SANTA CRUZ COUNTY BANK

2021 ANNUAL REPORT

SANTA CRUZ COUNTY BANK




by building
LASTING RELATIONSHIPS

We ♥ Our Clients




that together empowers
GROWTH



ECONOMIC VITALITY
and
COMMUNITY WELL-BEING

Good Things Happen When You

"The relationship building made it possible... it changed the game completely. A bank that focuses on relationships really understands what a business needs. We couldn't have done this without Santa Cruz County Bank."

Jamie Smith, Owner and Head Chef, Foodsmith

"Shared values. That's why we partner with with Santa Cruz County Bank. They're as committed as we are to personal service that makes customers feel like family."

Frank and Francesca Flores, Carpet Caravan

"We moved our business account to Santa Cruz County Bank after the superb service their team provided with our PPP loan. The importance of that level of service in those circumstances cannot be overstated. They earned our business before they had it."

"We switched all our banki
to Santa Cruz County Banl
which was smooth and eas
They listen and truly undei
agriculture and the needs
of our business."

Dane Scurich, President, Scurich Berry Farms, Inc.

Put Your Money Where Your Life Is.

Building Shareholder Value

Rewarding our Shareholders

Cash dividend amounts reflect post-dividend and post-stock split amounts

2021

JANUARY
Quarterly cash dividend of $0.0341 per share

APRIL
Quarterly cash dividend increased from $0.0341 to $0.045 per share

MAY
SCZC joins OTCQX U.S. Premier marketplace stock listing

JULY
Quarterly cash dividend increased from $0.045 cents to $0.0568 per share

OCTOBER
Quarterly cash dividend of $0.0568 per share

NOVEMBER
10% stock dividend

2022

JANUARY
Quarterly cash dividend of $0.0625 per share

MARCH
2-for-1 stock split

APRIL
Quarterly cash dividend of $0.09 per share

To Our Valued Shareholders:

We are pleased to present the Bank's 2021 financial performance and report on our eleventh consecutive year of record earnings and growth.

2021 — Our eleventh consecutive record year.

As presented in the financial statements, we completed another exceptional year of growth and achieved new historical milestones, with record earnings. For 2021, the Bank recorded net income of $21.3 million, an increase of 21% over the prior year, or $2.50 earnings per share. Book value per share of common stock at year-end was $21.81, a $1.93 increase over 2020.

Santa Cruz County Bank continues its top tier rankings for financial performance, both in the State and Nation. For 2021, the Bank was ranked 13th out of 127 California banks for overall financial performance, by Financial Management Consulting Group. When compared to peer banks in the Uniform Bank Performance Report, Santa Cruz County Bank is in the 91st percentile for efficiency and 92nd percentile for net interest margin, two measures which drive and impact earnings.

We combine financial resources with expert solutions, so local businesses succeed and our communities thrive.

The Federal Reserve's small business borrower's survey found that community banks were the most common source for Paycheck Protection Program (PPP) loans and ranked highest in net satisfaction compared to major banks and online lenders. Santa Cruz County Bank exhausted all available resources to deliver as many loans as possible throughout the continuing COVID-19 pandemic. The Bank processed over 4,200 applications for PPP loans, resulting in $573.7 million in funding, saving over 50,000 jobs in our region. Our community has taken notice of the impact community banks make on the local economy. The Santa Cruz County Chamber of Commerce recognized us as a Business of the Year, alongside our fellow local financial institutions who, together with the Bank, funded over $857 million in PPP loans to support local businesses.

Demand for loans, combined with our continued top-level SBA rankings and reputation, have propelled the expansion of our SBA lending team throughout California. For the 2021 fiscal year, we ranked 11th in the number of SBA loans generated in Silicon Valley, a region that spans Santa Cruz, San Mateo and Santa Clara counties, and ranked 27th in the state of California for SBA 7(a) lending.

Industry reports indicate that new loan requests and production for major and regional banks was sluggish in 2021 and the start of 2022. In contrast, Santa Cruz County Bank has experienced the opposite — a steady pipeline of borrowing requests. The Bank's success in funding as many PPP loan requests as possible, and subsequent forgiveness applications, has resulted in new relationships. We continue to establish and expand relationships as a result of business owners transferring their banking deposits and activity to the Bank. These new relationships remain a source of opportunity as clients seek additional funding through our lending services.

The pandemic has transformed the way we use and rely on digital technology to access information, communicate with others, and conduct business in new ways.

As our clients adopt and adapt to digital processes in all areas of their work and home life, the Bank is well-positioned to operate in this arena as we continue to make our products and services more robust. We were fortunate to have digital technology in place during the pandemic challenges of the past two years. As we move forward through 2022, our goal is to build greater efficiency for our clients, with a specific focus on improving and adding new technology, as well as streamlining internal processes. This effort also aligns with our environmental practices policy, whereby we strive to reduce our impact.

Another particular focus over the past year has been continuous improvement of the client experience, which impacts our reputation and drives new business to the Bank. We know that our clients are one of our best sources for new business — when our clients are happy, they tell a friend. These word-of-mouth recommendations are further reflected in our impactful marketing testimonials. When we deliver the best in service, it has a positive ripple effect.

We have started 2022 with exciting momentum and with many new team members, who have implemented significant internal transformation in order to hone our delivery of exceptional service.

In January 2022, we celebrated the first anniversary of our Monterey branch, which has exceeded all growth projections and goals. Construction has begun on our new Salinas branch which is slated to open by the end of 2022.

The Bank's longstanding commitment to serving our community and making a difference in the lives of others has never been stronger or more impactful. We've been acutely aware of the extraordinary need for support, heightened and amplified by the pandemic. The Bank was recognized for its efforts to fight hunger in the community by *Second Harvest Food Bank* with the Big Step Award, which acknowledges businesses who have significantly increased the number of meals raised compared to previous years. In 2021, the Bank raised 32,060 meals, which is 12,000 more meals compared to the prior year. We are grateful that our contributions will help even more families and children experiencing food insecurity.

On behalf of the Board of Directors of Santa Cruz County Bank, we thank you for your continued support of community banking and look forward to serving you in the years ahead.

William J. Hansen
Chairman of the Board

Krista Snelling
President and CEO

Expanding to Meet our Clients

We have made the commitment to open a branch in Salinas to better serve the community and to meet our customers where they live and work. Our entry into the Salinas Valley began well over a decade ago when Santa Cruz County Bank made the strategic commitment to serve the agricultural community and all of its supporting industries. We've worked with businesses in the Salinas/Monterey region as the result of a natural progression to serve our many customers: farmers, growers and businesses whose operations span across contiguous counties.

The future home of Santa Cruz County Bank's eighth full-service branch was built in the early 1970's. The building will undergo a complete remodel to provide a full-service banking office with space for additional staffing, ample parking and ATM/Night Depository. The improvements will contribute to the City's Downtown Vibrancy Plan, which included converting Main Street into a two-way street.

2021 RANKINGS & RECOGNITION

FINANCIAL PERFORMANCE

- Total assets over $1.7 billion
- Total deposits of $1.5 billion
- Net income exceeded $21 million

NATIONAL RECOGNITION

- **Independent Community Bankers of America** — Ranked 7th in Top Commercial Lenders
- **U.S. Small Business Administration** — 100 Most Active SBA 7(a) Lenders in the Nation
- **Bauer Financial** — Rated 5-Star "Superior" for every quarter in 2021

CALIFORNIA RECOGNITION

- **Financial Management Consulting Group, FMC** — Ranked 13th out of 127 for overall financial performance
- **Findley Reports** — Named a Super Premier Performing Bank, 12th year

REGIONAL AWARDS AND RECOGNITION

- **Silicon Valley Business Journal**
  Ranked in the Top 25 Banks and SBA Lenders in Silicon Valley
  Ranked 4th in overall deposit market share in Santa Cruz County*
  Ranked 15th in total deposits in Silicon Valley*
- **Santa Cruz Chamber of Commerce**
  Business of the Year, 2022 and 2018
- **Good Times "Best Of" Readers' Poll**
  Best Bank in Santa Cruz County, 10th year
- **Santa Cruz Sentinel Readers' Choice**
  Best Bank in Santa Cruz County, 7th year
- **Second Harvest Food Bank**
  Big Step Award and Platinum Can Award, 2021 Holiday Food & Fund Drive

