

2020

ANNUAL REPORT



River City Bank

BOARD OF DIRECTORS



SHAWN DEVLIN
Director since 2001
Chairman of the Board,
River City Bank



STEPHEN FLEMING
Director since 2008
President and Chief Executive Officer,
River City Bank



LON BURFORD
Director since 2012
Founding Partner,
Genovese, Burford & Brothers



FREDERICK DURST
Director since 2008
Farmer/Rancher



RYAN GILBERT
Director since 2012
Partner, Propel Venture Partners and
Executive Chairman, Better Finance



KERRY GORDON
Director since 2018
Retired Regional Managing Partner,
Moss Adams



ELAINE LINTECUM
Director since 2016
Retired Chief Financial Officer,
The McClatchy Company



MICHAEL J. NEWELL
Director since 2000
President, CC&B Holdings
Director of Business Development,
HP Hood LLC



GARY ORR
Director since 2019
Owner, Orr Business Consulting
Retired Bank Executive



STEVE PLEAU
Director since 2001
President,
Future Automotive Group



JON S. KELLY
IN MEMORIAM
Founder and former Chairman of
the Board, River City Bank

CONSOLIDATED FINANCIAL HIGHLIGHTS – UNAUDITED

(DOLLARS IN THOUSANDS EXCEPT FOR PER SHARE AMOUNTS)

	2020	2019	2018
For the Year:			
Net income	\$ 31,627	\$ 25,312	\$ 24,005
Earnings per common share – Basic	21.58	17.33	16.50
Earnings per common share – Diluted	21.58	17.33	16.50
At Year End:			
Total assets	\$ 3,322,054	\$ 2,544,697	\$ 2,206,367
Total deposits	3,010,460	2,144,516	1,722,566
Total gross loans	2,429,111	1,948,482	1,605,506
Total investments	676,719	507,068	505,697
Total shareholders' equity	269,478	236,638	208,676
Book value per share	186.44	164.61	146.01
Common shares outstanding	1,445,350	1,437,610	1,429,195
Selected Financial Ratios:			
Net interest margin (TE)	2.72%	2.72%	2.73%
Net recoveries to total gross loans	(0.01%)	(0.02%)	(0.05%)
Allowance for loan losses to total gross loans	2.23%	2.13%	2.19%
Allowance for loan losses to non-performing loans	NM	NM	2,826%
Return on average shareholders' equity	12.49%	11.34%	12.26%
Return on average assets	1.06%	1.07%	1.15%
Efficiency ratio (TE)	32.63%	38.65%	39.66%

INDEPENDENT AUDITOR'S REPORT

Board of Directors
River City Bank
Sacramento, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of River City Bank, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2020, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of River City Bank as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

We also have audited in accordance with auditing standards generally accepted in the United States of America, River City Bank's internal control over financial reporting as of December 31, 2020, 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 January 27, 2021 expressed an unmodified opinion.



Crowe LLP
Sacramento, California
January 27, 2021

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS)

	December 31,	
	2020	2019
ASSETS		
Cash and due from financial institutions	\$ 193,015	\$ 47,514
Interest-bearing deposits in other financial institutions	—	20,763
Debt securities, available-for-sale	669,373	503,310
Debt securities, held-to-maturity; fair values of \$1,732 and \$1,710 as of December 31, 2020 and 2019, respectively	1,700	1,700
Equity securities	5,646	2,058
Loans, net of allowance of \$54,255 and \$41,533 as of December 31, 2020 and 2019, respectively	2,379,960	1,902,787
Accrued interest receivable	10,188	8,566
Premises and equipment, net	13,128	13,491
Other assets	32,946	31,579
Deferred tax assets, net	16,098	12,929
Total assets	\$ 3,322,054	\$ 2,544,697
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing demand deposits	\$ 660,621	\$ 502,401
Interest-bearing deposits		
Money market accounts	792,261	615,282
NOW accounts	1,276,622	731,375
Savings deposits	192,062	158,882
Time deposits	88,894	136,576
Total interest-bearing deposits	2,349,839	1,642,115
Total deposits	3,010,460	2,144,516
Accrued interest payable	307	372
Federal Home Loan Bank advances	13,000	148,000
Other liabilities	28,809	15,171
Total liabilities	3,052,576	2,308,059
Commitments and contingencies		
Shareholders' equity		
Preferred stock, no par value; 40,000,000 shares authorized; none issued and outstanding	—	—
Common stock, no par value; 40,000,000 shares authorized, 1,445,350 and 1,437,610 shares issued and outstanding at December 31, 2020 and 2019, respectively	36,121	34,773
Accumulated other comprehensive income, net	3,728	2,103
Retained earnings	229,629	199,762
Total shareholders' equity	269,478	236,638
Total liabilities and shareholders' equity	\$ 3,322,054	\$ 2,544,697

CONSOLIDATED STATEMENTS OF OPERATIONS

(DOLLARS IN THOUSANDS EXCEPT FOR PER SHARE AMOUNTS)

	Years Ended December 31,		
	2020	2019	2018
INTEREST INCOME			
Interest and fees on loans	\$ 90,427	\$ 74,323	\$ 62,701
Taxable interest and dividends on securities	9,293	11,028	8,304
Tax exempt interest and dividends on securities	127	161	236
Interest on federal funds sold and other	391	1,092	469
Total interest income	100,238	86,604	71,710
INTEREST EXPENSE			
Interest on deposits	16,037	18,987	9,932
Interest on FHLB advances	391	4,477	5,362
Other interest expense	3,640	(206)	146
Total interest expense	20,068	23,258	15,440
Net interest income	80,170	63,346	56,270
Provision for loan losses	12,400	6,000	2,750
Net interest income after provision for loan losses	67,770	57,346	53,520
NONINTEREST INCOME			
Service charges on deposit accounts	1,040	1,304	1,298
Check card revenue	778	891	966
Net changes in the fair value of derivatives	611	(269)	—
Real estate lease income	1,229	1,384	1,467
FHLB dividends	767	885	1,009
Other noninterest income	1,254	1,191	1,188
Total noninterest income	5,679	5,386	5,928
NONINTEREST EXPENSE			
Salaries and employee benefits	17,837	16,746	15,406
Occupancy	2,709	3,398	3,113
Equipment	711	457	425
Data processing	2,886	2,508	2,242
Federal deposit insurance	682	315	635
Other noninterest expense	4,031	4,008	3,685
Total noninterest expense	28,856	27,432	25,506
Income before income taxes	44,593	35,300	33,942
Provision for income taxes	12,966	9,988	9,937
Net income available to common shareholders	\$ 31,627	\$ 25,312	\$ 24,005
Basic earnings per common share	\$ 21.58	\$ 17.33	\$ 16.50
Diluted earnings per common share	\$ 21.58	\$ 17.33	\$ 16.50
Weighted average shares – Basic	1,465,462	1,460,874	1,454,916
Weighted average shares – Diluted	1,465,462	1,460,874	1,454,916

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(DOLLARS IN THOUSANDS)

	Years Ended December 31,		
	2020	2019	2018
Net income	\$ 31,627	\$ 25,312	\$ 24,005
Other comprehensive income:			
Unrealized holding gain (loss) on debt securities available for sale arising during the period	2,217	5,226	(531)
Reclassification adjustment for losses on debt securities available for sale included in net income	105	132	174
Tax effect	(697)	(1,607)	116
Net of tax	1,625	3,751	(241)
Unrealized (loss) gain on cash flow hedge	—	(530)	296
Reclassification adjustment for losses included in net income	—	269	—
Tax effect	—	75	(89)
Net of tax	—	(186)	207
Total other comprehensive income (loss)	1,625	3,565	(34)
Comprehensive income	\$ 33,252	\$ 28,877	\$ 23,971

