Home Loan Bank ("FHLB") system, is required to maintain an investment in the capital stock of the FHLB of San Francisco based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.   classified as restricted security, and periodically evaluated for impairment based on ultimate recovery of par valueclassified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.. Both cash and stock dividends, if any, are reported as income. The FHLB stock is redeemable at its par value of $100 per share at the discretion of the FHLB of San Francisco. The FHLB can suspend dividends and redemptions upon notification to its members.

SANTA CRUZ COUNTY BANK
NOTES TO FINANCIAL STATEMENTS

Bankers Bank Stock: Pacific Coast Bankers Bank ("PCBB") stock and The Independent Bankers Bank ("TIB") are carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.   classified as restricted securities, and periodically evaluated for impairment based on ultimate recovery of par valueclassified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.. Both cash and stock dividends, if any, are reported as income.

On January 1, 2018, the Bank adopted a new accounting standard for Financial Instruments (ASU 2016-01), which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. Upon adoption, the amendments related to equity securities without readily determinable fair values (including disclosure requirements) are being applied prospectively to equity investments that existed at January 1, 2018. 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. The carrying amount of equity securities without readily determinable fair values was $456,215 and $170,000 as of December 31, 2019 and December 31, 2018, respectively.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

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Loan 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 loan servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Loan servicing rights were $529,270 and $591,828 at year-end 2019 and 2018 and were included in other assets on the balance sheets.

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

Servicing fee income, which is reported on the income statement as loan servicing fees, is recorded for fees earned on servicing loans. The fees are based on a fixed amount per loan and recorded as income when earned. The amortization of servicing rights is netted against loan servicing fee income. Servicing fees totaled $612,460 and $652,004 for the years ended December 31, 2019 and 2018, respectively. Late fees and ancillary fees related to loan servicing are not material.

Bank Premises and Equipment: Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is determined using the straight-line method of over the estimated useful lives of the related asset. The Bank's building and related components are depreciated over 39½ years. Furniture, fixtures and equipment are depreciated with useful lives ranging from 5 to 7 years. Leasehold improvements are amortized over the shorter of the estimated useful life of the assets or the initial term of the respective leases. The useful lives of leasehold improvements are estimated to be 3 to 15 years. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. All other maintenance and repair expenditures are charged to expense as incurred.

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

Goodwill and Intangible Assets: Goodwill arises from business combinations and is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. The Bank accounted for the acquisitions of Lighthouse Bank using the acquisition method of accounting. Under the acquisition method, assets and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. The Bank has selected September 30 as the date to perform the annual impairment test. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

The intangible assets at December 31, 2019 represent the estimated fair value of the core deposit relationships acquired in the business combination with Lighthouse Bank. Core deposit intangibles are being amortized using an accelerated basis based on dollar weighted deposit runoff on an annualized basis over an estimated life of ten years from the date of acquisition.

Loan Commitments and Related Financial Instruments: Financial instruments include offbalance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. The Bank estimates the fair value of each stock option award as of the date of grant using a Black-Scholes-Merton model, while the market price of the Bank's common stock at the date of grant is used for restricted stock awards.

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. The Bank's accounting policy is to recognize forfeitures as they occur.

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 taxes are computed using the asset and liability method, which represents the tax effects for the temporary differences between carrying amounts and tax bases of assets and liabilities, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Deferred tax assets and liabilities are calculated by applying current enacted tax rates against future deductible or taxable amounts. Realization of tax benefits of deductible temporary differences and operating loss carry forwards depends on having sufficient taxable income of an appropriate character within the carry forward periods.

The Bank 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.

The Bank recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans: Pension expense is the net of service and interest cost, return on plan assets and amortization of gains and losses not immediately recognized. Employee 401(k) plan expense is the amount of employer matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Earnings Per Common Share: Basic earnings per common share are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options. There is no adjustment to the number of outstanding shares for potential dilutive instruments, such as stock options, when a loss occurs because the conversion of potential common stock is anti-dilutive or when stock options are not in-the-money. Earnings per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes the adjustment to fully recognize the liability associated with the supplemental executive retirement plan and unrealized gains and losses on securities available for sale, which are also recognized as separate components of equity.

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 now are such matters that will have a material effect on the financial statements.

Restrictions on Cash and Due from Banks: The Bank is subject to Federal Reserve Act Regulation D, which requires banks to maintain average reserve balances with the Federal Reserve Bank. Reserve requirements are offset by usable cash reserves. The amount of such reserve balance requirement to meet regulatory reserve and clearing requirements at December 31, 2019 was $1,800,000.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to shareholders.

Fair Value of Financial Instruments: The Bank's estimated fair value amounts have been determined by the Bank using relevant market information and other assumptions, as more fully disclosed in a separate note. 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 particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Reclassifications**:** Certain reclassifications have been made to prior period financial statements to conform to the current year presentation. These reclassifications had no impact on prior year Bank's net income or shareholders' equity.

ADOPTION OF NEW ACCOUNTING STANDARDS

The following are descriptions of recently adopted accounting standards:

ASU 2016-02, Leases (Topic 842):
In February 2016, the FASB amended existing guidance that requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new guidance also requires enhanced disclosure about an entity's leasing arrangements.

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

- Carryover of historical lease determination and lease classification conclusion
- Carryover of historical initial direct cost balances for existing leases
- Accounting for lease and non-lease components in contracts in which the Bank is a lessee as a single lease component

Adoption of the leasing standard resulted in the recognition of operating right-of-use assets of $4,836,176, operating lease liabilities of $4,903,172 and a cumulative effect decrease to retained earnings of $66,671 as of January 1, 2019. These amounts were determined based on the present value of remaining minimum lease payments, discounted using the Bank's incremental borrowing rate as of the date of adoption. There was no material impact to the timing of expense or income recognition in the Bank's Income Statements. Prior periods were not restated and continue to be presented under legacy GAAP. Disclosures about the Bank's leasing activities are presented in Note 7 – Leases.

NEWLY ISSUED NOT EFFECTIVE ACCOUNTING STANDARDS

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326):
In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables and held to maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in certain cases recognized by a lessor. In addition, the amendments in this update require credit losses be presented as an allowance rather than as a write-down on available for sale debt securities. For the Bank, the standard will be effective for fiscal years beginning after December 31, 2022, including interim periods in those fiscal years.