SBA LENDING RANKINGS

- **National** — U.S. SBA's 100 Most Active 7(a) Lenders List, ranked by loan approval amounts**
- **California** — Ranked 27th in 7(a) lending by total volume in loan approvals**
- **San Francisco District** — Ranked 23rd in 7(a) lending by total volume in loan approvals**
- **Silicon Valley Region**
  Top 25 SBA Lenders, *Silicon Valley Business Journal***
    14th in SBA dollar volume
    11th in number of loans

**As of June 30, 2021*
***For the 2021 SBA fiscal year*

BOARD OF DIRECTORS


William J. Hansen
Chairman


John C. Burroughs
Vice Chairman


Kenneth R. Chappell


Craig French


Thomas N. Griffin


Stephen D. Pahl

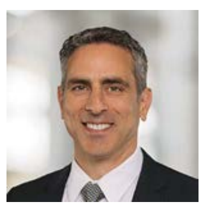

Krista Snelling

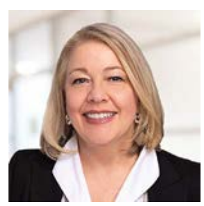

James L. Weisenstein

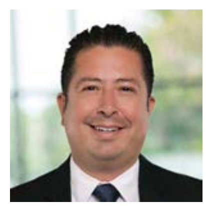
BANK MANAGEMENT TEAM


Krista Snelling
President
Chief Executive Officer

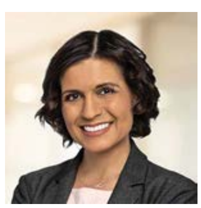

Vic Davis
EVP Chief Financial Officer

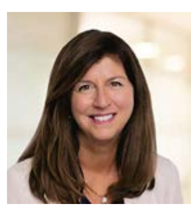

Angelo DeBernardo, Jr.
EVP Chief Lending Officer

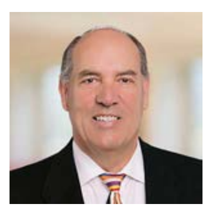

Susan Just
EVP Chief Credit Officer


Jaime Manriquez
EVP Chief Information Officer

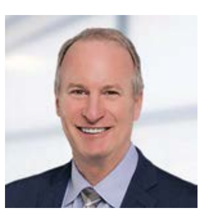

Jon P. Sisk
EVP Chief Banking Officer

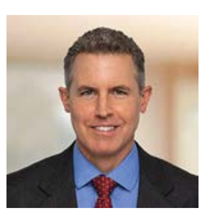

Shamara van der Voort
EVP Chief Operations Officer


Mary Anne Carson
EVP Chief Marketing Officer

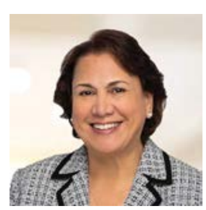

Frederick L. Caiocca
EVP Regional Credit Manager


Susan Chandler
SVP Director of SBA Lending


Douglas Fischer
SVP Director of Business Banking


Shawn Lipman
SVP Director of Credit Administration


Tracy Ruelas-Hashimoto
SVP Director of Finance


Charissa Sopoaga
SVP Director of Operations

STOCK INFORMATION

Santa Cruz County Bank stock is publicly traded on the OTCQX marketplace under the stock symbol SCZC.

Stock purchase orders may be placed through a brokerage firm or one of the Market Makers listed below.

SCZC
TRADED ON
OTCQX

D.A. Davidson & Co.
42605 Moonridge Road
Big Bear Lake, CA 92315
800.288.2811
Katy Ehlers
Michael Natzic

Monroe Financial Partners
100 North Riverside Plaza, Suite 1620
Chicago, IL 60606
312.506.8743
Steve Schroeder, CFA

Raymond James & Associates
One Embarcadero Center, Suite 650
San Francisco, CA 94111
888.317.8986
John Cavender

StockCross Financial Services, Inc. Equity Trading
15 Exchange Place, Suite 615
Jersey City, NJ 07302
800.993.2075
Tim Padala

Wedbush Securities
One SW Columbia Street, Suite 1000
Portland, OR 97258
866.662.0351
Joey Warmenhoven

SHAREHOLDER INFORMATION

Shareholders with questions regarding their account, stock transfers and registration, lost certificates or change of address should contact their broker, or if held directly, contact the Bank's transfer agent below.

Computershare Investor Services
P.O. Box 30170
College Station, TX 77842-3170
800.962.4284 ■ computershare.com

BANK FOUNDERS

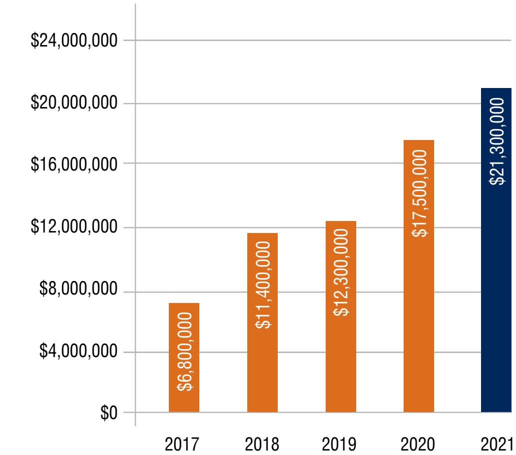
A group of local business people joined to create a local, community bank focused on serving the residents and businesses of Santa Cruz County when it became apparent that the last of the local independent banks was soon to be taken over by a large out-of-area bank holding company. This group that we recognize as Founders all contributed time, money, and talent, not only to the Bank's organizing effort, but continue to be involved and support our Bank as customers, referring family, friends and business contacts, and serving as ambassadors of the Bank in our community.

Richard Alderson
Joseph Anzalone[t]
Tila Bañuelos**
Victor Bogard
Anthony & Rebecca Campos
Charles Canfield
Kenneth R. Chappell*
Kate & Fred Chen
Marshall Delk
George R. Gallucci**
Thomas N. Griffin*
William J. Hansen*
David V. Heald**
Mark Holcomb[t]
Steven G. John**
Mateo Lettunich
Robert Lockwood
William Moncovich
Stuart Mumm
George Ow, Jr.
Louis Rittenhouse
Frank Saveria
Robert[t] **& Bjorg Yonts**

**denotes Bank Director*
***denotes former Bank Director*
t denotes deceased

FIVE YEAR HISTORICAL PERFORMANCE

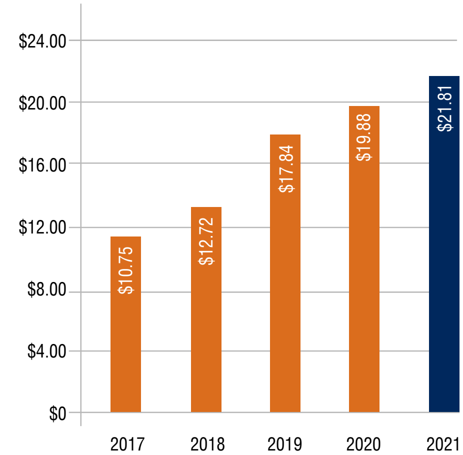
NET INCOME



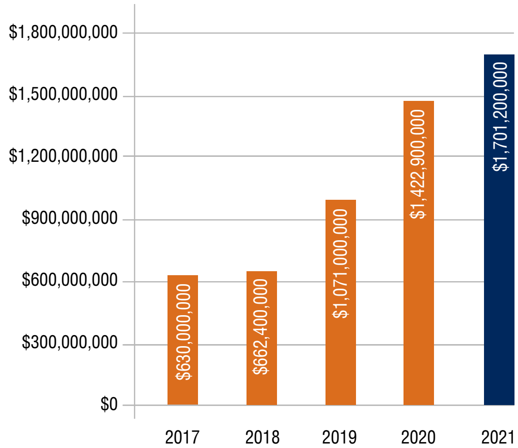
	2017	2018	2019	2020	2021
NET INCOME	$6,800,000	$11,400,000	$12,300,000	$17,500,000	$21,300,000
WACSO*	5,307,133	5,351,038	5,982,645	8,471,562	8,508,098
BASIC EARNINGS PER SHARE	$1.27	$2.13	$2.05	$2.07	$2.50