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(DOLLARS IN THOUSANDS EXCEPT FOR PER SHARE AMOUNTS)

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income (Loss), Net	Retained Earnings	Total Shareholders' Equity
Balance at January 1, 2018	1,420,636	\$32,727	\$ (1,219)	\$153,386	\$184,894
Net income				24,005	24,005
Other comprehensive loss			(34)		(34)
Stock compensation expense		1,412			1,412
Restricted shares vested	9,024				
Repurchase of common stock	(465)	(88)			(88)
Common dividends (\$1.04 per share)				(1,513)	(1,513)
Reclassification – Legislative Tax Rate Change			(209)	209	—
Balance at December 31, 2018	1,429,195	34,051	(1,462)	176,087	208,676
Net income				25,312	25,312
Other comprehensive income			3,565		3,565
Stock compensation expense		1,622			1,622
Restricted shares vested	13,002				
Repurchase of common stock	(4,587)	(900)			(900)
Common dividends (\$1.12 per share)				(1,637)	(1,637)
Balance at December 31, 2019	1,437,610	34,773	2,103	199,762	236,638
Net income				31,627	31,627
Other comprehensive income			1,625		1,625
Stock compensation expense		1,743			1,743
Restricted shares vested	10,139				
Repurchase of common stock	(2,399)	(395)			(395)
Common dividends (\$1.20 per share)				(1,760)	(1,760)
Balance at December 31, 2020	1,445,350	\$36,121	\$ 3,728	\$229,629	\$269,478

CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLARS IN THOUSANDS)

	Years Ended December 31,		
	2020	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 31,627	\$ 25,312	\$ 24,005
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	2,700	813	2,235
Provision for loan losses	12,400	6,000	2,750
Net increase in net deferred loan fees and costs	3,857	913	231
Deferred income taxes	(3,866)	(1,837)	(1,645)
Loss on abandonment of premises and equipment	—	55	1
Net (gain) loss in the fair value of derivatives	(611)	269	—
Increase in accrued interest receivable	(1,622)	(1,401)	(993)
Increase in other assets	(1,415)	(615)	(1,203)
Stock compensation expense	1,598	1,647	1,532
(Decrease) increase in accrued interest payable	(64)	(48)	165
Increase in other liabilities	1,364	86	981
Net cash provided by operating activities	45,968	31,194	28,059
CASH FLOWS FROM INVESTING ACTIVITIES			
Net decrease (increase) in interest-bearing deposits in other financial institutions	20,763	(15,000)	12,756
Available-for-sale debt securities			
Maturities, prepayments and calls	259,788	180,277	131,292
Purchases	(424,953)	(175,595)	(173,841)
Equity securities purchases	(3,684)	(523)	(1,090)
Loan originations and payments, net	(480,307)	(342,540)	(140,624)
Purchases of premises and equipment	(863)	(2,096)	(428)
Net cash used in investing activities	(629,256)	(355,477)	(171,935)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposits, money market accounts, NOW accounts and savings deposits	913,626	483,043	186,517
Net (decrease) increase in time deposits	(47,682)	(61,093)	3,986
Net decrease in advances from FHLB	(135,000)	(117,000)	(47,000)
Repurchase of common stock	(395)	(900)	(88)
Cash dividends paid – common	(1,760)	(1,637)	(1,513)
Net cash provided by financing activities	728,789	302,413	141,902
Net increase (decrease) in cash and equivalents	145,501	(21,870)	(1,974)
Cash and cash equivalents at beginning of year	47,514	69,384	71,358
Cash and cash equivalents at end of year	\$ 193,015	\$ 47,514	\$ 69,384
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the year for			
Interest	\$ 20,133	\$ 23,152	\$ 15,210
Income taxes	\$ 16,078	\$ 12,766	\$ 10,167
SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES			
Unrealized gain (loss) on debt securities	\$ 2,322	\$ 5,358	\$ (357)
Lease liabilities arising from obtaining right-of-use assets	\$ 362	\$ 5,353	\$ —

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – Summary of Significant Accounting Policies

The accounting and reporting policies of River City Bank (the Bank) and its wholly owned subsidiaries River City Property Corporation (RCPC) and River City Money Management Company (RCMMC) conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Nature of Operations and Principles of Consolidation

The Bank is a California state chartered bank headquartered in Sacramento, California, and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the applicable amounts. The Bank operates ten branch locations within El Dorado, Placer, Sacramento and Yolo counties. Additionally, the Bank operates two loan production offices in San Francisco and Sonoma counties. The Bank's primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial real estate, commercial, agriculture, residential mortgage, and consumer loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate in the six county service area noted above, the greater Bay Area and Southern California. 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. The Bank's wholly owned subsidiaries, RCPC and RCMMC, have not had significant operations in 2020, 2019 and 2018.

The consolidated financial statements include the accounts of the Bank and its wholly owned subsidiaries for all periods presented. All significant inter-company balances and transactions have been eliminated in consolidation.

Risks and Uncertainties

In the normal course of business, the Bank encounters two significant types of risk: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Bank is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default, primarily in the loan portfolio, that results from the borrowers' inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of securities, the value of collateral underlying loans receivable, the valuation of other investments, the valuation of deferred tax assets, the valuation of the interest rate swaps and the valuation of interest rate caps.

The Bank is subject to the regulations of various governmental agencies. These regulations can change from period to period. Such regulations can also restrict the Bank's ability to sustain continued growth as a result of capital and other requirements. The Bank also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required allowance for loan losses and operating restrictions resulting from the regulators' judgments based upon information available to them at the time of their examination.

The extent to which the COVID-19 pandemic will impact the Bank, its results of operations and financial condition will depend on future developments, which are highly uncertain and difficult to predict. Those developments and factors include the duration and spread of the pandemic, its severity, the actions to contain the pandemic or address its impact, and how quickly and to what extent normal economic and operating conditions can resume. Management does not yet know the full extent of the impact. However, the effects could have a material adverse impact on asset valuations, financial condition and results of operations. Material adverse impacts may include all or a combination of valuation impairments on the Bank's investments, loans, or deferred tax assets.

Subsequent Events

The Bank has evaluated subsequent events for recognition and disclosure through January 27, 2021, which is the date the financial statements were available to be issued.

As of December 31, 2020, included in other assets is a \$4,830,000 equity investment in a Sacramento based investment advisory firm. On January 9, 2021, the advisory firm sold its business and merged into a national, private investment advisory firm. The Bank received consideration of \$3,101,000 in cash and also received stock in the combined firm. The determination of the value of the stock and the related gain on sale is still under consideration.

Use of Estimates

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America management makes 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.

Interest-Bearing Deposits in Other Financial Institutions

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Securities

Debt securities at December 31, 2020 and 2019 consist of U.S. Treasury and U.S. Government agency obligations, mortgage-backed securities, municipal securities, collateralized mortgage obligations, corporate bonds and other securities. At the time of purchase of a security the Bank designates debt securities as held-to-maturity or available-for-sale, based on the investment objectives, operational needs and intent to hold. The Bank does not purchase securities with the intent to engage in trading activity. Equity securities include legacy VISA stock, investments in Small Business Investment Company (SBIC) funds and in a Small Business Administration loan fund. The equity securities are carried at cost as the fair market value for these securities are not readily determinable and reviewed for impairment at least annually.

Securities purchased which are classified as held-to-maturity securities are classified as such based on the Bank's ability and intent to hold such securities to maturity. Debt securities held-to-maturity are stated at cost adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income.

Available-for-sale securities are carried at fair value with unrealized gains or losses included in other comprehensive income (loss), net of tax. Gains and losses realized upon disposition of securities are recorded as a component of noninterest income on the trade date, based upon the net proceeds and the adjusted carrying value of the securities using the specific identification method.