For debt securities with other than temporary impairment (OTTI), the guidance will be applied prospectively. For all other assets within the scope of CECL, a cumulative effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Bank is currently assessing data and system needs in order to evaluate the impact of adopting the new guidance. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the one-time adjustment or the overall impact of the new guidance on the Bank's financial position, results of operation, or cash flows.

NOTE 2. BUSINESS COMBINATION

On October 18, 2019, the Bank completed the acquisition of Lighthouse Bank ("LHB") for an aggregate transaction value of $70,424,788. LHB was merged into the Bank and the Bank issued 1,394,443 shares of common stock to the former shareholders of LHB. Under the terms of the acquisition, LHB common shareholders received 0.5204 of a share of the Bank's common stock in exchange for each share of LHB common stock. With the LHB acquisition, the Bank added two full service branches located in Santa Cruz and Cupertino. LHB's assets as of October 18, 2019 totaled $325,547,624. The fair value of the common shares issued as part of the consideration paid for LHB was determined in the basis of the closing price of the Bank's common shares on the acquisition date.

In accordance with GAAP guidance for business combinations, the Bank recorded $25,761,654 of goodwill and $3,707,000 of core deposit intangible assets on the acquisition date. The core deposit intangibles are being amortized using an accelerated basis method over a period of ten years with no significant residual value. For tax purposes, purchase accounting adjustments including goodwill are all non-taxable and/or non-deductible. Acquisition related costs of $3,341,558 are included in Noninterest Expense in the Bank's income statement for the year ended December 31, 2019.

The acquisition was consistent with the Bank's strategy to expand the scale of our geographic footprint. The acquisition allows the Bank to deliver enhanced banking and lending services to our valued customers, added resources for our community and even greater efficiencies for the benefit of our shareholders. Goodwill arising from the acquisition consisted largely of synergies and the expected cost savings resulting from the combined operations.

The following table summarizes the consideration paid for LHB and the amounts of the assets and liabilities assumed recognized at the acquisition date:

Merger consideration:

Common stock issued	$ 70,424,788
Fair value of total consideration transferred	$ 70,424,788

Recognized amounts of identifiable assets acquired and liabilities assumed:

Cash and cash equivalents	$ 55,286,309
Interest-bearing deposits in other financial institutions	19,600,000
Debt securities available for sale	12,363,815
Bankers' Bank stock	1,370,815
Loans, net	222,751,515
Premises and equipment	4,727,595
Core deposit intangibles	3,707,000
Deferred taxes and taxes receivable	41,265
Bank owned life insurance	4,972,759
Other assets	4,913,166
Total assets acquired	329,734,239
Deposits	$283,587,359
Deposit Premium	355,156
Other liabilities	1,128,590
Total liabilities assumed	285,071,105
Total identifiable net assets	44,663,134
Goodwill	$ 25,761,654

The fair value of net assets acquired includes fair value adjustments to certain loans that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. However, the Bank believes that all contractual cash flows related to these financial instruments will be collected. As such, those loans were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit impaired (PCI) loans, which have shown evidence of credit deterioration since origination. Loans acquired that were not subject to PCI requirements include non-impaired loans and customer receivables with a fair value and gross contractual amounts receivable of $222,751,515 and $226,502,607 respectively, on the date of acquisition.

The Bank decreased the fair value of premises and equipment by $78,111 with a corresponding increase to goodwill due to the receipt of an updated appraisal and disposal of assets with no value at the date of acquisition.

NOTE 3. INVESTMENT SECURITIES

The following tables summarize the amortized cost and fair value of securities available for sale and held to maturity at December 31, 2019 and 2018 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) and gross unrecognized gains and losses:

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
U.S. treasury bonds	$ 8,026,415	$ 10,353	$ (668)	$ 8,036,100
U.S. government sponsored agencies	5,008,147	925	(11,022)	4,998,050
Mortgage backed securities: residential	3,441,152	7,642	(21,714)	3,427,080
Collateralized mortgage obligations	31,471,869	42,080	(217,615)	31,296,334
State and political subdivision	4,652,976	7,870	(73,514)	4,587,332
Corporate	-	-	-	-
Total available for sale	$ 52,600,559	$ 68,870	$ (324,533)	$ 52,344,896
Held to maturity:				
U.S. government sponsored agencies	$ 988,636	$ 11,934	$ -	$ 1,000,570
Mortgage backed securities: residential	1,472,993	35,932	(85)	1,508,840
Collateralized mortgage obligations	6,629,432	70,647	(57)	6,700,022
State and political subdivision	5,987,616	247,314	-	6,234,930
Total held to maturity	$ 15,078,677	$ 365,827	$ (142)	$ 15,444,362

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
U.S. treasury bonds	$ 9,919,796	$ 572	$ (14,188)	$ 9,906,180
U.S. government sponsored agencies	7,018,440	-	(103,080)	6,915,360
Collateralized mortgage obligations	8,765,446	-	(112,312)	8,653,134
State and political subdivision	698,882	832	(2,472)	697,242
Corporate	100,490	-	(356)	100,134
Total available for sale	$ 26,503,054	$ 1,404	$ (232,408)	$ 26,272,050
Held to maturity:				
U.S. government sponsored agencies	$ 979,433	$ -	$ (1,453)	$ 977,980
Mortgage backed securities: residential	2,182,352	2,345	(13,121)	2,171,576
Collateralized mortgage obligations	8,811,265	21,891	(30,369)	8,802,787
State and political subdivision	9,639,835	201,933	-	9,841,768
Total held to maturity	$ 21,612,885	$ 226,169	$ (44,943)	$ 21,794,111

There were no transfers between available for sale and held to maturity during 2019 or 2018.

The proceeds from sales and calls of investment securities and the associated gains and losses during 2019 and 2018 are listed below:

	2019	2018
Proceeds	$ 16,815,000	$ 8,015,000
Gains	-	-
Losses	-	-

The amortized cost and fair value of debt securities are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers 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.