**Note: Weighted average common shares outstanding (basic).*
Lighthouse Bank merger closing date was October 18, 2019.

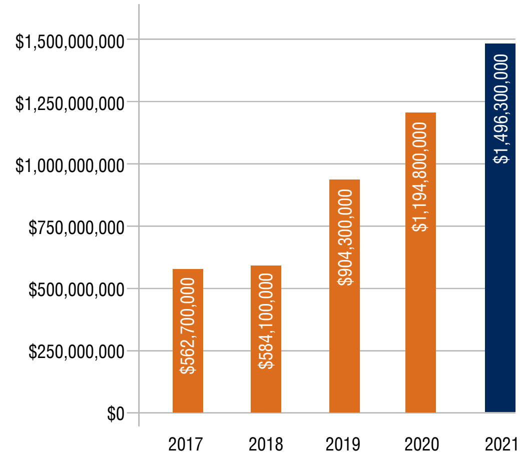
BOOK VALUE PER SHARE



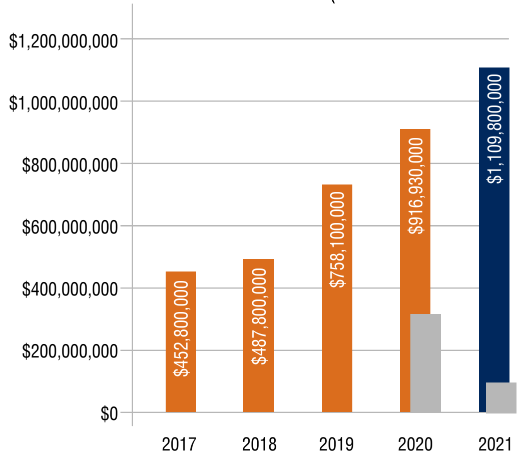
TOTAL ASSETS



TOTAL DEPOSITS

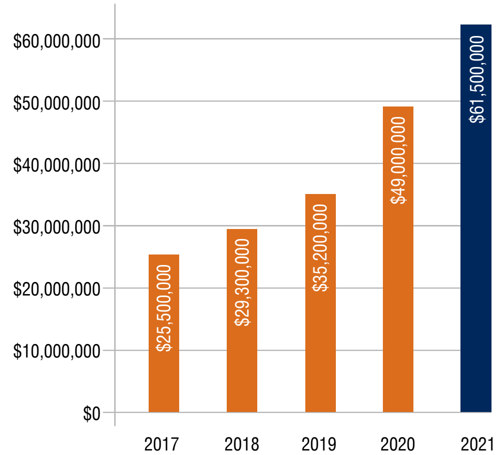


GROSS LOANS (EXCLUDING PPP)



Gray bars for years 2020 and 2021, represent PPP loans - $320,800 and $93,300 respectively - which are in addition to gross loans.

NET INTEREST INCOME



All numbers rounded to the nearest $100,000.

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Santa Cruz County Bank, which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Santa Cruz County Bank as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, Santa Cruz County Bank's internal control over financial reporting as of December 31, 2021, based on criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 21, 2022 expressed an unmodified opinion.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Crowe LLP

Crowe LLP

Sacramento, California
March 21, 2022

BALANCE SHEETS

December 31, 2021 and 2020
Dollar amounts in thousands

ASSETS		2021		2020
Cash and due from financial institutions	$	135,626	$	12,530
Federal funds sold		3,796		–
Cash and cash equivalents		139,422		12,530
Interest-bearing deposits in other financial institutions		18,811		55,235
Debt securities available-for-sale		275,657		49,850
Debt securities held-to-maturity (fair value 2021-$3,493; 2020-$7,620)		3,242		7,228
Loans held for sale		69,507		31,630
Loans, net of allowance of $19,978 in 2021; $13,021 in 2020		1,112,320		1,189,227
Federal Home Loan Bank stock, at cost		5,476		3,561
Bankers' Bank stock, at cost		456		456
Premises and equipment, net		12,285		10,372
Goodwill		25,762		25,762
Core deposit intangible asset, net		2,440		2,926
Bank owned life insurance		17,172		15,562
Accrued interest receivable and other assets		18,699		18,533
Total assets	$	1,701,249	$	1,422,872

LIABILITIES AND SHAREHOLDERS' EQUITY				
Deposits				
Noninterest-bearing	$	716,888	$	552,645
Interest-bearing		779,448		642,139
Total deposits		1,496,336		1,194,784
Federal Home Loan Bank advances and other borrowings		–		40,364
Accrued interest payable and other liabilities		18,823		19,238
Total liabilities		1,515,159		1,254,386
Commitments and contingencies – See Note 16				
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; 8,536,000 and 7,704,682 shares issued at December 31, 2021 and 2020		95,061		94,858
Additional paid-in capital		30,767		12,903
Retained earnings		62,332		60,099
Accumulated other comprehensive (loss) income		(2,070)		626
Total shareholders' equity		186,090		168,486
Total liabilities and shareholders' equity	$	1,701,249	$	1,422,872

See accompanying notes

STATEMENTS OF INCOME

Years ended December 31, 2021 and 2020

Dollar amounts in thousands, except per share data

Interest and dividend income	2021	2020
Loans, including fees	$ 61,090	$ 48,277
Interest-bearing deposits in other financial institutions	551	1,961
Taxable securities	1,261	956
Tax-exempt securities	90	187
Dividends on FHLB, PCBB and TIB stock	311	210
Federal funds sold	48	105
Total interest and dividend income	63,351	51,696
Interest expense		
Deposits	1,804	2,584
Federal Home Loan Bank advances and other borrowings	12	125
Total interest expense	1,816	2,709
Net interest income before provision for loan losses	61,535	48,987
Provision for loan losses	6,858	2,816
Net interest income after provision for loan losses	54,677	46,171
Noninterest income		
Service charges on deposits	444	474
Net gains on sales of loans	1,311	1,049
Loan servicing fees	736	600
ATM fee income	870	663
Other	1,415	1,427
Total noninterest income	4,776	4,213
Noninterest expense		
Salaries and employee benefits	17,562	15,003
Occupancy	1,937	1,843
Furniture and equipment	1,574	1,315
Marketing and business development	608	785
Data and item processing	1,142	1,097
Federal deposit insurance	652	270
Amortization of core deposit intangibles	486	643
Acquisition expenses	–	351
Other	5,427	4,399
Total noninterest expense	29,388	25,706
Income before income taxes	30,065	24,678
Income tax expense	8,791	7,128
Net income	$ 21,274	$ 17,550
Earnings per share:		
Basic	$ 2.50	$ 2.07
Diluted	$ 2.49	$ 2.06

See accompanying notes

STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2021 and 2020

Dollar amounts in thousands

	2021	2020
Net income	$ 21,274	$ 17,550
Other comprehensive income		
Unrealized gains (losses) on available-for-sale securities		
Unrealized holding (loss) gain arising during the period	(4,013)	1,339
Amortization of unrealized frozen gain during the period	3	18
Tax effect	1,186	(401)
Net of tax	(2,824)	956
Defined benefit pension plans		
Actuarial net gain (loss) arising during the period	130	(525)
Reclassification adjustment for amortization of prior service cost and net gain included in net periodic pension cost	53	54
Tax effect	(55)	139
Net of tax	128	(332)
Total other comprehensive income	(2,696)	624
Comprehensive income	$ 18,578	$ 18,174

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years ended December 31, 2021 and 2020

Dollar amounts in thousands, except per share data

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2019	7,699,682	$ 94,834	$ 12,558	$ 43,704	$ 2	$ 151,098
Net income	–	–	–	17,550	–	17,550
Other comprehensive income	–	–	–	–	624	624
Cash dividends declared ($0.15 per share)	–	–	–	(1,155)	–	(1,155)
Stock-based compensation	–	–	345	–	–	345
Exercise of stock options	4,400	24	–	–	–	24
Restricted stock awards granted	600	–	–	–	–	–
Balance at December 31, 2020	7,704,682	94,858	12,903	60,099	626	168,486
Net income	–	–	–	21,274	–	21,274
Other comprehensive loss	–	–	–	–	(2,696)	(2,696)
Cash dividends declared ($0.2375 per share)	–	–	–	(1,890)	–	(1,890)
Stock dividends declared	775,366	–	17,151	(17,151)	–	–
Stock-based compensation	–	–	328	–	–	328
Exercise of stock options	33,378	203	–	–	–	203
Restricted stock compensation	–	–	385	–	–	385
Restricted stock awards granted	22,574	–	–	–	–	–
Balance at December 31, 2021	8,536,000	$ 95,061	$ 30,767	$ 62,332	$ (2,070)	$ 186,090