Premiums and discounts on securities are amortized or accreted over the life of the investment security as an adjustment to yield using the effective interest method. For securities purchased at a premium with a call date, the premium is amortized to that call date.

Management evaluates debt securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. During the years ending December 31, 2020, 2019 and 2018, the Bank did not recognize any other-than-temporary losses in earnings.

Loans and Allowance for Loan Losses

Loans are stated at the principal amounts outstanding less deferred loan fees and costs and the allowance for loan losses. Interest income is accrued using methods that approximate a level yield on the principal outstanding, based on the contractual terms of the loan. Substantially all loan origination and commitment fees and certain direct loan origination costs are deferred and amortized as an adjustment to the related loan's yield, generally over the contractual lives of the loans, a method approximating the interest method. Loans are placed on nonaccrual status when the full timely collection of principal or interest becomes uncertain or when principal or interest is past due for 90 days or more, except for loans that are both well secured and in the process of collection. Past due status is based on the contractual terms of the loan. Loans that are placed on nonaccrual status are considered to be non-performing; all other loans are considered to be performing. At the time a loan is placed on nonaccrual status, any interest income previously accrued but not collected is reversed. Subsequent payments received in cash are generally recognized as interest income if the collectability of the remaining balance of the loan is not in doubt. Interest accruals are resumed when such loans are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

In general, a loan is impaired when, based upon current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified in a manner representing a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, the Bank may measure impairment based on the fair value of the collateral if the loan is collateral dependent. 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. Loans are measured for impairment as part of the Bank's ongoing asset review process. Income recognition on impaired loans materially conforms to the method the Bank uses for income recognition on nonaccrual loans.

Troubled debt restructurings (TDRs) 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. 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 allowance for loan losses is established through a provision for loan losses charged to operations in an amount which management believes to be adequate to absorb probable incurred credit losses. Loans which management believes are uncollectible are charged against the allowance, and subsequent recoveries, if any, are added to the allowance. For consumer loans, management will generally charge off the balance if the loan is 90 days or more past due.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The general component of the allowance for loan losses covers non impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the more recent period. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments and classes have been identified: commercial and industrial; construction and land development; commercial real estate; residential real estate; consumer and agricultural. The Bank reviews the credit risk exposure of all its portfolio segments, except for residential real estate and consumer, by internally assigned grades. For the residential real estate and consumer portfolio segments, the Bank's primary monitoring tool is reviewing past due listings to determine if the loans are performing.

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. These risk grades are given to the commercial and industrial; commercial real estate; construction and land development and agricultural portfolio segments. The Bank uses the following definitions for risk ratings:

- **Special Mention** – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.
- **Substandard** – Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
- **Doubtful** – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be Pass rated loans.

The determination of the allowance for loan losses is based on estimates that are particularly susceptible to changes in the economic environment and market conditions. Management believes that as of December 31, 2020 and 2019 the allowance for loan losses is adequate based on information currently available. Should there be deterioration in the economy of the Bank's principal market area, the Bank's loan portfolios could be adversely impacted and higher charge-offs and increases in non-performing assets could result. Such an adverse impact could also require a larger allowance for loan losses.

Other Real Estate Owned

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Land is carried at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, principally 10 to 39 years for buildings and improvements and 3 to 7 years for equipment and furniture. The cost of leasehold improvements is amortized on a straight-line basis over the lesser of the terms of the related leases or estimated useful life.

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. The cash surrender value of these insurance policies was \$7,381,000 and \$7,142,000 as of December 31, 2020 and 2019, respectively, and is recorded in other assets.

Federal Home Loan Bank of San Francisco (FHLB) Stock

The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. As of December 31, 2020 and 2019, the Bank owned stock with a book value of \$15,000,000 and \$13,192,000, respectively. These amounts are included in other assets in the consolidated balance sheets. Both cash and stock dividends are reported as income. The Bank received cash dividends of \$767,000, \$885,000, and \$1,009,000, in 2020, 2019 and 2018, respectively. No ready market exists for the FHLB stock, and it has no quoted market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Qualified Affordable Housing Project Investments

The Bank invests in qualified affordable housing projects. The Bank's balance of the investment for qualified affordable housing projects was \$1,186,000 and \$1,369,000 as of December 31, 2020 and 2019, respectively. These balances are included in other assets. At the time the Bank enters into an investment, the Bank is required to record the entire commitment to the investment on the balance sheet as an investment and the related obligation. Total unfunded commitments to the investments in qualified affordable housing projects totaled \$191,000 at December 31, 2020 and 2019. During the years ended December 31, 2020, 2019 and 2018, the Bank recognized amortization expense of \$183,000, \$188,000, and \$188,000, respectively, which was included within income tax expense on the consolidated statements of operations. Additionally, during the years ended December 31, 2020, 2019 and 2018, the Bank recognized tax credits and other benefits from its investment in affordable housing tax credits of \$200,000, \$207,000, and \$207,000.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

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 penalties related to income tax matters in income tax expense.

Earnings per Common Share

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable assuming the conversion of preferred stock.

Derivative Instruments and Hedging Activity

The Bank's accounting for derivative instruments, including certain derivative instruments embedded in other contracts, requires the Bank to recognize those items as assets or liabilities in the consolidated balance sheet and measure them at fair value. At the inception of a derivative contract, the Bank designates the derivative as one of three types based on the Bank's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income or loss and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as noninterest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in noninterest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Bank formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Bank also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Statements of Cash Flows

For purposes of reporting cash flows, the Bank considers cash and cash equivalents to include cash and due from financial institutions. Net cash flows are reported for customer loan and deposit transactions, interest-bearing deposits in other financial institutions and FHLB advances.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on debt securities available for sale and unrealized gains and losses on cash flow hedges which are also recognized as separate components of equity. For the years ending December 31, 2020, 2019, and 2018, amounts of previous other-than-temporary impairment of \$105,000, \$132,000, and \$174,000 were reclassified into taxable interest and dividends on securities on the Consolidated Statements of Operations.

Fair Values of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in *Note 9*. 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 the estimates.

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. A Black-Scholes model is utilized to estimate the fair value of stock options, 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. See also *Note 13*.

Recently Adopted Accounting Pronouncements

There have been no recently adopted accounting pronouncements during the year ending December 31, 2020.

Recently Issued Accounting Pronouncements

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

The Financial Accounting Standards Board (FASB) issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in 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.

For debt securities with OTTI, the guidance will be applied prospectively. Existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The asset will be grossed up for the allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield of such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance. 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 standard will be effective for fiscal years beginning after December 15, 2022, including interim periods in those fiscal years. Management is assessing data and system needs in order to evaluate the impact of adopting the new guidance. The Bank expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. Management expects the adoption will result in an increase to the allowance for loan losses balance. At this time, the impact is being evaluated.

ASU 2020-04, *Reference Rate Reform (Topic 848)*

On March 12, 2020, the FASB issued Update 2020-04 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 LIBOR or another reference rate expected to be discontinued due to reference rate reform.

The new guidance provides optional expedients that reduce costs and complexity of accounting for reference rate reform. These include, simplifying accounting analyses for contract modifications. Hedging relationships continue without de-designation if there are qualifying changes in the critical terms of an existing hedging relationship due to reference rate reform. The guidance allows for a change in the systematic and rational method used to recognize in earnings the components excluded from the assessment of hedge effectiveness. Additionally, changes in the designated benchmark interest rate to a different eligible benchmark interest rate is allowed in a fair value hedging relationship and shortcut method may continue for remainder of the hedging relationship. It also simplifies the assessment of hedge effectiveness and provides temporary optional expedients for cash flow hedging relationships affected by reference rate reform.