	December 31, 2019	
	Amortized Cost	Estimated Fair Value
Available for sale:		
Within one year	$ 11,016,326	$ 11,015,950
One to five years	2,605,855	2,613,689
Five to ten years	582,285	574,333
Beyond ten years	3,483,072	3,417,510
Mortgage backed securities	3,441,152	3,427,080
Collateralized mortgage obligations	31,471,869	31,296,334
Total	$ 52,600,559	$ 52,344,896
Held to maturity:		
Within one year	$ 655,200	$ 659,074
One to five years	3,983,454	4,045,540
Five to ten years	2,026,383	2,143,356
Beyond ten years	311,215	387,530
Mortgage backed securities	1,472,993	1,508,840
Collateralized mortgage obligations	6,629,432	6,700,022
Total	$ 15,078,677	$ 15,444,362

Investment securities pledged at year-end 2019 and 2018 had a carrying amount of $25,141,000 and $22,651,000, respectively, and were pledged to secure public deposits.

At year-end 2019 and 2018, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes investment securities with unrealized and unrecognized losses at December 31, 2019 and December 31, 2018, aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position:

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December 31, 2019	Less than 12 months		12 months or more		Total	
		Unrealized		Unrealized		Unrealized
Available for sale:	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. treasury bonds	$ 4,032,500	$ (668)	$ -	$ -	$ 4,032,500	$ (668)
U.S. government sponsored agencies	3,346,941	(22,094)	1,996,180	(10,642)	5,343,121	(32,736)
Collateralized mortgage obligations	25,573,902	(209,933)	1,553,896	(7,682)	27,127,798	(217,615)
State and political subdivision	3,991,843	(73,514)	-	-	3,991,843	(73,514)
Total available for sale	$ 36,945,186	$ (306,209)	$ 3,550,076	$ (18,324)	$ 40,495,262	$ (324,533)
Held to maturity:						
Mortgage backed securities: residential	$ -	$ -	$ 20,664	$ (85)	$ 20,664	$ (85)
Collateralized mortgage obligations	51,466	(57)	-	-	51,466	(57)
Total held to maturity	$ 51,466	$ (57)	$ 20,664	$ (85)	$ 72,130	$ (142)

December 31, 2018	Less than 12 months		12 months or more		Total	
		Unrealized		Unrealized		Unrealized
Available for sale:	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. treasury bonds	$ 7,914,920	$ (14,188)	$ -	$ -	$ 7,914,920	$ (14,188)
U.S. government sponsored agencies	1,998,200	(1,540)	4,917,160	(101,540)	6,915,360	(103,080)
Collateralized mortgage obligations	1,151,872	(14,714)	7,501,262	(97,598)	8,653,134	(112,312)
State and political subdivision	231,506	(901)	250,696	(1,571)	482,202	(2,472)
Corporate	-	-	100,134	(356)	100,134	(356)
Total available for sale	$ 11,296,498	$ (31,343)	$ 12,769,252	$ (201,065)	$ 24,065,750	$ (232,408)
Held to maturity:						
U.S. government sponsored agencies	$ 977,980	$ (1,453)	$ -	$ -	$ 977,980	$ (1,453)
Mortgage backed securities: residential	726,548	(3,127)	890,026	(9,994)	1,616,574	$ (13,121)
Collateralized mortgage obligations	7,231,934	(21,700)	739,713	(8,669)	7,971,647	(30,369)
Total held to maturity	$ 8,936,462	$ (26,280)	$ 1,629,739	$ (18,663)	$ 10,566,201	$ (44,943)

Unrealized losses on corporate bonds have not been recognized into income because the issuers bonds are of high credit quality (rated AA or higher), management does not intend to sell and it is likely 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 issuers continue to make timely principal and interest payments on the bonds. The fair value is expected to recover as the bonds approach maturity.

As of December 31, 2019, the Bank's security portfolio consisted of 97 investment securities, 31 of which were in an unrealized loss position. The majority of unrealized losses are related to the Bank's collateralized mortgage obligations and U.S. government sponsored agencies as discussed below.

Collateralized Mortgage Obligations:

At December 31, 2019, 100% of the collateralized mortgage obligations held by the Bank were issued by U.S. government or government-sponsored entities and agencies, primarily Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Bank 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 Bank does not consider these securities to be other-than-temporarily impaired at December 31, 2019. The Bank's mortgage backed securities portfolio does not include non-agency collateralized mortgage obligations.

NOTE 4. LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2019 and 2018 were as follows:

	2019	2018
Commercial and industrial	$ 159,978,860	$ 108,598,861
Commercial real estate	402,560,300	238,325,291
Land and construction	100,693,621	59,265,255
Agricultural land, real estate and production	30,992,191	21,883,097
Consumer	40,050,565	40,538,002
Gross loans receivable	734,275,537	468,610,506
Net deferred loan fees	(560,284)	2,568,528
Allowance for loan losses	(10,296,230)	(9,836,731)
Loans receivable, net	$ 723,419,023	$ 461,342,303

At December 31, 2019 and 2018, loans originated under Small Business Administration (SBA) programs totaled $23,800,497 and $19,202,395, respectively. Approximately $287,843,681 in loans were pledged under a blanket lien as collateral to the FHLB for the Bank's remaining borrowing capacity of $145,763,272 as of December 31, 2019. The Bank's credit limit varies according to the amount of composition of the investment and loan portfolios pledged as collateral.

Salaries and employee benefits totaling $2,120,559 and $1,931,798 have been deferred as loan origination costs for the years ended December 31, 2019 and 2018, respectively.

The following table presents the activity in the allowance for loan losses by portfolio segment for each of the years ending December 31, 2019 and December 31, 2018:

December 31, 2019:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 2,853,397	$ 3,124,492	$ 3,388,867	$ 205,861	$ 226,745	$ 37,369	$ 9,836,731
Provision for loan losses	198,007	(207,548)	243,465	90,222	23,187	102,667	450,000
Loans charged-off	-	-	-	-	-	-	-
Recoveries	9,499	-	-	-	-	-	9,499
Total ending allowance balance	$ 3,060,903	$ 2,916,944	$ 3,632,332	$ 296,083	$ 249,932	$ 140,036	$ 10,296,230

December 31, 2018:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 2,218,227	$ 3,288,312	$ 3,260,709	$ 170,854	$ 227,450	$ (59,294)	$ 9,106,258
Provision for loan losses	593,698	(163,820)	128,158	35,007	(2,205)	96,663	687,501
Loans charged-off	-	-	-	-	-	-	-
Recoveries	41,472	-	-	-	1,500	-	42,972
Total ending allowance balance	$ 2,853,397	$ 3,124,492	$ 3,388,867	$ 205,861	$ 226,745	$ 37,369	$ 9,836,731