See accompanying notes

STATEMENTS OF CASH FLOWS

Years ended December 31, 2021 and 2020

Dollar amounts in thousands

		2021		2020
Cash flows from operating activities				
Net income	$	21,274	$	17,550
Adjustments to reconcile net income to net cash from operating activities:				
Provision for loan losses		6,858		2,816
Depreciation and amortization of premises and equipment		1,088		804
Amortization of core deposit intangibles		486		643
Net amortization of securities		1,036		430
Net accretion of loans		(13,069)		(4,309)
Deferred income tax benefit		(734)		(1,161)
Net gain on sale of loans		(1,311)		(1,049)
Stock-based compensation expense		713		345
Earnings on bank owned life insurance		(410)		(377)
Originations of loans held for sale		(59,683)		(35,049)
Proceeds from loans held for sale		17,404		15,368
Provision (reduction) of off balance sheet commitments		68		(30)
Non cash lease expense		31		54
Deferred post-retirement benefit expense		510		549
Increase in deferred loan fees, net of costs		7,959		1,309
Decrease (increase) in accrued interest receivable and other assets		1,402		(905)
Increase in accrued interest payable and other liabilities		1,542		2,364
Net cash from operating activities		(14,836)		(648)
Cash flows from investing activities				
Net change in interest-bearing deposits in other financial institutions		36,424		80,551
Available-for-sale securities:				
Maturities, prepayments and calls		2,300		13,000
Purchases		(241,042)		(13,931)
Principal repayments		7,944		4,455
Held-to-maturity securities:				
Maturities, prepayments and calls		2,755		2,475
Principal repayments		1,213		5,320
Loan originations and payments, net		78,749		(453,323)
Purchases of premises and equipment		(3,001)		(3,528)
Purchase of bank owned life insurance		(1,200)		(1,400)
Purchases of Federal Home Loan Bank stock		(1,915)		(141)
Net cash used in investing activities		(117,773)		(366,522)
Cash flows from financing activities				
Increase in deposits		301,552		290,436
Federal Home Loan Bank advances and other debt, net of repayments		(40,364)		40,364
Cash dividends paid		(1,890)		(1,155)
Proceeds from exercise of stock options, including tax benefit		203		24
Net cash from financing activities		259,501		329,669
Net change in cash and cash equivalents		126,892		(37,501)
Beginning cash and cash equivalents		12,530		50,031
Ending cash and cash equivalents	$	139,422	$	12,530
Supplemental cash flow information				
Interest paid	$	1,876	$	2,624
Income taxes paid	$	7,500	$	6,110
Supplemental noncash disclosure				
Transfer from loans held for sale to portfolio loans	$	7,251	$	17,102

See accompanying notes

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Santa Cruz County Bank ("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, Monterey, 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 Department of Financial Protection and Innovation ("DFPI") and the Federal Deposit Insurance Corporation ("FDIC"). The Bank's deposits are insured by the FDIC up to applicable legal limits.

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, multifamily, 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.

Presentation of Notes 2 to 17

All dollar amounts presented in the tables in Notes 2 to 17 are in thousands, unless otherwise indicated, except per share information. Dollar amounts in paragraphs are in whole dollars, unless otherwise indicated.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure from December 31, 2021 through March 21, 2022, which is the date the financial statements were available to be issued. On February 15, 2022, the Board of Directors declared a two-for-one stock split of its common stock to shareholders of record as of March 3, 2022. The stock split was approved by DFPI on March 10, 2022 and has been retroactively reflected in these financial statements.

Use of Estimates

The preparation of these 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. The Bank could experience a material adverse effect on its business as a result of the impact of the novel coronavirus pandemic ("COVID-19") and the resulting governmental actions to curtail its spread. The extent to which the ongoing COVID-19 pandemic, including the potential existence of additional COVID-19 variants, impacts the Bank's business, financial condition, and results of operations, including the allowance for loan losses and the carrying value of goodwill, will depend on future developments, which are highly uncertain and cannot be accurately predicted, including the scope and duration of the COVID-19 pandemic. While economic conditions have improved since the onset of the COVID-19 pandemic, there can be no assurance the recovery will continue and could potentially place a strain on our borrowers and ultimately impact the credit quality of our loan portfolio, which could result in increases in the level of past due, nonaccrual, and classified loans. If the COVID-19 pandemic persists, it could have an impact on loans, interest income, and credit quality. If the economic recovery begins to wane, it may have an impact on our borrowers, the businesses they operate, and their financial condition.

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 oneday 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

Interest-bearing deposits in other financial institutions mature within three years and are carried at cost.

Debt 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) 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 nonaccrual 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 nonaccrual status in accordance with the Bank's policy, typically after 90 days of non-payment. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual 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 nonaccrual 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 nonaccrual 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 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. Loan modifications or concessions granted to borrowers resulting directly from the effects of the COVID-19 pandemic, who were otherwise in current payment status, are not considered to be TDRs. 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 DFPI, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures

The 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 $384,000 at December 31, 2021 and $316,000 at December 31, 2020, 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. FHLB stock is carried at cost, classified as 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.

Bankers’ Bank Stock

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

Equity investments not using the equity method of accounting are measured at fair value with changes in fair value recognized in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment. The carrying amount of equity securities without readily determinable fair values was $456,000 as of December 31, 2021 and 2020.

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 $717,000 and $658,000 at year-end 2021 and 2020, 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 $736,000 and $600,000 for the years ended December 31, 2021 and 2020, respectively. Late fees and ancillary fees related to loan servicing are not material.

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 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.

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 acquisition of Lighthouse Bank in 2019 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 will perform qualitative impairment analysis as of each quarter end. Management assessed qualitative factors including performance trends and noted no factors indicating goodwill impairment. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Core deposit intangibles represent the estimated fair value of the core deposit relationships acquired in the business combination with Lighthouse Bank and 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.

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.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance 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.

Accounting for Uncertainty in Income Taxes

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 and dividends 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 are 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 Bank had no reserve requirement at December 31, 2021 to meet regulatory reserve and clearing requirements.

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.

Newly Issued Not Effective Accounting Standards

ASU 2016-13, Financial Instruments -
Credit Losses (Topic 326)

Measurement of Credit Losses on Financial Instruments, as amended — In June 2016, FASB issued new guidance ("Topic 326") to replace the incurred loss model for loans and other financial assets 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 leases recognized by a lessor. In addition, the amendments in Topic 326 require credit losses on available-for-sale to be presented as a valuation allowance rather than as a direct 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.

ASU 2020-04, Reference Rate Reform (Topic 848)
In March 2020, the FASB issued guidance to ease the potential burden in accounting for reference rate reform. The amendments in Update 2020-04 are elective and apply to all entities that have contracts, hedging relationships, and other transactions that reference London Interbank Offered Rate ("LIBOR") or another reference rate expected to be discontinued due to reference rate reform.

The new guidance provides a number of optional expedients that reduce costs and complexity of accounting for reference rate reform. Under the guidance, the Bank could elect not to apply certain modification accounting requirements to contracts affected by reference rate transition, if certain criteria are met. A company that makes this election would not be required to re-measure the contracts at the modification date or reassess a previous accounting determination. This guidance also permits a company to elect various optional expedients that would allow it to continue applying hedge accounting for hedging relationships affected by reference rate transition, if certain criteria are met. The guidance is effective upon issuance and generally can be applied through December 31, 2022. The Bank is currently assessing the impact of this guidance on its financial statements.

NOTE 2 – DEBT SECURITIES

The fair value of securities available-for-sale reflected an unrealized gain (loss) of ($2,929,000) and $1,084,000 at December 31, 2021 and 2020, respectively. The unrealized gain (loss) recorded is net of ($865,000) and $321,000 tax effect as accumulated other comprehensive income within shareholders' equity at December 31, 2021 and 2020, respectively.