The amendments are effective and an entity may elect to apply the amendments prospectively through December 31, 2022. The adoption of this standard is not expected to have material effect on the Bank's operating results or financial condition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Reclassifications

Some items in the prior year consolidated financial statements have been reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – Securities

The following table summarizes the amortized cost and fair value of the available-for-sale securities and held-to-maturity securities portfolio at December 31, 2020 and 2019 and the corresponding amounts of gross unrealized gains and losses (*dollars in thousands*):

	2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. Treasury securities	\$214,368	\$ 691	\$ (6)	\$215,053
U.S. government sponsored entities and agency securities	204,083	1,016	(20)	205,079
Municipal securities	5,113	326	—	5,439
Mortgage-backed securities: residential	86,956	987	(10)	87,933
Mortgage-backed securities: commercial	12,524	—	(64)	12,460
Collateralized mortgage obligations	31,824	436	(53)	32,207
Corporate debt securities	89,528	2,012	(41)	91,499
Asset-backed securities	19,650	54	(1)	19,703
Total available-for-sale	<u>\$664,046</u>	<u>\$ 5,522</u>	<u>\$ (195)</u>	<u>\$669,373</u>
Held-to-maturity				
U.S. Treasury securities	\$ 1,700	\$ 32	\$ —	\$ 1,732
2019				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
U.S. Treasury securities	\$ 43,243	\$ 141	\$ (6)	\$ 43,378
U.S. government sponsored entities and agency securities	370,874	1,842	(27)	372,689
Municipal securities	5,155	230	—	5,385
Mortgage-backed securities: residential	24,546	343	(112)	24,777
Mortgage-backed securities: commercial	15,384	—	(74)	15,310
Collateralized mortgage obligations	967	465	—	1,432
Corporate debt securities	40,138	209	(8)	40,339
Total available-for-sale	<u>\$500,307</u>	<u>\$ 3,230</u>	<u>\$ (227)</u>	<u>\$503,310</u>
Held-to-maturity				
U.S. Treasury securities	\$ 1,700	\$ 10	\$ —	\$ 1,710

The Bank also has equity securities of \$5,646,000 and \$2,058,000 as of December 31, 2020 and 2019. These equity securities are held at cost and evaluated for impairment on at least an annual basis.

The proceeds from sales and calls of securities and the associated gains and losses are listed below (*dollars in thousands*):

	2020	2019	2018
Proceeds	\$ —	\$ 570	\$ 995
Gross gains	—	—	—
Gross losses	\$ —	\$ —	\$ —

The amortized cost and fair value of debt securities at December 31, 2020 by contractual maturity are shown below (*dollars in thousands*). Expected maturities, primarily in the mortgage-backed securities, collateralized mortgage obligation securities and asset-backed securities will differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties. The contractual maturities of the mortgage-backed securities, collateralized mortgage obligations and asset-backed securities range from 2021 through 2066.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$273,817	\$275,073	\$ —	\$ —
Due after one year through five years	219,913	222,485	1,700	1,732
Due after five years through ten years	16,719	16,837	—	—
After ten years	2,643	2,675	—	—
	513,092	517,070	1,700	1,732
Mortgage-backed securities, collateralized mortgage obligations and assetbacked securities	150,954	152,303	—	—
	\$664,046	\$669,373	\$ 1,700	\$ 1,732

At December 31, 2020, securities with a carrying value of \$471,043,000 and \$1,732,000 were pledged as collateral for deposits of public funds and other purposes, respectively. These amounts at December 31, 2019, were \$313,700,000 and \$1,710,000, respectively. At December 31, 2020 and 2019 there were no holdings of investment securities of any one issuer, other than the U. S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss positions, at December 31, 2020 and 2019, were as follows (*dollars in thousands*):

	2020					
	Less than 12 months		12 months or more		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Available-for-sale						
U.S. Treasurer securities	\$ (6)	\$ 86,430	\$ —	\$ —	\$ (6)	\$ 86,430
U.S. government sponsored entities and agency securities	(5)	7,111	(15)	1,818	(20)	8,929
Mortgage-backed securities: residential	(10)	3,033	—	—	(10)	3,033
Mortgage-backed securities: commercial	—	—	(64)	12,460	(64)	12,460
Collateralized mortgage obligations	(53)	22,032	—	—	(53)	22,032
Corporate debt securities	(41)	10,555	—	—	(41)	10,555
Assetbacked securities	(1)	1,529	—	—	(1)	1,529
Total unrealized losses	\$ (116)	\$ 130,690	\$ (79)	\$ 14,278	\$ (195)	\$ 144,968

	2019					
	Less than 12 months		12 months or more		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Available-for-sale						
U.S. Treasurer securities	\$ (6)	\$ 13,117	\$ —	\$ —	\$ (6)	\$ 13,117
U.S. government sponsored entities and agency securities	(11)	21,979	(16)	26,019	(27)	47,998
Mortgage-backed securities: residential	(33)	4,005	(79)	10,123	(112)	14,128
Mortgage-backed securities: commercial	(11)	3,634	(63)	11,676	(74)	15,310
Corporate debt securities	(5)	10,020	(3)	10,047	(8)	20,067
Total unrealized losses	\$ (66)	\$ 52,755	\$ (161)	\$ 57,865	\$ (227)	\$ 110,620

In determining OTTI for debt securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Bank has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether the Bank intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If the Bank intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Bank does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income (loss), net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

As of December 31, 2020, the Bank's security portfolio consisted of 201 debt securities, 29 of which were in an unrealized loss position of \$195,000. Twenty-four of these securities with a market value of \$132,883,000 which had unrealized losses of \$153,000 at December 31, 2020, were issued by the U.S. government, U.S. government-sponsored entities and agencies, Fannie Mae and Freddie Mac, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because it is likely that the Bank 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, 2020.

The Bank's corporate debt securities portfolio includes four securities with a market value of \$10,555,000 which had unrealized losses of \$41,000 at December 31, 2020. The Bank monitors certain credit characteristics of each corporate issuer on a quarterly basis and these issuers appear to be able to service all outstanding debt. The Bank believes there is no OTTI and does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

The Bank's debt securities portfolio includes one asset-backed security with a market value of \$1,529,000 which had unrealized losses of \$1,000 at December 31, 2020. The Bank monitors certain credit characteristics of each asset-backed security issuer as necessary and these issuers appear to be able to service all outstanding debt. The Bank believes there is no OTTI and does not have the intent to sell this security and it is likely that it will not be required to sell the security before its anticipated recovery.

The Bank did not have any additional credit losses recognized in earnings for each of the years ending December 31, 2020, 2019 and 2018. The remaining amount of credit losses previously recognized into earnings for securities held at December 31, 2020 and 2019 was \$360,000 and \$465,000. The Bank recognized gains of \$49,000 and \$62,000 for the years ending December 31, 2020 and 2019 for payments received from securities which have been fully written down.

NOTE 3 – Loans and Allowances for Loan Losses

The composition of the Bank's loan portfolio is as follows (*dollars in thousands*):

	December 31,	
	2020	2019
Commercial and industrial	\$ 354,266	\$ 126,761
Commercial real estate	1,847,513	1,635,756
Construction and land development	24,427	9,718
Residential real estate	149,257	128,144
Consumer	11,465	14,217
Agricultural	42,183	33,886
	<u>2,429,111</u>	<u>1,948,482</u>
Less: Net deferred loan fees	(9,202)	(5,345)
Fair value adjustment on hedged loans	14,306	1,183
Allowance for loan losses	(54,255)	(41,533)
	<u>\$2,379,960</u>	<u>\$1,902,787</u>

The Bank grants commercial and industrial, commercial real estate, construction and land development, residential real estate, consumer and agricultural loans to customers principally located in northern, central and southern California, including the Bay Area. The Bank actively participated in the Paycheck Protection Program ("PPP"), under the provisions of the CARES Act during the second and third quarter of 2020. As of December 31, 2020, PPP loans had an outstanding balance of approximately \$235,612,000 and are included with commercial and industrial loans in the table above. The loans have two and five year terms and are fully guaranteed by the SBA and do not carry any allowance. The majority of the PPP loans outstanding as of December 31, 2020 are expected to be forgiven by the SBA in 2021.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A significant portion of its customers' ability to repay the loans is dependent upon the economic conditions in the Bank's market areas. Secured loans are generally collateralized by real estate, accounts receivable and personal property. Substantially the entire consumer portfolio segment is home equity loans. For purposes of disclosure below, the Bank has shown the carrying value of loans as the recorded investment, as the accrued interest receivable and net deferred loan fee positions are immaterial.