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2019 and 2018:

December 31, 2019:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively evaluated for impairment	3,060,903	2,916,944	3,632,332	296,083	249,932	140,036	10,296,230
Total ending allowance balance	$ 3,060,903	$ 2,916,944	$ 3,632,332	$ 296,083	$ 249,932	$ 140,036	$ 10,296,230
Loans							
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Loans collectively evaluated for impairment	159,978,860	402,560,300	100,693,621	30,992,191	40,050,565	-	734,275,537
Total ending loans balance	$ 159,978,860	$ 402,560,300	$ 100,693,621	$ 30,992,191	$ 40,050,565	$ -	$ 734,275,537

December 31, 2018:	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$
Collectively evaluated for impairment	2,853,397	3,124,492	3,388,867	205,861	226,745	37,369	9,836,
Total ending allowance balance	$ 2,853,397	$ 3,124,492	$ 3,388,867	$ 205,861	$ 226,745	$ 37,369	$ 9,836,
Loans							
Loans individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$
Loans collectively evaluated for impairment	108,598,861	238,325,291	59,265,255	21,883,097	40,538,002	-	468,610,
Total ending loans balance	$ 108,598,861	$ 238,325,291	$ 59,265,255	$ 21,883,097	$ 40,538,002	$ -	$ 468,610,

The Bank did not have any impaired loans at the end of 2019 and 2018.

Non-accrual loans and loans past due over 89 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. The Bank had no loans in non-accrual as of December 31, 2019 and December 31, 2018.

The following table presents the recorded investment in loans past due over 89 days still on accrual by class of loans as of December 31, 2019 and December 31, 2018.

	Loans Past Due Over 89 Days and Still Accruing	
	2019	2018
Commercial and industrial	$ 739,606	$ -
Commercial real estate	-	-
Land and construction	-	-
Agricultural land, real estate and production	-	-
Consumer	-	-
Total	$ 739,606	$ -

The following table presents the aging of the recorded investment in past due loans as of December 31, 2019 and 2018 by class of loans.

	Greater Than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	$ 739,606	$ 889,316	$ 159,089,544	$ 159,978,860
Commercial real estate	-	659,051	401,901,249	402,560,300
Land and construction	-	-	100,693,621	100,693,621
Agricultural land, real estate and production	-	14,980	30,977,211	30,992,191
Consumer	-	9,656	40,040,909	40,050,565
Total	$ 739,606	$ 1,573,003	$ 732,702,534	$ 734,275,537

Troubled Debt Restructurings:

As of December 31, 2019 and 2018, the Bank had no troubled debt restructurings.

Credit Quality Indicators:

The Bank assigns loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial condition of borrowers and guarantors, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $1,500,000 and non-homogeneous loans, such as commercial and commercial real estate loans. The analysis is performed on a semi-annual basis. These risk ratings are also subject to examination by independent specialists engaged by the Bank and the Bank's regulators. The risk categories can be grouped into four major categories, defined as follows:

Pass – A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

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 Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard – A substandard loan is inadequately protected by the current net worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well-defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified doubtful have all the weaknesses inherent in those classified as 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.

Loans not meeting the criteria above are analyzed individually as part of the above described process are considered to be pass-rated loans. Loans listed as not rated are either less than $300,000 or are included in groups of homogeneous loans.

SANTA CRUZ COUNTY BANK
NOTES TO FINANCIAL STATEMENTS

The following table shows the risk category of the loan portfolio by class at December 31, 2019 and 2018:

December 31, 2019	Pass	Special Mention	Substandard	Doubtful	Not Rated
Commercial and Industrial	$ 155,430,952	$ 2,195,102	$ 2,352,806	$ -	$ -
Commercial Real Estate	392,178,125	5,809,181	4,572,994	-	-
Land and Construction	100,693,621	-	-	-	-
Agricultural Land, Real Estate and Production	29,184,248	1,807,943	-	-	-
Consumer	40,050,565	-	-	-	-
Total	$ 717,537,511	$ 9,812,226	$ 6,925,800	$ -	$ -

December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Not Rated
Commercial and Industrial	$ 100,237,600	$ 5,702,199	$ 2,659,062	$ -	$ -
Commercial Real Estate	227,454,826	8,072,844	2,797,621	-	-
Land and Construction	59,265,255	-	-	-	-
Agricultural Land, Real Estate and Production	21,006,655	876,442	-	-	-
Consumer	40,538,002	-	-	-	-
Total	$ 448,502,338	$ 14,651,485	$ 5,456,683	$ -	$ -

NOTE 5. FAIR VALUE

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. The Bank groups its assets and liabilities measured at fair value into three levels. Valuations within these levels are based upon:

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

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

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

The Bank used the following methods and significant assumptions to estimate fair value:

Cash and Cash Equivalents: The carrying amount of cash and cash equivalents is a reasonable estimate of fair value and are classified as Level 1.

Interest-Bearing Deposits in Other Financial Institutions: The fair values were calculated using discounted cash flow models based on market rates resulting in a Level 2 classification.

Investment Securities: The fair values of investment securities classified as available for sale and held to maturity are based on quoted market prices, if available (Level 1) at the reporting date. For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2), using matrix pricing. Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded, values debt securities without relying exclusively on quoted prices for the specific securities but rather relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Loans Held For Sale: Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Loans: The fair value of fixed rate loans is determined as the present value of expected future cash flows discounted at the current interest rate that represents a mix of residential and commercial real estate. The market rate is initially set at the 30-year mortgage rate resulting in a Level 3 classification. Variable rate loans that reprice frequently with changes in approximate market rates were valued using the outstanding principal balance resulting in a Level 3 classification. The estimated fair values of financial instruments disclosed below follow the guidance in ASU 2016-01, which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors.

Bankers' Bank Stock: Bankers' Bank Stock includes Federal Home Loan Bank Stock, The Independent Bankers Bank Stock, and Pacific Coast Bankers Bank Stock. The Federal Home Loan Bank investment is carried at cost and is redeemable at par with certain restrictions. It is not practical to determine fair value of bank stock due to restrictions placed on its transferability.

Accrued Interest Receivable/Payable: The respective carrying values of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include accrued interest receivable and accrued interest payable. Carrying values were assumed to approximate fair values for these financial instruments as they are short term in nature and their recorded amounts approximate fair values or are receivable or payable on demand. The Bank does not use derivative financial instruments. The carrying amounts of accrued interest approximate their fair value resulting in a Level 2 or Level 3 classification.