The following tables summarize the carrying value and estimated fair value of securities available-for-sale and held-to-maturity at December 31, 2021 and 2020:

December 31, 2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. Treasury bonds	$ 210,140	$ 16	$ (2,784)	$ 207,372
U.S. Government sponsored agencies	5,961	1	(160)	5,802
Mortgage backed securities: residential	28,655	1	(374)	28,282
Collateralized mortgage obligations	26,642	339	(128)	26,853
State and political subdivision	4,333	160	–	4,493
Collateralized certificates of deposit	2,855	–	–	2,855
Total available-for-sale	$ 278,586	$ 517	$ (3,446)	$ 275,657
Held-to-maturity:				
Mortgage backed securities: residential	$ 496	$ 28	$ –	$ 524
Collateralized mortgage obligations	941	60	–	1,001
State and political subdivision	1,805	163	–	1,968
Total held-to-maturity	$ 3,242	$ 251	$ –	$ 3,493

December 31, 2020		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
Available-for-sale:								
U.S. Treasury bonds	$	2,001	$	4	$	–	$	2,005
U.S. Government sponsored agencies		5,102		3		(10)		5,095
Mortgage backed securities: residential		7,268		3		(64)		7,207
Collateralized mortgage obligations		29,756		845		(4)		30,597
State and political subdivision		4,639		307		–		4,946
Total available-for-sale	$	48,766	$	1,162	$	(78)	$	49,850
Held-to-maturity:								
U.S. Government sponsored agencies	$	998	$	6	$	–	$	1,004
Mortgage backed securities: residential		858		57		–		915
Collateralized mortgage obligations		1,839		96		–		1,935
State and political subdivision		3,533		233		–		3,766
Total held-to-maturity	$	7,228	$	392	$	–	$	7,620

There were no transfers between available-for-sale and held-to-maturity during 2021 or 2020.

The proceeds from sales and calls of investment securities were $5,055,000 and $15,475,000 for the years ended December 31, 2021 and 2020, respectively. There were no gains or losses associated with these transactions.

The amortized cost and estimated fair value of debt securities at December 31, 2021 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, 2021			
		Amortized Cost		Estimated Fair Value
Available-for-sale:				
Within one year	$	165	$	165
One to five years		159,986		158,256
Five to ten years		61,618		60,532
Beyond ten years		1,520		1,569
Mortgage-backed securities		28,655		28,282
Collateralized mortgage obligations		26,642		26,853
Total	$	278,586	$	275,657
Held-to-maturity:				
Within one year	$	–	$	–
One to five years		1,467		1,537
Five to ten years		338		431
Beyond ten years		–		–
Mortgage-backed securities		496		524
Collateralized mortgage obligations		941		1,001
Total	$	3,242	$	3,493

Securities pledged at year-end 2021 and 2020 to secure public deposits had an amortized cost of $36,288,000 and $32,969,000, respectively and a fair value of $36,768,000 and $34,281,000, respectively.

At year-end 2021 and 2020, 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, 2021 and 2020, aggregated by major security type and length of time in a continuous unrealized or unrecognized loss position:

December 31, 2021	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
U.S. Treasury bonds	$ 197,504	$ (2,784)	$ –	$ –	$ 197,504	$ (2,784)
U.S. Government sponsored agencies	2,747	(62)	2,896	(98)	5,643	(160)
Mortgage backed securities: residential	22,036	(313)	5,236	(61)	27,272	(374)
Collateralized mortgage obligations	7,290	(86)	1,139	(42)	8,429	(128)
Total available-for-sale	$ 229,577	$ (3,245)	$ 9,271	$ (201)	$ 238,848	$ (3,446)
Held-to-maturity:						
Mortgage backed securities: residential	$ –	$ –	$ –	$ –	$ –	$ –
Total held-to-maturity	$ –	$ –	$ –	$ –	$ –	$ –

December 31, 2020	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale:						
U.S. Government sponsored agencies	$ 2,985	$ (10)	$ –	$ –	$ 2,985	$ (10)
Mortgage backed securities: residential	4,306	(40)	1,917	(24)	6,223	(64)
Collateralized mortgage obligations	1,203	(4)	–	–	1,203	(4)
Total available-for-sale	$ 8,494	$ (54)	$ 1,917	$ (24)	$ 10,411	$ (78)
Held-to-maturity:						
Mortgage backed securities: residential	$ 4	$ –	$ –	$ –	$ 4	$ –
Total held-to-maturity	$ 4	$ –	$ –	$ –	$ 4	$ –

As of December 31, 2021, the Bank performed an analysis of the investment portfolio to determine whether any of the investments held in the portfolio had an other-than-temporary impairment ("OTTI"). Management evaluated all investment securities with an unrealized loss at December 31, 2021 and identified those that had an unrealized loss for at least a consecutive 12-month period. For securities identified, management reviews the investment credit ratings and government sponsored guarantees. There were no OTTI losses recorded during the twelve months ended December 31, 2021 or 2020.

As of December 31, 2021, the Bank's security portfolio consisted of 157 investment securities, 72 of which were in an unrealized loss position for less than twelve months and eight were in a loss position and had been in a loss position for twelve months or more. All unrealized losses are related to the Bank's U.S. Government and U.S. Government sponsored agencies as discussed below.

U.S. Treasury Bonds

At December 31, 2021, treasury securities, such as bills, notes and bonds held by the Bank were issued by the federal government, which the U.S. Government has affirmed its commitment to support. The decline in fair value on the banks investments in treasury securities is attributable to changes in interest rates and not credit quality, and because the Bank does not have the intent to sell these treasury securities. It is more likely than not 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, 2021.

U.S. Government Sponsored Agencies

At December 31, 2021, U.S. Government or Government sponsored entities and agencies held by the Bank were issued by Small Business Administration, which the government has affirmed its commitment to support. The decline in fair value is attributable to changes in interest rates 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, 2021. The Bank's mortgage backed securities portfolio does not include non-agency collateralized mortgage obligations.

Mortgage Backed Securities: Residential

At December 31, 2021, residential mortgage-backed securities held by the Bank were issued by U.S. Government sponsored entities such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), which the government has affirmed its commitment to support. The decline in fair value on the Bank's investments in U.S. Government sponsored entities collateralized by residential mortgage obligations is attributable to changes in interest rates and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities, and it is more likely than not 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, 2021.

Collateralized Mortgage Obligations

At December 31, 2021, collateralized mortgage obligation securities held by the Bank were issued by U.S. Government sponsored entities collateralized by high quality mortgages on residential properties. The decline in fair value on the Bank's investments in collateralized mortgage obligations is attributable to changes in interest rates and not credit quality, and because the Bank does not have the intent to sell these mortgage backed securities, and it is more likely than not 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, 2021.

NOTE 3 - LOANS RECEIVABLE

The outstanding loan portfolio balances at December 31, 2021 and 2020 were as follows:

		2021		2020
Commercial and industrial	$	280,177	$	502,408
Commercial real estate		637,085		548,092
Land and construction		145,121		84,214
Agricultural land, real estate and production		31,227		24,698
Consumer		39,964		46,705
Gross loans receivable		1,133,574		1,206,117
Net deferred loan fees		(1,276)		(3,869)
Allowance for loan losses		(19,978)		(13,021)
Loans receivable, net	$	1,112,320	$	1,189,227

At December 31, 2021 and 2020, loans held for sale that were originated under Small Business Administration ("SBA") programs totaled $69,507,000 and $31,630,000, respectively. The Bank participated in the SBA Paycheck Protection Program ("PPP") to originate loans to support our community and classified in Commercial and Industrial loan category above. During 2021, the Bank originated 1,673 Paycheck Protection Program covered loans under Round 2 totaling $198,736,000. As of December 31, 2021, the Bank has received $118,631,000 in forgiveness payments on Round 2 loans, leaving an outstanding balance of $80,104,000. As of December 31, 2021, the Bank has received $307,645,000 in forgiveness payments on Round 1 loans, leaving an outstanding balance of $13,174,000.

Salaries and employee benefits totaling $4,010,000 and $4,347,000 have been deferred as loan origination costs for the years ended December 31, 2021 and 2020, respectively.