For the year ended December 31, 2020, activity in the allowance for loan losses by portfolio segment is as follows (*dollars in thousands*):

	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Agricultural	Unallocated	Total
Allowance for loan losses:								
Beginning balance	\$ 3,326	\$35,062	\$ 471	\$ 1,089	\$ 497	\$ 1,033	\$ 55	\$41,533
Provision (reversal of) for loan losses	487	6,527	2,424	254	(451)	715	2,444	12,400
Loans charged-off	—	—	—	—	—	—	—	—
Recoveries	—	—	—	—	322	—	—	322
Total ending allowance balance	\$ 3,813	\$41,589	\$ 2,895	\$ 1,343	\$ 368	\$ 1,748	\$ 2,499	\$54,255

For the year ended December 31, 2019, activity in the allowance for loan losses by portfolio segment is as follows (*dollars in thousands*):

	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Agricultural	Unallocated	Total
Allowance for loan losses:								
Beginning balance	\$ 2,865	\$27,370	\$ 262	\$ 1,023	\$ 702	\$ 866	\$ 2,009	\$35,097
Provision (reversal of) for loan losses	278	7,692	209	66	(458)	167	(1,954)	6,000
Loans charged-off	—	—	—	—	(1)	—	—	(1)
Recoveries	183	—	—	—	254	—	—	437
Total ending allowance balance	\$ 3,326	\$35,062	\$ 471	\$ 1,089	\$ 497	\$ 1,033	\$ 55	\$41,533

For the year ended December 31, 2018, activity in the allowance for loan losses by portfolio segment is as follows (*dollars in thousands*):

	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Agricultural	Unallocated	Total
Allowance for loan losses:								
Beginning balance	\$ 2,225	\$24,759	\$ —	\$ 1,006	\$ 901	\$ 1,538	\$ 1,108	\$31,537
Provision (reversal of) for loan losses	445	2,611	262	17	(814)	(672)	901	2,750
Loans charged off	—	—	—	—	—	—	—	—
Recoveries	195	—	—	—	615	—	—	810
Total ending allowance balance	\$ 2,865	\$27,370	\$ 262	\$ 1,023	\$ 702	\$ 866	\$ 2,009	\$35,097

The reserve for unfunded credit commitments of \$200,000 is included in "Other liabilities" on the Consolidated Balance Sheets as of December 31, 2020 and 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the balances in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2020 and 2019 (*dollars in thousands*):

As of December 31, 2020:

	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Agricultural	Unallocated	Total
Allowance for loan losses:								
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ending balance: collectively evaluated for impairment	3,813	41,589	2,895	1,343	368	1,748	2,499	54,255
Total ending balance	\$ 3,813	\$ 41,589	\$ 2,895	\$ 1,343	\$ 368	\$ 1,748	\$ 2,499	\$ 54,255
Loans:								
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ 25	\$ —	\$ —	\$ 25
Ending balance: collectively evaluated for impairment	354,266	1,847,513	24,427	149,257	11,440	42,183	—	2,429,086
Total ending balance	\$ 354,266	\$ 1,847,513	\$ 24,427	\$ 149,257	\$ 11,465	\$ 42,183	\$ —	\$ 2,429,111

As of December 31, 2019:

	Commercial and Industrial	Commercial Real Estate	Construction and Land Development	Residential Real Estate	Consumer	Agricultural	Unallocated	Total
Allowance for loan losses:								
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ending balance: collectively evaluated for impairment	3,326	35,062	471	1,089	497	1,033	55	41,533
Total ending balance	\$ 3,326	\$ 35,062	\$ 471	\$ 1,089	\$ 497	\$ 1,033	\$ 55	\$ 41,533
Loans:								
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ending balance: collectively evaluated for impairment	126,761	1,635,756	9,718	128,144	14,217	33,886	—	1,948,482
Total ending balance	\$ 126,761	\$ 1,635,756	\$ 9,718	\$ 128,144	\$ 14,217	\$ 33,886	\$ —	\$ 1,948,482

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2020 (*dollars in thousands*):

As of December 31, 2020:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no specific allowance recorded:					
Consumer	\$ 25	\$ 25	\$ —	\$ 26	\$ 1
With an allowance recorded:					
Consumer	\$ —	\$ —	\$ —	\$ —	\$ —
Total	\$ 25	\$ 25	\$ —	\$ 26	\$ 1

As of December 31, 2019, the Bank did not have loans which were individually evaluated for impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2018 (dollars in thousands):

As of December 31, 2018:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no specific allowance recorded:					
Commercial and industrial	\$ —	\$ —	\$ —	\$ —	\$ —
Consumer	42	42	—	45	2
With an allowance recorded:					
Commercial and industrial	\$ 1,200	\$ 1,200	\$ 600	\$ 532	\$ 25
Consumer	—	—	—	—	—
Total:					
Commercial and industrial	\$ 1,200	\$ 1,200	\$ 600	\$ 532	\$ 25
Consumer	42	42	—	45	2
Total	<u>\$ 1,242</u>	<u>\$ 1,242</u>	<u>\$ 600</u>	<u>\$ 577</u>	<u>\$ 27</u>

The following table presents the aging of the recorded investment in past due loans which are still accruing and nonaccrual loans as of December 31, 2020 and 2019 by class of loans (dollars in thousands):

As of December 31, 2020:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days	Total Past Due	Non-Accrual	Current	Total Loans
Commercial and industrial	\$ —	\$ 4	\$ —	\$ 4	\$ —	\$ 354,262	\$ 354,266
Commercial real estate	—	—	—	—	—	1,847,513	1,847,513
Construction and land development	—	—	—	—	—	24,427	24,427
Residential real estate	295	—	—	295	—	148,962	149,257
Consumer	34	30	—	64	25	11,376	11,465
Agricultural	—	—	—	—	—	42,183	42,183
Total	<u>\$ 329</u>	<u>\$ 34</u>	<u>\$ —</u>	<u>\$ 363</u>	<u>\$ 25</u>	<u>\$ 2,428,723</u>	<u>\$ 2,429,111</u>

As of December 31, 2019:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days	Total Past Due	Non-Accrual	Current	Total Loans
Commercial and industrial	\$ —	\$ 3	\$ —	\$ 3	\$ —	\$ 126,758	\$ 126,761
Commercial real estate	—	—	—	—	—	1,635,756	1,635,756
Construction and land development	—	—	—	—	—	9,718	9,718
Residential real estate	—	—	—	—	—	128,144	128,144
Consumer	163	8	—	171	—	14,046	14,217
Agricultural	—	—	—	—	—	33,886	33,886
Total	<u>\$ 163</u>	<u>\$ 11</u>	<u>\$ —</u>	<u>\$ 174</u>	<u>\$ —</u>	<u>\$ 1,948,308</u>	<u>\$ 1,948,482</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Credit Quality Indicators:

Non-classified loans are those with credit risk ratings of either Pass or Special Mention, while classified loans are those with a credit risk ratings of either Substandard, Doubtful or Impaired. The following table presents the credit risk rating categories by class of loans as of December 31, 2020 and 2019 (*dollars in thousands*):

As of December 31, 2020:

	Nonclassified	Classified	Total
Commercial and industrial	\$ 348,482	\$ 5,784	\$ 354,266
Commercial real estate	1,837,629	9,884	1,847,513
Construction and land development	9,320	15,107	24,427
Residential real estate	149,257	—	149,257
Consumer	11,440	25	11,465
Agricultural	35,367	6,816	42,183
Total	<u>\$2,391,495</u>	<u>\$ 37,616</u>	<u>\$2,429,111</u>

As of December 31, 2019:

	Nonclassified	Classified	Total
Commercial and industrial	\$ 125,751	\$ 1,010	\$ 126,761
Commercial real estate	1,635,756	—	1,635,756
Construction and land development	9,718	—	9,718
Residential real estate	128,144	—	128,144
Consumer	14,217	—	14,217
Agricultural	33,886	—	33,886
Total	<u>\$1,947,472</u>	<u>\$ 1,010</u>	<u>\$1,948,482</u>

Troubled Debt Restructurings:

The Bank had no troubled debt restructurings at any date or during any period presented.