Deposits: The fair values of demand deposits, savings deposits, and money market deposits without defined maturities were the amounts payable on demand at the reporting date resulting in a Level 1 classification. For variable rate deposits where the Bank has the contractual right to change rates, carrying value was assumed to approximate fair value resulting in a Level 1 classification. For certificates of deposit with defined maturities, the fair values were calculated using discounted cash flow models based on market interest rates for different product types and maturity dates. The discount rates used were based on rates for comparable deposits resulting in a Level 2 classification.

SANTA CRUZ COUNTY BANK
NOTES TO FINANCIAL STATEMENTS

Assets Recorded at Fair Value

The Bank's assets measured at fair value on a recurring basis as of December 31, 2019 and 2018 are summarized below:

	Fair Value Measurements at December 31, 2019 Using:			
	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Securities available for sale:				
U.S. treasury bonds	$ -	$ 8,036,100	$ -	$ 8,036,100
U.S. government sponsored agencies	-	8,425,130	-	8,425,130
Collateralized mortgage obligations	-	31,296,334	-	31,296,334
State and political subdivision	-	4,587,332	-	4,587,332
Corporate	-	-	-	-
Total assets measured at fair value	$ -	$ 52,344,896	$ -	$ 52,344,896

	Fair Value Measurements at December 31, 2018 Using:			
	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Securities available for sale:				
U.S. treasury bonds	$ -	$ 9,906,180	$ -	$ 9,906,180
U.S. government sponsored agencies	-	6,915,360	-	6,915,360
Collateralized mortgage obligations	-	8,653,134	-	8,653,134
State and political subdivision	-	697,242	-	697,242
Corporate	-	100,134	-	100,134
Total assets measured at fair value	$ -	$ 26,272,050	$ -	$ 26,272,050

There were no transfers between Level 1 and Level 2 during 2019 and 2018. There were no recurring Level 3 assets or liabilities measured at fair value during 2019 or 2018.

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market value that were recognized at fair value, which was below cost at the reporting date. There were no assets measured at fair value at year-end 2019 or 2018.

Fair Value of Financial Instruments:

The carrying amounts and estimated fair values of financial instruments not carried at fair value, at December 31, 2019 and 2018 are as follows:

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
		Fair Value Measurements at December 31, 2019 Using:			
Financial Assets:					
Cash and cash equivalents	$ 50,031	$ 50,031	$ -	$ -	$ 50,031
Interest bearing deposits in other Financial Institutions	135,786	-	135,786	-	135,786
Securities held to maturity	15,079	-	15,444	-	15,444
Loans held for sale	23,800	-	23,800	-	23,800
Loans, net	723,419	-	-	722,948	722,948
FHLB and Bankers' Bank stock	3,876	N/A	N/A	N/A	N/A
Accrued interest receivable	3,221	-	453	2,768	3,221
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 345,605	$ 345,605	$ -	$ -	$ 345,605
Interest-bearing demand deposits	121,162	121,984	-	-	121,984
Savings and money market deposits	275,734	275,878	-	-	275,878
Time certificates of deposit	161,847	-	161,380	-	161,380
Accrued interest payable	193	9	184	-	193

(Dollars in thousands)	Carrying Amount	Level 1	Level 2	Level 3	Total Fair Value
		Fair Value Measurements at December 31, 2018 Using:			
Financial Assets:					
Cash and cash equivalents	$ 16,922	$ 16,922	$ -	$ -	$ 16,922
Interest bearing deposits in other Financial Institutions	95,205	-	95,047	-	95,047
Securities held to maturity	21,613	-	21,794	-	21,794
Loans held for sale	19,202	-	19,202	-	19,202
Loans, net	461,342	-	-	448,157	448,157
FHLB and Bankers' Bank stock	2,350	N/A	N/A	N/A	N/A
Accrued interest receivable	2,398	-	396	2,002	2,398
Financial Liabilities:					
Noninterest-bearing demand deposits	$ 259,725	$ 259,725	$ -	$ -	$ 259,725
Interest-bearing demand deposits	88,934	91,578	-	-	91,578
Savings and money market deposits	156,154	155,945	-	-	155,945
Time certificates of deposit	79,313	-	78,807	-	78,807
Accrued interest payable	158	7	151	-	158

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.

SANTA CRUZ COUNTY BANK
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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.

There were no transfers between Level 1, Level 2, and Level 3 during 2019.

NOTE 6. PREMISES AND EQUIPMENT

The following presents the cost of premises and equipment including leasehold improvements and the related accumulated depreciation and amortization at December 31, 2019 and 2018:

	December 31, 2019	2018
Land	$ 830,000	$ -
Building	3,410,000	-
Furniture, fixtures and equipment	2,232,860	1,993,308
Software and capitalized data & item processing	185,448	117,285
Computer equipment	946,900	850,997
Automobile	16,215	-
Leasehold improvements	3,083,713	2,880,710
Construction-in-progress	195,640	-
Total premises and equipment	10,900,776	5,842,300
Less accumulated depreciation and amortization	(3,253,034)	(2,746,261)
Premises and equipment, net	$ 7,647,742	$ 3,096,039

Depreciation expense was $609,992 and $395,873 for 2019 and 2018, respectively.

NOTE 7. LEASES

Lessee Arrangements

The Bank enters into leases in the normal course of business primarily for branches, back-office operations, and loan production offices. The Bank's leases have remaining terms ranging from 1 to 13 years, some of which include renewal options to extend the lease for up to 5 years and some of which include options to terminate the lease within 90 days. The Bank's leases do not include residual value guarantees or covenants.

The Bank leases certain branch properties and equipment under long-term operating lease agreements. These leases expire on various dates through 2033 and have various renewal options of five years each. Some leases may include a free rent period or have net operating costs associated with them.

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

In addition to the office building leases, the Bank has two leases for ATM and night depository kiosks. The operating leases had initial terms of five years each and various renewal options of three years each.

Building and kiosk rent expense for the years ended December 31, 2019 and 2018, was approximately $662,578 and $749,355, respectively.