The following table presents the activity in the allowance for loan losses by portfolio segment for each of the years ending December 31, 2021 and December 31, 2020:

December 31, 2021	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 3,367	$ 4,632	$ 4,490	$ 219	$ 313	$ –	$ 13,021
Provision for loan losses	1,801	1,196	3,958	(82)	(15)	–	6,858
Loans charged-off	–	–	–	–	–	–	–
Recoveries	96	3	–	–	–	–	99
Total ending allowance balance	$ 5,264	$ 5,831	$ 8,448	$ 137	$ 298	$ -	$ 19,978

December 31, 2020	Commercial and Industrial	Commercial Real Estate	Land and Construction	Agricultural Land, Real Estate and Production	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 3,060	$ 2,917	$ 3,633	$ 296	$ 250	$ 140	$ 10,296
Provision for loan losses	401	1,712	857	(77)	63	(140)	2,816
Loans charged-off	(103)	–	–	–	–	–	(103)
Recoveries	9	3	–	–	–	–	12
Total ending allowance balance	$ 3,367	$ 4,632	$ 4,490	$ 219	$ 313	$ –	$ 13,021

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, 2021 and 2020:

December 31, 2021	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	$ 1,736	$ –	$ –	$ 68	$ –	$ –	$ 1,804
Collectively evaluated for impairment	3,528	5,831	8,448	69	298	–	18,174
Total ending allowance balance	$ 5,264	$ 5,831	$ 8,448	$ 137	$ 298	$ –	$ 19,978
Loans							
Loans individually evaluated for impairment	$ 1,852	$ –	$ 990	$ 68	$ 60	$ –	$ 2,970
Loans collectively evaluated for impairment	278,325	637,085	144,131	31,159	39,904	–	1,130,604
Total ending loans balance	$ 280,177	$ $637,085	$ 145,121	$ 31,227	$ 39,964	$ –	$ 1,133,574

December 31, 2020		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		3,367		4,632		4,490		219		313		–		13,021
Total ending allowance balance	$	3,367	$	4,632	$	4,490	$	219	$	313	$	–	$	13,021
Loans														
Loans individually evaluated for impairment	$	–	$	–	$	–	$	–	$	31	$	–	$	31
Loans collectively evaluated for impairment		502,408		548,092		84,214		24,698		46,674		–		1,206,086
Total ending loans balance	$	502,408	$	548,092	$	84,214	$	24,698	$	46,705	$	–	$	1,206,117

The Bank had eight loans with a recorded investment of $2,974,000 impaired at the end of 2021.

Nonaccrual 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 $375,000 and $31,000 in nonaccrual as of December 31, 2021 and 2020 respectively.

The following table presents the recorded investment in loans past due over 89 days by class of loans as of December 31, 2021 and December 31, 2020.

		Nonaccrual				Loans Past Due Over 89 Days and Still Accruing		
		2021		2020		2021		2020
Commercial and industrial	$	247	$	–	$	105	$	–
Commercial real estate		–		–		–		–
Land and construction		–		–		–		–
Agricultural land, real estate and production		68		–		–		–
Consumer		60		31		–		–
Total	$	375	$	31	$	105	$	–

The following table presents the aging of the recorded investment in past due loans as of December 31, 2021 and 2020 by class of loans.

2021		30 – 59 Days Past Due		60 – 89 Days Past Due		Greater Than 89 Days Past Due		Total Past Due		Loans Not Past Due		Total
Commercial and industrial	$	33	$	33	$	261	$	327	$	279,850	$	280,177
Commercial real estate		–		–		–		–		637,085		637,085
Land and construction		–		–		–		–		145,121		145,121
Agricultural land, real estate and production		–		–		68		68		31,159		31,227
Consumer		–		–		60		60		39,904		39,964
Total	$	33	$	33	$	389	$	455	$	1,133,119	$	1,133,574

2020		30 – 59 Days Past Due		60 – 89 Days Past Due		Greater Than 89 Days Past Due		Total Past Due		Loans Not Past Due		Total
Commercial and industrial	$	–	$	–	$	–	$	–	$	502,408	$	502,408
Commercial real estate		–		–		–		–		548,092		548,092
Land and construction		–		–		–		–		84,214		84,214
Agricultural land, real estate and production		–		68		–		68		24,630		24,698
Consumer		–		–		31		31		46,674		46,705
Total	$	–	$	68	$	31	$	99	$	1,206,018	$	1,206,117

The Bank worked with borrowers impacted by COVID-19 and provided modifications to include interest only deferral or principal and interest deferral. These modifications were excluded from troubled debt restructuring classification under the "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Corona virus (Revised)." As of December 31, 2021, there were no loans outstanding on deferrals under CARES act. As of December 31, 2020, the Bank had 22 loans on deferral with outstanding balances of $17,360,000.

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 all loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $25,000 and non-homogeneous loans, such as commercial and commercial real estate loans. The loans are evaluated and rated at the time of underwriting, at renewal, if payment becomes past due, or if an event of default occurs. 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.

Overdraft lines of credit and loans that do not meet the criteria above are considered to be pass-rated loans.

The following table shows the risk category of the loan portfolio by class at December 31, 2021 and 2020:

December 31, 2021	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	$ 274,315	$ 3,789	$ 2,073	$ –	$ 280,177
Commercial real estate	627,155	7,913	2,017	–	637,085
Land and construction	144,131	–	990	–	145,121
Agricultural land, real estate and production	30,716	443	68	–	31,227
Consumer	39,904	–	60	–	39,964
Total	$ 1,116,221	$ 12,145	$ 5,208	$	$ 1,133,574

December 31, 2020	Pass	Special Mention	Substandard	Doubtful	Total
Commercial and industrial	$ 498,338	$ 3,469	$ 601	$ –	$ 502,408
Commercial real estate	541,544	2,665	3,883	–	548,092
Land and construction	84,214	–	–	–	84,214
Agricultural land, real estate and production	24,630	68	–	–	24,698
Consumer	46,705	–	–	–	46,705
Total	$ 1,195,431	$ 6,202	$ 4,484	$ –	$ 1,206,117

The following tables show information related to impaired loans at ended December 31, 2021 and 2020:

December 31, 2021	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	$ –	$ –	$ –	$ –	$ –
Commercial real estate	–	–	–	–	–
Land and construction	990	990	–	990	51
Agricultural land, real estate and production	–	–	–	–	–
Consumer	62	62	–	64	–
Total	$ 1,052	$ 1,052	$ –	$ 1,054	$ 51
With an allowance recorded:					
Commercial and industrial	$ 1,854	$ 1,854	$ 1,736	$ 1,997	$ 84
Commercial real estate	–	–	–	–	–
Land and construction	–	–	–	–	–
Agricultural land, real estate and production	68	68	68	68	–
Consumer	–	–	–	–	–
Total	$ 1,922	$ 1,922	$ 1,804	$ 2,065	$ 84
Total:					
Commercial and industrial	$ 1,854	$ 1,854	$ 1,736	$ 1,997	$ 84
Commercial real estate	–	–	–	–	–
Land and construction	990	990	–	990	51
Agricultural land, real estate and production	68	68	68	68	–
Consumer	62	62	–	64	–
Total	$ 2,974	$ 2,974	$ 1,804	$ 3,119	$ 135

December 31, 2020	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial and industrial	$ –	$ –	$ –	$ –	$ –
Commercial real estate	–	–	–	–	–
Land and construction	–	–	–	–	–
Agricultural land, real estate and production	–	–	–	–	–
Consumer	31	31	–	33	3
Total	$ 31	$ 31	$ –	$ 33	$ 3
With an allowance recorded:					
Commercial and industrial	$ –	$ –	$ –	$ –	$ –
Commercial real estate	–	–	–	–	–
Land and construction	–	–	–	–	–
Agricultural land, real estate and production	–	–	–	–	–
Consumer	–	–	–	–	–
Total	$ –	$ –	$ –	$ –	$ –
Total:					
Commercial and industrial	$ –	$ –	$ –	$ –	$ –
Commercial real estate	–	–	–	–	–
Land and construction	–	–	–	–	–
Agricultural land, real estate and production	–	–	–	–	–
Consumer	31	31	–	33	3
Total	$ 31	$ 31	$ –	$ 33	$ 3

NOTE 4 – 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.

Debt Securities
The fair values of debt 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.

Federal Home Loan Bank and Bankers' Bank Stock
Bankers' Bank Stock includes TIB The Independent BankersBank 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.