The terms of certain other loans were modified during the years ending December 31, 2020 and 2019 that did not meet the definition of a troubled debt restructuring. These loans have a total recorded investment as of December 31, 2020 and 2019, of \$22,256,000 and \$23,735,000. The modification of these loans generally involved a modification of the terms of a loan to borrowers who were not experiencing financial difficulties, primarily in the form of rate changes or maturity date extensions.

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

NOTE 4 – Premises and Equipment

Premises and equipment consist of the following (*dollars in thousands*):

	December 31, 2020	2019
Land	\$ 2,858	\$ 2,858
Building and improvements	20,276	20,534
Equipment and furniture	5,752	5,049
	<u>28,886</u>	<u>28,441</u>
Less accumulated depreciation and amortization	<u>(15,758)</u>	<u>(14,950)</u>
	<u>\$ 13,128</u>	<u>\$ 13,491</u>

Depreciation and amortization expense amounted to \$1,180,000, \$983,000, and \$1,000,000 for the years ending December 31, 2020, 2019 and 2018, respectively. During the years ended December 31, 2020, 2019 and 2018, the Bank had losses on abandonment of premises and equipment of \$0, \$55,000, and \$1,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 – Time Deposits

As of December 31, 2020 and 2019, time deposits that meet or exceed the FDIC insurance limit of \$250,000 totaled \$62,426,000 and \$108,491,000, respectively.

At December 31, 2020, the aggregate scheduled maturities for time deposits are as follows (*dollars in thousands*):

Years Ending December 31,	
2021	\$ 48,357
2022	38,400
2023	508
2024	695
2025	875
Thereafter	59
	<u>\$ 88,894</u>

NOTE 6 – FHLB Advances

At December 31, 2020 and 2019, FHLB Advances were comprised of the following (*dollars in thousands*):

	December 31,	
	2020	2019
Overnight borrowing with a rate of 1.66% at December 31, 2019	\$ —	\$120,000
Maturities from May 2021 through October 2022, fixed rate at rates from 0.00% to 2.25%.		
Average rates of 1.38% and 1.90% at December 31, 2020 and 2019, respectively	13,000	28,000
	<u>\$ 13,000</u>	<u>\$148,000</u>

The Bank maintains a collateralized line of credit with the FHLB. Based on the FHLB stock requirements at December 31, 2020, this line provided for maximum borrowings of \$778,772,000 of which \$13,000,000 was outstanding in advances and \$250,000,000 was outstanding as a letter of credit. At December 31, 2019, this line provided for maximum borrowings of \$654,956,000 of which \$148,000,000 was outstanding in advances and \$324,500,000 was outstanding as a letter of credit. See Note 2 for a discussion of securities pledged as collateral and advances from FHLB. The Bank has also pledged certain loans of approximately \$1,115,815,000 and \$775,879,000 under a blanket lien arrangement to collateralize the line of credit with the FHLB as of December 31, 2020 and 2019.

FHLB advance maturities over the next five years are as follows (*dollars in thousands*):

2021	\$ 5,000
2022	8,000
2023	—
2024	—
2025	—
Thereafter	—
	<u>\$ 13,000</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 – Leases

The Bank enters into leases in the normal course of business primarily for branch offices, administrative facility, loan production offices and land. The Bank's leases have remaining terms ranging from three to twelve years, some of which have renewal or termination options to extend the lease between four and fifteen years. One lease includes an option to terminate the lease within two years. The Bank's leases do not include residual value guarantees or covenants. All of the Bank's leases are classified as operating leases.

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

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the Bank's right to use an underlying asset for the lease term and lease liabilities represent the Bank's 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 the 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 advance rate, adjusted for the lease term and other factors. As of December 31, 2020 and 2019, the Bank's weighted average incremental borrowing rates (discount rate) were 1.84% and 2.64% for the existing operating leases, respectively.

As of December 31, 2020, the right-of-use assets for the Bank's leases were \$3,624,000 and included in Other Assets and the lease liabilities were \$3,859,000 and included in Other Liabilities on the Bank's Consolidated Balance Sheets. As of December 31, 2019, the right-of-use assets for the Bank's leases were \$4,156,000 and the lease liabilities were \$4,409,000.

Rental expense charged to operations for all operating leases was \$1,207,000, \$1,547,000, and \$1,427,000, for the years ended December 31, 2020, 2019 and 2018, respectively.

Future undiscounted lease payments for operating leases with initial terms of one year or more as of December 31, 2020 are as follows (*dollars in thousands*):

Years Ending December 31,	
2021	\$ 1,078
2022	1,100
2023	536
2024	332
2025	242
Thereafter	752
Total undiscounted lease payments	<u>\$ 4,040</u>
Less: imputed interest	(181)
Net lease liabilities	<u>\$ 3,859</u>

As of December 31, 2020 and 2019, the weighted average remaining lease term for the Bank's operating leases was 5.7 years and 6.0 years, respectively.

Additionally, the Bank is the lessor on certain properties adjacent to branch offices and an administrative facility. These non-cancelable lease agreements have been accounted for as operating leases and the rental income is recognized as non-operating income in the Consolidated Statements of Operations. Rental income recognized for all operating leases was \$1,229,000, \$1,384,000, and \$1,467,000, for the years ended December 31, 2020, 2019 and 2018, respectively.

Future minimum rentals to be made by the tenants by year under long-term, non-cancelable operating leases are as follows (*dollars in thousands*):

Years Ending December 31,	
2021	\$ 1,109
2022	706
2023	38
2024	—
2025	—
Thereafter	—
	<u>\$ 1,853</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 – Income Taxes

Following is a summary of the provision for income tax expense (*dollars in thousands*):

	Years Ended December 31,		
	2020	2019	2018
Current tax expense			
Federal	\$ 10,775	\$ 7,460	\$ 7,464
State	6,057	4,365	4,118
	<u>16,832</u>	<u>11,825</u>	<u>11,582</u>
Deferred tax (benefit) expense			
Federal	(2,594)	(1,103)	(1,098)
State	(1,272)	(734)	(547)
	<u>(3,866)</u>	<u>(1,837)</u>	<u>(1,645)</u>
	<u>\$ 12,966</u>	<u>\$ 9,988</u>	<u>\$ 9,937</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below (*dollars in thousands*):