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 bases over the lease term. Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

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

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2019 are as follows:

	Operating Leases
2020	$ 630,172
2021	612,128
2022	561,330
2023	530,815
2024	461,300
Thereafter	3,259,727
Total undiscounted lease payments	6,055,472
Less: imputed interest	998,266
Net lease liabilities	$ 5,057,206

NOTE 8. GOODWILL AND INTANGIBLE ASSETS

The change in goodwill during the year is as follows:

	2019
Balance at beginning of year	$ -
Acquired goodwill	25,761,654
Impairment	-
Balance at end of year	$ 25,761,654

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2019 consisted of $25,761,654

representing the excess of the cost of LHB over the net of the amounts assigned to assets acquired and liabilities assumed in the transaction accounted for under the purchase method of accounting. The value of goodwill is ultimately derived from the Bank's ability to generate net earnings after the acquisition and is not deductible for tax purposes.

Acquired Intangible Assets: Acquired intangible assets were as follows at year-end:

	2019	
	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:		
Core deposit intangibles	$ 3,707,000	$ 138,000
Other customer relationship intangibles	-	-
Total	$ 3,707,000	$ 138,000

The intangible assets at December 31, 2019 represents the estimated fair value of the core deposit relationships acquired in the acquisition of LHB in 2019 of $3,707,000. Core deposit intangibles are being amortized using a dollar weighted deposit runoff on an annualized basis over an estimated life of ten years from the date of acquisition. At December 31, 2019, the weighted average remaining amortization period is 9.75 years. The carrying value of intangible assets at December 31, 2019 was $3,569,000, net of $138,000 in accumulated amortization expense.

The following table summarizes the Bank's estimated core deposit intangible amortization expense for each of the next five years:

Year ending December 31,	Estimated Core Deposit Intangible Amortization
2020	$ 643,000
2021	486,000
2022	406,000
2023	363,000
2024	331,000
Thereafter	1,340,000
Total	$ 3,569,000

NOTE 9. DEPOSITS

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year-end 2019 and 2018 were $78,792,989 and $34,994,657, respectively.

The scheduled maturities for all time deposits for the next five years were as follows:

	2019
2020	$ 149,236,661
2021	9,604,945
2022	2,359,954
2023	361,435
2024	50,505
Thereafter	233,735
	$ 161,847,235

NOTE 10. BORROWED FUNDS

At December 31, 2019, the Bank had unsecured lines of credit with its correspondent banks in an aggregate amount of $11,000,000, at interest rates that vary with market conditions. As of December 31, 2019, the Bank had no federal funds purchased.

The Bank has established a secured borrowing arrangement, secured by loans totaling approximately $287,843,681 with the Federal Home Loan Bank of San Francisco ("FHLB"). As of December 31, 2019, the Bank had $145,763,272 in borrowing capacity available through the FHLB under which overnight and term advances were available. These advances are secured by assets including the Bank's ownership interest in the capital stock of the FHLB, securities and loans. The Bank's credit limit varies according to the amount and composition of the investments and loan portfolios pledged as collateral.

The Bank had no borrowed funds outstanding at December 31, 2019 and December 31, 2018 under these arrangements.

NOTE 11. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

The Bank established the Supplemental Executive Retirement Plan (SERP), an unfunded noncontributory defined benefit pension plan, to provide supplemental retirement benefits to a select group of key executives and senior officers. The Bank uses December 31 as the measurement date for this plan.

The following table reflects the changes in obligations and plan assets of the defined benefit pension plan for the years ended December 31, 2019 and 2018.

	2019	2018
Change in benefit obligation		
Beginning benefit obligation	$ 3,273,567	$ 2,824,132
Service cost	113,036	131,364
Interest cost	95,085	106,292
Amendments	-	322,398
Actuarial gain (loss)	(261,770)	(66,078)
Benefits paid	(45,655)	(44,541)
Ending benefit obligation	3,174,263	3,273,567
Change in plan assets		
Beginning plan assets	-	-
Employer contributions	45,655	44,541
Benefits paid	(45,655)	(44,541)
Ending plan assets	-	-
Funded status at end of year	$ (3,174,263)	$ (3,273,567)

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

Change in benefit obligation	**2019**	**2018**
Unrecognized net actuarial gain	$ (389,162)	$ (152,717)
Unrecognized prior service cost	107,466	161,199
Net liability recognized in earnings	$ (281,696)	$ 8,482

The components of net periodic benefit cost and other amounts recognized in other comprehensive income at December 31 are as follows:

	Year ended December 31,		
	2020	**2019**	**2018**
Components of net periodic benefit cost	(forecast)		
Service cost	$ 116,280	$ 113,036	$ 131,364
Interest cost	94,841	95,085	106,292
Amortization of prior service cost	53,733	53,733	161,199
Amortization of actuarial (gains)/ losses	(10,248)	(25,325)	-
Net periodic benefit cost	$ 254,606	$ 236,529	$ 398,855

Amounts recognized in other comprehensive income

	Year ended December 31,	
	2019	**2018**
Net loss (gain)	$ (261,770)	$ (66,078)
Prior service cost (credit)	-	322,398
Amortization of gain/(loss)	25,325	-
Amortization of prior service cost	(53,733)	(161,199)
Total recognized in other comprehensive (loss) income	(290,178)	95,121
Total recognized in net periodic benefit cost and other comprehensive (loss) income	$ (526,707)	$ (303,734)

The components of net periodic benefit cost other than the service cost component are included in the line item "other noninterest expense" in the income statement.

The estimated net gain and prior service costs for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next year are $10,248 and $53,733.

Assumptions

Weighted average assumptions used to determine pension benefit obligations and net periodic pension cost at December 31:

	2019	**2018**
Discount rate used to determine net periodic benefit cost	3.27%	3.84%
Discount rate used to determine benefit obligations	3.01%	4.05%
Future salary increases	N/A	N/A

SANTA CRUZ COUNTY BANK
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NOTE 12. EMPLOYEE BENEFIT PLANS

401(k) Plan: All employees of the Bank are eligible to participate in the Bank's 401(k) benefit plan, which is a tax-deferred savings plan designed to assist employees in preparing for their retirement years. The 401(k) Plan allows employees to contribute to the plan up to certain limits prescribed by the Internal Revenue Service. The Bank matches 25% of contributions up to 6% of compensation. Total expense for the years ended December 31, 2019 and December 31, 2018 was $136,552 and $110,460, respectively.