Assets Recorded at Fair Value

The Bank's assets measured at fair value on a recurring basis as of December 31, 2021 and 2020 are summarized below:

	Fair Value Measurements at December 31, 2021 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	$ –	$ 207,372	$ –	$ 207,372
U.S. Government sponsored agencies	–	5,802	–	5,802
Mortgage backed securities: residential	–	28,282	–	28,282
Collateralized mortgage obligations	–	26,853	–	26,853
State and political subdivision	–	4,493	–	4,493
Certificates of deposits	–	2,855	–	2,855
Total assets measured at fair value	$ –	$ 275,657	$ –	$ 275,657

	Fair Value Measurements at December 31, 2020 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	$ –	$ 2,005	$ –	$ 2,005
U.S. Government sponsored agencies	–	5,095	–	5,095
Mortgage backed securities: residential	–	7,207	–	7,207
Collateralized mortgage obligations	–	30,597	–	30,597
State and political subdivision	–	4,946	–	4,946
Corporate	–	–	–	–
Total assets measured at fair value	$ –	$ 49,850	$ –	$ 49,850

There were no transfers between Level 1 and Level 2 during 2021 and 2020. There were no recurring Level 3 assets or liabilities measured at fair value during 2021 or 2020.

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 2021 or 2020.

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments not carried at fair value, at December 31, 2021 and 2020 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2021 Using: Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$ 139,422	$ 139,422	$ -	$ –	$ 139,422
Interest-bearing deposits in other financial institutions	18,811	–	18,811	–	18,811
Securities held-to-maturity	3,242	–	3,493	–	3,493
Loans held for sale	69,507	–	69,507	–	69,507
Loans, net	1,112,320	–	–	1,102,284	1,102,284
FHLB and Bankers' Bank stock	5,932	N/A	N/A	N/A	N/A
Accrued interest receivable	5,393	–	873	4,520	5,393
Financial liabilities:					
Noninterest-bearing deposits	$ 716,888	$ 716,888	$ –	$ –	$ 716,888
Interest-bearing deposits	779,448	654,427	114,359	–	768,786
Accrued interest payable	95	14	81	–	95

	Carrying Amount	Fair Value Measurements at December 31, 2020 Using: Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$ 12,530	$ 12,530	$ –	$ –	$ 12,530
Interest-bearing deposits in other financial institutions	55,235	–	55,235	–	55,235
Securities held-to-maturity	7,228	–	7,620	–	7,620
Loans held for sale	31,630	–	31,630	–	31,630
Loans, net	1,189,227	–	–	1,184,851	1,184,851
FHLB and Bankers' Bank stock	4,018	N/A	N/A	N/A	N/A
Accrued interest receivable	6,187	–	274	5,913	6,187
Financial liabilities:					
Noninterest-bearing demand deposits	$ 552,645	$ 552,645	$ –	$ –	$ 552,645
Interest-bearing demand deposits	642,139	504,798	128,053	–	632,851
Accrued interest payable	154	70	84	–	154

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

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

There were no transfers between Level 1, Level 2, and Level 3 during 2021 and 2020.

NOTE 5 – 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, 2021 and 2020:

		2021		2020
Land	$	2,512	$	830
Building		6,434		3,410
Furniture, fixtures and equipment		2,808		2,437
Software and capitalized data & item processing		292		292
Computer equipment		1,422		1,273
Automobile		16		16
Leasehold improvements		3,189		3,103
Construction-in-progress		757		3,068
Total premises and equipment		17,430		14,429
Less accumulated depreciation and amortization		(5,145)		(4,057)
Premises and equipment, net	$	12,285	$	10,372

Depreciation expense was $1,088,000 and $804,000 for 2021 and 2020, respectively.

NOTE 6 – 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 12 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, 2021 and 2020, was approximately $847,000 and $874,000, 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 basis over the lease term. Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

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

Right-of-use assets and lease liabilities by lease type, and the associated balance sheet classifications, as follows on next page:

	Balance Sheet Classification		2021		2020
Right-of-use assets:					
Operating leases	Accrued interest receivable and other assets	$	4,853	$	5,489
Total right-of-use assets		$	4,853	$	5,489
Lease liabilities:					
Operating leases	Accrued interest receivable and other assets	$	5,052	$	5,657
Total lease liabilities		$	5,052	$	5,657

Lease Expense

The components of total lease cost were as follows for the period ending:

		2021		2020
Operating lease cost	$	840	$	832
Short-term lease cost		7		42
Total lease cost, net	$	847	$	874

Lease Obligations

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2021 are as follows:

		Operating Leases
2022	$	764
2023		682
2024		616
2025		560
2026		475
Thereafter		2,711
Total undiscounted lease payments		5,808
Less: imputed interest		756
Net lease liabilities	$	5,052

NOTE 7 – GOODWILL AND INTANGIBLE ASSETS

The change in goodwill during the year is as follows:

		2021		2020
Balance at beginning of year	$	25,762	$	25,762
Acquired goodwill		–		–
Impairment		–		–
Balance at end of year	$	25,762	$	25,762

Business combinations involving the Bank's acquisition of the equity interests or net assets of another enterprise give rise to goodwill. Total goodwill at December 31, 2021 and 2020 consisted of $25,762,000 representing the excess of the cost of Lighthouse Bank over the net of the amounts assigned to assets acquired and liabilities assumed in the 2019 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. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed at least quarterly for impairment.

Other Acquired Intangible Assets

Other acquired intangible assets were as follows for the years ended December 31, 2021 and 2020:

	2021		2020	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Core deposit intangibles	$ 3,707	$ 1,267	$ 3,707	$ 781
Total	$ 3,707	$ 1,267	$ 3,707	$ 781

The other acquired intangible assets at December 31, 2021 represent the estimated fair value of the core deposit relationships acquired in the acquisition of Lighthouse Bank 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, 2021, the weighted average remaining amortization period is 7.75 years.

The carrying value of intangible assets at December 31, 2021 and 2020 was $2,440,000 and $2,926,000, net of accumulated amortization expense. Amortization expense recognized was $486,000 for 2021 and $643,000 for 2020.

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
2022	$ 406
2023	363
2024	331
2025	312
2026	293
Thereafter	735
Total	$ 2,440

NOTE 8 – DEPOSITS

Time deposits that meet or exceed the FDIC Insurance limit of $250,000 at year-end 2021 and 2020 were $63,030,000 and $65,358,000, respectively.

Interest-bearing deposits at December 31, 2021 and 2020, consisted of the following:

		2021		2020
Demand deposit	$	219,072	$	170,804
Money market		314,541		243,645
Time deposits $250,000 or more		63,030		65,358
Time deposits less than $250,000		51,352		62,436
Savings		131,453		99,896
Total interest-bearing deposits	$	779,448	$	642,139

Aggregate annual maturities of time deposits are as follows:

2022	$	106,835
2023		4,214
2024		1,513
2025		1,147
2026		673
	$	114,382

NOTE 9 – BORROWED FUNDS

At December 31, 2021, the Bank had unsecured lines of credit with its correspondent banks in an aggregate amount of $59,000,000, at interest rates that vary with market conditions. As of December 31, 2021, the Bank had no federal funds purchased.

The Bank has established a secured borrowing arrangement, secured by loans totaling approximately $635,138,000 with the Federal Home Loan Bank of San Francisco ("FHLB"). The Bank had a remaining borrowing capacity of $315,709,000 and $201,470,000 as of December 31, 2021 and 2020, respectively, 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.

NOTE 10 – 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, 2021 and 2020:

		2021		2020
Change in benefit obligation:				
Beginning benefit obligation	$	3,998	$	3,174
Service cost		419		264
Interest cost		88		82
Actuarial (gain) loss		(130)		525
Benefits paid		(145)		(47)
Ending benefit obligation		4,230		3,998
Change in plan assets:				
Beginning plan assets		–		–
Employer contributions		145		47
Benefits paid		(145)		(47)
Ending plan assets		–		–
Funded status at end of year	$	(4,230)	$	(3,998)

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

		2021		2020
Change in benefit obligation:				
Unrecognized net actuarial loss	$	6	$	136
Unrecognized prior service cost		–		54
	$	6	$	190

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

Components of net periodic benefit cost		2021		2020
Service cost	$	419	$	263
Interest cost		88		82
Amortization of prior service cost		53		54
Amortization of actuarial gains		–		–
Net periodic benefit cost	$	560	$	399
		2021		2020
Net (gain) loss	$	(130)	$	525
Amortization of gain		–		–
Amortization of prior service cost		(53)		(54)
Total recognized in other comprehensive (loss) income		(183)		471
Total recognized in net periodic benefit cost and other comprehensive (loss) income	$	(743)	$	72

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.