Split-Dollar Life Insurance: The Bank accounts for split-dollar life insurance in accordance with ASC 715-60, Compensation - Nonretirement Postemployment Benefits, which requires that endorsement split-dollar life insurance arrangements which provide a postretirement benefit to an employee be recorded based on the substance of the agreement with the employee. If the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue, over the service period, a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date. The total liability recorded as of years ended December 31, 2019 and December 31, 2018 was $1,386,015 and $1,132,925, respectively. Total expense recognized during the years ended December 31, 2019 and December 31, 2018 was $201,830 and $95,279, respectively.

NOTE 13. INCOME TAXES

The provision for income taxes is as follows for the years ended December 31, 2019 and 2018:

	2019	**2018**
Current expense:		
Federal	$ 3,400,622	$ 2,800,509
State	1,977,142	1,805,820
Total current	5,377,764	4,606,329
Deferred expense:		
Federal	(197,189)	(36,393)
State	(27,864)	(83,551)
Total deferred	(225,053)	(119,944)
Total provision	$ 5,152,711	$ 4,486,385

The effective tax rates differ from the federal statutory rate of 21% for 2019 and 2018 applied to income before income taxes due to the following:

	2019	**2018**
Federal statutory rate	21.00%	21.00%
State income tax, net of federal effect	8.83%	8.56%
Tax exempt interest	(0.89%)	(1.02%)
Acquisition related costs	0.55%	0.00%
Bank owned life insurance	(0.34%)	(0.26%)
Split dollar expense	0.24%	0.13%
Stock-based compensation	0.09%	0.02%
Other	0.16%	(0.15%)
Net	29.64%	28.28%

Deferred income taxes are the result of differences between income tax accounting and accounting principles generally accepted in the United States of America, with respect to income and expense recognition. The tax effects of temporary differences that gave rise to deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are as follows:

	2019	2018
Deferred tax assets:		
Allowance for loan losses	$ 3,043,936	$ 2,833,754
Deferred compensation	1,021,706	965,277
Accruals	1,145,611	1,174,065
Current state income tax	421,111	385,152
Unrealized loss on available for sale securities and pension	-	87,676
Fair value of loans and deposits	1,159,637	-
Lease liability	1,495,092	-
Other deferred tax assets	173,186	112,303
Gross deferred tax assets	8,460,279	5,558,227
Deferred tax liabilities:		
Deferred loan costs	(1,541,698)	(1,251,685)
Core deposit intangible	(1,055,125)	-
Premises and equipment	(386,311)	(370,775)
Right-of-use asset	(1,461,235)	-
Other deferred tax liabilities	(52,710)	(48,702)
Unrealized gain on available for sale securities and pension	(749)	-
Gross deferred tax liabilities	(4,497,828)	(1,671,162)
Net deferred tax asset	$ 3,962,451	$ 3,887,065

Management believes, that it is more likely than not, that the deferred tax assets will be realized as a result of expected continued profitability. Accordingly, no valuation allowance has been established as of December 31, 2019 or December 31, 2018.

The Bank has no material unrecognized tax benefits at December 31, 2019 and 2018 and does not expect the total amount of unrecognized tax benefits to significantly increase or decrease within the next twelve months.

The Bank did not have any interest and penalties recorded in the income statement for the year ended December 31, 2019 and December 31, 2018 from unrecognized tax benefits.

The Bank is subject to U.S. federal income tax as well as income tax of the state of California. The Bank is no longer subject to examination by taxing authorities for years before 2016 and 2015, for federal and California purposes, respectively.

NOTE 14. RELATED PARTY TRANSACTIONS

Loan related activity to principal officers, directors, and their affiliates during 2019 were as follows:

	2019
Beginning balance	$ 685,826
New loans or disbursements	203,403
Effect of changes in composition of related partie:	12,775,679
Principal repayments	(314,846)
Ending balance	$ 13,350,062

At December 31, 2019 and 2018, no related party loans were on non-accrual or classified for regulatory reporting purposes. Deposits from principal officers, directors, and their affiliates at year-end 2019 and 2018 were $1,218,489 and $1,127,799, respectively.

NOTE 15. STOCK-BASED COMPENSATION

The Bank has two share based compensation plans as described below. Total compensation cost that has been charged against income for those plans was $474,449 and $448,109 for 2019 and 2018, respectively. The total income tax benefit was $37,183 and $51,417 for 2019 and 2018, respectively.

The Bank estimates the fair value of each option award as of the date of grant using a closed form option valuation (Black-Scholes) model and the following assumptions. Expected volatilities are based on historical volatilities of the Bank's common stock commensurate with the expected term of the option. The "simplified" method described in the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 is used to determine the expected term of the options due to the lack of sufficient historical data. 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.

The fair value of options granted was determined using the following weighted average assumptions as of grant date.

	2019	2018
Risk-free interest rate	1.69%	2.22%
Expected term (yrs.)	6.00	6.00
Expected stock price volatility	26.72%	34.00%
Dividend yield	0.57%	0.55%

2003 Stock Option Plan: The Bank adopted a qualified stock option plan (the "Option Plan") for employees, non-employee directors and Bank founders, under which a maximum of 500,202 shares of Bank's common stock may be issued. The Option Plan calls for the exercise prices of the options to be equal to or greater than the fair market value of the stock at the time of grant. Options granted to Bank founders who are not also Bank directors or Bank officers were fully vested upon the date of grant. All other options shares granted have daily vesting over the first four years of the option contract. All option contracts for founders who are not also Bank directors or Bank officers have expiration dates of 10 years from the date of grant. All director and employee option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant. The Option Plan expired during 2014 and was replaced with the 2014 Omnibus Plan (the "Omnibus Plan").

All options granted under the Option 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 non-qualified stock option awards to the organizers vested 100% immediately, whereas regular stock option awards to directors and employees vest over a four-year period from the date the options were granted.

The following is a summary of the activity relating to the Bank's Option Plan for 2019 as presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	14,750	$11.27		
Granted	-	-		
Exercised	(3,700)	$13.08		
Expired	-	-		
Forfeited	-	-		
Options outstanding at end of year	11,050	$10.67	1.88 years	$462,220
Options fully vested and expected to vest	11,050			$462,220
Exercisable at end of year	11,050	$10.67	1.88 years	$462,220

Information related to the stock option plan during each year follows:

	2019	2018
Intrinsic value of options exercised	$133,554	$565,413
Cash received from option exercises	$48,382	$126,470
Tax benefit realized from option exercises	$25,784	$27,867
Weighted average fair value of options granted	-	-

As of December 31, 2019, there was no unrecognized compensation cost related to non-vested stock options granted under the Option Plan. All shares issued under this plan fully vested during the year 2016.

2014 Omnibus Plan: The Bank adopted the Omnibus Plan in May 2014 for employees and non-employee directors, which will continue in effect until February 19, 2024. The Omnibus Plan allows qualified stock option grants for employees and non-qualified restricted stock awards for officers and non-employee directors. The maximum number of shares of common stock that may be issued under this plan is 469,970 unless amended by the Board or the shareholders of the Bank.

The Omnibus Plan permits the grant of non-statutory options, incentive stock options and restricted stock awards to directors and employees of the Bank. Options granted under the Omnibus Plan may be incentive stock options or non-statutory stock options, as determined by the plan administrator at the time of grant of an option, however incentive stock options may be granted only to employees. In addition, restricted stock awards may be granted under the Omnibus Plan to directors and employees.

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NOTES TO FINANCIAL STATEMENTS

Stock Options

The per share exercise price for the shares to be issued upon exercise of any option shall be such price as is determined by the plan administrator, but no less than 100 percent of the fair market value per share on the date of grant. All option contracts have expiration dates on the earlier of termination of service or 10 years from the date of grant.

The following is a summary of the activity relating to the Bank's Omnibus Plan for 2019 as presented below:

Stock Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	58,071	$37.99		
Granted	53,500	$50.34		
Exercised	(2,204)	$21.71		
Expired	-	-		
Forfeited	-	-		
Options outstanding at end of year	109,367	$44.36	8.27 years	$889,915
Options fully vested and expected to vest	92,324			$757,474
Exercisable at end of year	41,798	$34.80	6.57 years	$739,682

Information related to the stock option plan during each year follows:

	2019	2018
Intrinsic value of options exercised	$60,944	$93,434
Cash received from option exercises	$47,854	$71,566
Tax benefit realized from option exercises	-	$4,926
Weighted average fair value of options granted	$13.64	$17.57

As of December 31, 2019, there was $920,388 of total unrecognized compensation cost related to non-vested stock options granted under the plan. The cost is expected to be recognized over a weighted average period of 3.19 years.

Restricted Stock Awards

The following is a summary of the activity relating to the Bank's non-vested shares under this plan for the year ended December 31, 2019 as presented below:

Nonvested Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested awards at January 1, 2019	10,205	$44.78
Granted	900	$49.17
Vested	(6,993)	$42.29
Forfeited	-	-
Nonvested awards at December 31, 2019	4,112	$49.98

As of December 31, 2019, there was no unrecognized compensation cost related to non-vested shares granted under the Omnibus Plan. The total fair value of shares vested during the years ended December 31, 2019 and December 31, 2018 was $261,592 and $45,900.

NOTE 16. REGULATORY CAPITAL MATTERS

Regulatory Capital: The Bank is subject to various regulatory capital adequacy requirements administered by the banking regulatory 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 accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if not undertaken, would have a direct material effect on the Bank's financial statements. Management believes as of December 31, 2019, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations define five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2019 and 2018, the most recent regulatory notifications categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (in thousands) and ratios are presented below at year-end.

(Dollars in thousands)	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019						
Total capital to risk weighted assets	$ 131,913	16.26%	$ 80,116	9.875%	$ 81,130	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 121,766	15.01%	$ 63,890	7.875%	$ 64,904	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 121,766	15.01%	$ 51,720	6.375%	$ 52,734	6.50%
Tier 1 (Core) capital to average assets	$ 121,766	11.85%	$ 41,088	4.000%	$ 51,359	5.00%
As of December 31, 2018						
Total capital to risk weighted assets	$ 75,165	14.71%	$ 50,468	9.875%	$ 51,107	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 68,732	13.45%	$ 40,247	7.875%	$ 40,886	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 68,732	13.45%	$ 32,581	6.375%	$ 33,220	6.50%
Tier 1 (Core) capital to average assets	$ 68,732	10.26%	$ 26,801	4.000%	$ 33,501	5.00%

Dividend Restrictions: The Board of Directors may, to the extent of such earnings and the Bank's net capital requirements and subject to the provisions of the California Financial Code, declare and pay a portion of such earnings to its shareholders as dividends. No cash dividend will be declared without a complete analysis of capital impact, current economic assessment, and current risk analysis.

NOTE 17. LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Correspondent Banking: At times, the Bank maintains deposit amounts at corresponding banks that exceed federally insured limits. Uninsured deposits totaled $11,198,086 at December 31, 2019. The Bank has not experienced any losses on amounts exceeding the insured limits.

Financial Investments With Off-Balance Sheet Risk: The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, overdraft protection and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit, standby letters of credit, and financial guarantees is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

The contractual amounts of financial instruments with off-balance-sheet risk at year-end December 31 were as follows:

	December 31, 2019		December 31, 2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	$27,256,734	$ 156,258,958	$ 6,889,685	$ 135,616,464
Unused lines of credit	462,204	47,672,666	469,308	33,938,511
Standby letters of credit	-	514,000	-	2,136,756
	$27,718,938	$ 204,445,624	$ 7,358,993	$ 171,691,731

Commitments to make loans are generally made for periods of 90 days or less.

NOTE 18. EARNINGS PER SHARE

The factors used in the earnings per share computation follow:

	2019	2018
Basic earnings per share:		
Net income	$ 12,275,250	$ 11,380,086
Weighted average common shares outstanding	2,719,384	2,432,290
Basic earnings per common share	$ 4.51	$ 4.68
Diluted earnings per share:		
Net income	$ 12,275,250	$ 11,380,086
Weighted average common shares outstanding for basic earnings per common share	2,719,384	2,432,290
Add: Dilutive effects of assumed exercises of stock options	25,400	33,732
Weighted average outstanding and dilutive potential common shares	2,744,784	2,466,022
Diluted earnings per common share	$ 4.47	$ 4.61

Stock options for 89,000 and 42,225 shares of common stock were not considered in computing diluted earnings per common share for the years ended December 31, 2019 and December 31, 2018, respectively, because they were anti-dilutive.

SANTA CRUZ COUNTY BANK

MEMBER FDIC EQUAL HOUSING LENDER