Assumptions

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

	2021	2020
Discount rate used to determine net periodic benefit cost	2.23%	2.38%
Discount rate used to determine benefit obligations	2.38%	2.23%
Future salary increases	N/A	N/A

NOTE 11 – 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 30% of contributions up to 6% of compensation. Total expense for the years ended December 31, 2021 and December 31, 2020 was $307,000 and $205,000, 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, 2021 and December 31, 2020 was $1,655,000 and $1,618,000, respectively. Total expense recognized during the years ended December 31, 2021 and December 31, 2020 was $37,000 and $232,000, respectively.

NOTE 12 – INCOME TAXES

The provision for income taxes is as follows for the years ended December 31, 2021 and 2020:

		2021		2020
Current expense:				
Federal	$	5,918	$	5,339
State		3,607		2,950
Total current		9,525		8,289
Deferred expense (benefit):				
Federal		(378)		(885)
State		(356)		(276)
Total deferred		(734)		(1,161)
Total provision	$	8,791	$	7,128

The effective tax rates differ from the federal statutory rate of 21% for 2021 and 2020 applied to income before income taxes due to the following:

	2021	2020
Federal statutory rate	21.00%	21.00%
State income tax, net of federal effect	8.54%	8.54%
Tax exempt interest	(0.48%)	(0.68%)
Bank owned life insurance	(0.29%)	(0.32%)
Split dollar expense	0.03%	0.20%
Stock-based compensation	0.13%	0.19%
Other	0.29%	(0.05%)
Net	29.22%	28.88%

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, 2021 and 2020 are on the following table:

		2021		2020
Deferred tax assets:				
Allowance for loan losses	$	5,906	$	3,850
Deferred compensation		1,249		1,128
Accruals		748		1,002
Current state income tax		711		661
Fair value of loans and deposits		589		838
Lease liability		1,493		1,672
Unrealized losses on available-for-sale securities and pension		869		–
Other deferred tax assets		164		637
Gross deferred tax assets		11,729		9,788
Deferred tax liabilities:				
Deferred loan costs		(1,919)		(1,755)
Core deposit intangibles		(723)		(866)
Premises and equipment		(332)		(377)
Right-of-use asset		(1,435)		(1,623)
Other deferred tax liabilities		(594)		(44)
Unrealized gain on available-for-sale securities and pension		–		(264)
Gross deferred tax liabilities		(5,003)		(4,929)
Net deferred tax asset	$	6,726	$	4,859

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, 2021 or December 31, 2020.

The Bank has no material unrecognized tax benefits at December 31, 2021 and 2020 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, 2021 and December 31, 2020 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 2018 and 2017, for federal and California purposes.

NOTE 13 – RELATED PARTY TRANSACTIONS

Loan related activity to principal officers, directors, and their affiliates during 2021 were as follows:

		2021
Beginning balance	$	13,438
New loans or disbursements		17,005
Principal repayments		(3,015)
Ending balance	$	27,428

At December 31, 2021 and 2020, no related party loans were on nonaccrual or classified for regulatory reporting purposes. Deposits from principal officers, directors, and their affiliates at year-end 2021 and 2020 were $8,448,000 and $4,958,000, respectively.

NOTE 14 – 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 $328,000 and $345,000 for 2021 and 2020, respectively. The total income tax benefit was $29,000 and $15,000 for 2021 and 2020, 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-Merton) 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.

	2021	2020
Risk-free interest rate	0.68%	0.74%
Expected term (yrs.)	5.78	6.00
Expected stock price volatility	35.87%	29.33%
Dividend yield	0.35%	0.74%

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 1,000,404 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 2021 as presented on the next page:

	December 31, 2021				
	Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	19,470	$	5.29		
Granted	–		–		
Exercised	(18,150)		4.65		
Expired	–		–		
Forfeited	–		–		
Options outstanding at end of year	1,320	$	7.09	1.58 years	$ 19
Options fully vested and expected to vest	1,320				$ 19
Exercisable at end of year	1,320	$	7.09	1.58 years	$ 19

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

	2021	2020
Intrinsic value of options exercised	$ 380	$ 81
Cash received from option exercises	$ 47	$ 24
Tax benefit realized from option exercises	$ 29	$ 12
Weighted average fair value of options granted	–	–

As of December 31, 2021, 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 939,940 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. On October 19, 2021, the Bank declared a 10% stock dividend for shareholders of record as of November 8, 2021. Stock option awards and the related price per share amounts reflected in the table below have been restated to give retroactive effect to the 10% stock dividend declared in October 2021.

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 2021 as presented below:

	December 31, 2021			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at beginning of year	283,838	$ 21.36		
Granted	50,902	22.44		
Exercised	(24,564)	11.36		
Expired	(25,704)	22.63		
Forfeited	(22,500)	19.89		
Options outstanding at end of year	261,972	$ 20.43	7.39 years	$ 508
Options fully vested and expected to vest	238,720			$ 693
Exercisable at end of year	153,666	$ 19.85	7.39 years	$ 566

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

	2021	2020
Intrinsic value of options exercised	$ 324	$ –
Cash received from option exercises	$ 156	$ –
Tax benefit realized from option exercises	$ –	$ –
Weighted average fair value of options granted	$ 7.07	$ 5.12

As of December 31, 2021, there was $658,000 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 2.59 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, 2021 as presented at right:

	Shares	Weighted Average Grant Date Fair Value
Non-vested awards at January 1, 2021	–	$ –
Granted	24,262	22.13
Vested	(14,280)	21.63
Forfeited	–	–
Non-vested awards at December 31, 2021	9,982	$ 22.86

As of December 31, 2021, there was $185,000 in unrecognized compensation cost related to non-vested shares granted under the Omnibus Plan. The cost is expected to be recognized over a weighted average period of 3.27 years. The total fair value of shares vested during the years ended December 31, 2021 and December 31, 2020 was $309,000 and $219,000.

NOTE 15 – 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, 2021, 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 2021 and 2020, 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 and ratios are presented below at year-end.

	Actual		Required for Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Regulations	
As of December 31, 2021						
Total capital to risk weighted assets	$ 174,706	14.88%	$ 123,289	10.50%	$ 117,418	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 159,959	13.62%	$ 99,805	8.50%	$ 93,935	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 159,959	13.62%	$ 82,193	7.00%	$ 76,322	6.50%
Tier 1 (Core) capital to average assets	$ 159,959	9.50%	$ 67,344	4.00%	$ 84,180	5.00%

	Actual		Required for Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Regulations	
As of December 31, 2020						
Total capital to risk weighted assets	$ 151,320	15.59%	$ 101,916	10.50%	$ 97,063	10.00%
Tier 1 (Core) capital to risk weighted assets	$ 139,172	14.34%	$ 82,504	8.50%	$ 77,651	8.00%
Common Tier 1 (CET1) to risk weighted assets	$ 139,172	14.34%	$ 67,944	7.00%	$ 63,091	6.50%
Tier 1 (Core) capital to average assets	$ 139,172	10.27%	$ 54,196	4.00%	$ 67,745	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 16 –
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 $9,403,000 at December 31, 2021. 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, 2021		December 31, 2020	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	$ 3,427	$ 331,069	$ 3,218	$ 269,138
Unused lines of credit	528	48,850	499	42,664
Standby letters of credit	–	–	–	130
	$ 3,955	$ 379,919	$ 3,717	$ 311,932

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

NOTE 17 – EARNINGS PER SHARE

The factors used in the earnings per share computation follow:

		2021		2020
Basic earnings per share:				
Net income	$	21,274	$	17,550
Weighted average common shares outstanding		8,508,098		8,471,562
Basic earnings per common share	$	2.50	$	2.07
Diluted earnings per share:				
Net income	$	21,274	$	17,550
Weighted average common shares outstanding for basic earnings per common share		8,508,098		8,471,562
Add: Dilutive effects of assumed exercises of stock options		27,788		40,928
Weighted average outstanding and dilutive potential common shares		8,535,886		8,512,490
Diluted earnings per common share	$	2.49	$	2.06

Stock options for 225,500 and 214,000 shares of common stock were not considered in computing diluted earnings per common share for the years ended December 31, 2021 and December 31, 2020, respectively, because they were anti-dilutive.

SANTA CRUZ COUNTY BANK

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