	Years Ended December 31,	
	2020	2019
Deferred tax assets		
Allowance for loan losses	\$ 17,338	\$ 13,288
Lease liability	1,229	1,542
Supplemental retirement plan expense	1,417	1,192
Other-than-temporary impairment	115	148
Accrued bonuses	594	517
Other deferred taxable expenses	461	491
	<u>21,154</u>	<u>17,178</u>
Deferred tax liabilities		
Deferred loan costs, net	(706)	(573)
Depreciation	(898)	(911)
Federal Home Loan Bank stock dividends	(325)	(325)
Investment in equity method investments	(134)	(46)
Capitalization of prepaid assets	(86)	(34)
State taxes	(30)	(104)
Unrealized gains on available-for-sale investment securities, net	(1,598)	(901)
Net changes in fair value of derivatives	(125)	(32)
Right-of-use asset	(1,154)	(1,323)
	<u>(5,056)</u>	<u>(4,249)</u>
Net deferred tax assets	<u>\$ 16,098</u>	<u>\$ 12,929</u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, and the implementation of various tax planning strategies, if necessary, management believes it is more likely than not the Bank will realize the benefits of these deductible differences as of December 31, 2020 and 2019 and, accordingly, no valuation allowance has been provided.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reconciles the statutory income tax rate to the consolidated effective income tax rate:

	Years Ended December 31,		
	2020	2019	2018
Federal income tax rate	21.0%	21.0%	21.0%
State franchise tax rate, net of federal income tax effect	8.5	8.1	8.3
Effect in tax rate resulting from:			
Tax exempt income	(0.2)	(0.2)	(0.1)
Low income housing tax credits	(0.1)	(0.1)	(0.1)
Bank owned life insurance	(0.1)	(0.1)	(0.1)
Restricted stock benefit	—	(0.3)	(0.3)
Other items, net	—	(0.1)	0.6
	29.1%	28.3%	29.3%

The Bank and its subsidiaries are 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 federal taxing authorities for years before 2017 and by state taxing authorities for years before 2016. During 2019, the State of California Franchise Tax Board completed its examination for tax years ended December 31, 2011, 2012 and 2013. The Bank does not believe that there are other tax jurisdictions in which the outcome of unresolved issues or claims is likely to be material to the Bank's financial position, cash flows or results of operations. The Bank further believes that adequate provisions have been made for all income tax uncertainties.

The amount of the accrued income tax liability for uncertainties related to tax benefits was not material to the consolidated financial statements as of December 31, 2020 and 2019. The Bank does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. Additionally, the total amount of interest and penalties recorded in the Consolidated Statements of Operations for the years ended December 31, 2020, 2019 and 2018 was also not material.

NOTE 9 – Fair Values Measurements

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

Level 1: Quoted 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 reporting entity'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:

Investment Securities, Available for Sale

The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, included certain collateralized mortgage and debt obligations, agency preferred stock and certain high-yield debt securities. 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). The fair values of level 3 investment securities are determined by the Bank's Accounting department, which reports to the Chief Financial Officer. Assumptions such as cash flows, loss severities, volatility, credit spread and optionality are reviewed as necessary. During times when trading is more liquid, broker quotes are used (if available) to validate the model. The Bank's evaluations are based on market data and the Bank employs combinations of these approaches for its valuation methods depending on the asset class.

Impaired Loans

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals or broker opinions of value, collectively referred to as appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. Subsequent to a loan being deemed impaired, the Bank will generally evaluate using internally developed desktop valuations, using similar approaches as the initial appraisal.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Appraisals for collateral-dependent impaired loans are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bank. Once received, a member of the Credit Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Bank management may make additional adjustments to the fair value of the properties through desktop valuations.

Derivatives

The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2). The derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using qualitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below (*dollars in thousands*):

Fair Value Measurements at December 31, 2020	Carrying Value	Level 1	Level 2	Level 3
Assets:				
Investment securities, available-for-sale				
U.S. Treasury securities	\$215,053	\$ —	\$215,053	\$ —
U.S. government sponsored entities and agency securities	205,079	—	205,079	—
Municipal securities	5,439	—	5,439	—
Mortgage-backed securities – residential	87,933	—	87,933	—
Mortgage-backed securities – commercial	12,460	—	12,460	—
Collateralized mortgage obligations	32,207	—	32,207	—
Corporate debt securities	91,499	—	91,499	—
Asset-based securities	19,703	—	19,703	—
Total investment securities, available-for-sale	<u>\$669,373</u>	<u>\$ —</u>	<u>\$669,373</u>	<u>\$ —</u>
Liabilities: Derivatives	<u>\$ (13,905)</u>	<u>\$ —</u>	<u>\$ (13,905)</u>	<u>\$ —</u>
Fair Value Measurements at December 31, 2019	Carrying Value	Level 1	Level 2	Level 3
Assets:				
Investment securities, available-for-sale				
U.S. Treasury securities	\$ 43,378	\$ —	\$ 43,378	\$ —
U.S. government sponsored entities and agency securities	372,689	—	372,689	—
Municipal securities	5,385	—	5,385	—
Mortgage-backed securities – residential	24,777	—	24,777	—
Mortgage-backed securities – commercial	15,310	—	15,310	—
Collateralized mortgage obligations	1,432	—	1,432	—
Corporate debt securities	40,339	—	40,339	—
Total investment securities, available-for-sale	<u>\$503,310</u>	<u>\$ —</u>	<u>\$503,310</u>	<u>\$ —</u>
Liabilities: Derivatives	<u>\$ (1,079)</u>	<u>\$ —</u>	<u>\$ (1,079)</u>	<u>\$ —</u>

There were no transfers between Level 1 and Level 2 during 2020 and 2019.

Assets Measured at Fair Value on a Non-Recurring Basis

There were no assets measured at fair value on a non-recurring basis as of December 31, 2020 or December 31, 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments not carried at fair value, at December 31, 2020 and December 31, 2019 are as follows (*dollars in thousands*):

Fair Value Measurements at December 31, 2020 Using:					
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 193,015	\$ 193,015	\$ —	\$ —	\$ 193,015
Investment securities, held to maturity	1,700	—	1,732	—	1,732
Loans, net	2,379,960	—	—	2,390,035	2,390,035
Accrued interest receivable	10,188	—	2,231	7,957	10,188
Financial liabilities					
Noninterest-bearing demand deposits, money market accounts, NOW accounts and savings accounts	\$2,921,566	\$ —	\$2,921,566	\$ —	\$2,921,566
Time deposits	88,894	—	89,974	—	89,974
FHLB advances	13,000	—	13,268	—	13,268
Accrued interest payable	307	—	307	—	307
Fair Value Measurements at December 31, 2019 Using:					
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 47,514	\$ 47,514	\$ —	\$ —	\$ 47,514
Interest-bearing deposits in other financial institutions	20,763	20,763	—	—	20,763
Investment securities, held to maturity	1,700	—	1,710	—	1,710
Loans, net	1,902,787	—	—	1,823,385	1,823,385
Accrued interest receivable	8,566	72	2,522	5,972	8,566
Financial liabilities					
Noninterest-bearing demand deposits, money market accounts, NOW accounts and savings accounts	\$2,007,940	\$ —	\$2,007,940	\$ —	\$2,007,940
Time deposits	136,576	—	137,182	—	137,182
FHLB advances	148,000	—	148,047	—	148,047
Accrued interest payable	372	—	372	—	372

NOTE 10 – Commitments and Contingencies

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Bank enters into certain transactions, which involve financial instruments with off-balance-sheet risk. These instruments include commitments to extend credit and standby letters of credit and are not reflected in the accompanying consolidated balance sheets. These transactions may involve, to varying degrees, credit and interest rate risk in excess of the amount, if any, recognized in the consolidated balance sheets. The Bank's off-balance-sheet credit risk exposure is the contractual amount of commitments to extend credit and standby letters of credit. At December 31, 2020, commitments to extend credit totaled \$314,660,000 and standby letters of credit totaled \$16,076,000. At December 31, 2019, commitments to extend credit totaled \$277,104,000 and standby letters of credit totaled \$11,611,000. The Bank applies the same credit standards to these contracts as it uses in its lending process. The fair values associated with commitments to extend credit and standby letters of credit were not material at December 31, 2020 and 2019.

Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates, but may be terminated by the Bank if certain conditions of the contract are violated. Although currently subject to drawdown, many of these commitments are expected to expire or terminate without funding. Therefore, the total commitment amounts do not necessarily represent future cash requirements. Collateral held relating to these commitments varies. For secured loans, it generally includes real estate, accounts receivable and personal property.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Bank upon default of performance. Collateral held for standby letters of credit is based on an individual evaluation of each customer's credit worthiness, but may include real estate and cash.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Litigation

Loss contingencies, including claims and legal actions arising in the ordinary course of business are recorded as liabilities when the likelihood of a loss is probable and an amount or range of loss can be reasonably estimated. The Bank is a defendant in legal actions arising in the ordinary course of business which, in the opinion of management, after consulting with legal counsel, are either adequately covered by insurance, should they result in any adverse judgments, or will not materially affect the consolidated financial position or results of operations of the Bank.

NOTE 11 – Regulatory Matters

Cash Reserve Requirements

The Bank is required to maintain cash on hand or certain minimum average balances of noninterest-bearing deposits primarily with the Federal Reserve Bank. As of December 31, 2020 and 2019, such required balances amounted to \$0 and \$22,631,000, respectively. The Board of Governors of the Federal Reserve System reduced reserve requirement ratios to zero percent effective March 26, 2020. This action eliminated reserve requirements for all depository institutions.

Dividend Limitations

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to shareholders. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described below. As of December 31, 2020, \$76,034,000 of retained earnings is available to pay dividends, outside of other capital constraints.

Capital Guidelines

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Accumulated other comprehensive income (loss) is not included in computing regulatory capital. Management believes as of December 31, 2020 and 2019, the Bank met all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. 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 December 31, 2020 and 2019, 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.

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (CBLR framework), for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank during 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rules the community bank leverage ratio minimum requirement is 8% as of December 31, 2020, 8.5% for calendar year 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the Bank maintains a leverage ratio of 7% as of December 31, 2020, 7.5% for calendar year 2021, and 8% for calendar year 2022 and beyond.

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2020, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

The Bank has a formal dividend policy, and dividends are issued solely at the discretion of the Bank's Board of Directors subject to compliance with regulatory requirements. There are certain regulatory limitations on the payment of cash dividends by banks as discussed above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Presented below are the Bank's actual and required capital amounts and ratios as of December 31, 2020 and 2019 (*dollars in thousands*).

As of December 31, 2020	Actual		Required to Be Well Capitalized under Prompt Corrective Action Regulations (CBLR Framework)			
	Amount	Ratio	Amount		Ratio	
Tier 1 Capital (to average assets)	\$265,750	8.1%	\$261,864		8.0%	

As of December 31, 2019	Actual		Required for Capital Adequacy Purposes		Required to Be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk-weighted assets)	\$261,246	12.3%	\$169,751	8.0%	\$212,188	10.0%
Tier 1 Capital (to risk-weighted assets)	\$234,535	11.1%	\$127,313	6.0%	\$169,751	8.0%
Common Tier 1 (CET1)	\$234,535	11.1%	\$ 95,485	4.5%	\$137,922	6.5%
Tier 1 Capital (to average assets)	\$234,535	9.5%	\$ 99,189	4.0%	\$123,986	5.0%

NOTE 12 – Benefit Plans

Tax Deferred Investment Plan

The Bank participates in a trustee tax deferred investment plan (the Plan). The Plan permits each eligible employee to contribute up to 100% of compensation on a pre-tax basis, to a maximum amount allowed by law per year. The Bank provides a matching contribution in the amount equal to 50% of the participant's salary deferrals, up to 10% of the participant's compensation. The Bank's Plan expense was \$427,000, \$370,000, and \$310,000, for the years ended December 31, 2020, 2019 and 2018, respectively.

Supplemental Retirement Plan

The Bank has a Supplemental Retirement Plan that is a non-qualified salary continuation plan for certain senior officers of the Bank. Under the plan, the Bank has agreed to pay these officers retirement benefits for a fifteen year period after their retirement so long as they meet certain length of service vesting requirements. A liability is accrued for the obligation under this plan and it is unsecured and unfunded. Supplemental Retirement Plan expense totaled \$708,000, \$533,000, and \$178,000 for the years ended December 31, 2020, 2019 and 2018, respectively, resulting in a liability of \$4,452,000 and \$3,744,000 as of year-end 2020 and 2019. The discount rates used to value the plan liability at December 31, 2020 and 2019 were 2.95% and 3.75%, respectively. At December 31, 2020 and 2019, the plan had five participants. The Bank has purchased insurance on the lives of some of the participants as a cost recovery of the Bank's retirement obligations. The Bank records a liability for the post-employment benefit obligations under its split dollar life insurance arrangements. The accrued obligation was \$369,000 and \$350,000 as of December 31, 2020 and 2019, respectively.

NOTE 13 – Stock Based Compensation

Stock Option Plan

The Bank has a Non-Qualified Stock Option Plan (the Option Plan), whereby officers or directors of the Bank may be awarded stock options. There were 200,000 shares authorized for grant under the Option Plan. As of December 31, 2020 and 2019, there remained 200,000 shares available for grant. Option awards are granted with an exercise price equal to the market price of the Bank's common stock at the date of grant and have contractual terms which ranged from five to ten years. The fair value of each option award is estimated on the date of grant using a Black-Scholes model. There were no options granted during the years ended December 31, 2020, 2019 and 2018, as the Option Plan is currently dormant.

Restricted Stock Plan

During 2009, the Bank implemented the River City Bank Restricted Stock Plan ("RSP") to provide for the issuance of Bank shares to selected key employees and directors. The stock to be awarded under the RSP shall consist of shares of the Bank's common stock and may be authorized but unissued shares or reacquired shares, or both. Owners of the stock awards shall have all of the rights of a shareholder including the right to vote the shares and to all dividends, cash or stock. Compensation expense will be recognized over the vesting period of the awards based on the fair value of the stock at issue date. Fair value of the stock at issue date is determined the most recent trading information. RSP shares vest in 20% increments on each anniversary date and fully vest on the fifth anniversary of the grant date. Certain employees and directors' RSP awards vest over a shorter period of time due to their retirement date. An aggregate of 200,000 shares of the Bank's common stock has been authorized and available for awards under the plan as of December 31, 2020. Total shares issuable under the plan and authorized for awards are 102,151 and 13,356 at December 31, 2020 and 2019, respectively. During the years ended December 31, 2020 and 2019, 11,662 and 8,950 shares were granted, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of changes in the Bank's non-vested shares for the year follows:

Non-vested Shares	Shares	Weighted Average Grant Date Fair Value
Non-vested at January 1, 2020	22,808	\$170.14
Granted	11,662	\$173.58
Vested	(10,139)	\$162.45
Forfeited	(457)	\$195.92
Non-vested at December 31, 2020	23,874	\$174.59

Total stock compensation cost related to the RSP recorded in the Consolidated Statements of Operations for 2020, 2019 and 2018 was \$1,597,000, \$1,647,000, and \$1,532,000, respectively. As of December 31, 2020 and 2019, there was \$3,187,000 and \$2,995,000, respectively, of total unrecognized compensation cost related to non-vested shares granted under the Plan. As of December 31, 2020, the total unrecognized compensation cost is expected to be recognized over a weighted-average period of 3.4 years. The total fair value of shares vested during the years ended December 31, 2020, 2019 and 2018 was \$1,431,000, \$2,125,000, and \$1,348,000.

NOTE 14 – Related Party Transactions

The Bank, in the ordinary course of business, has had loan and deposit transactions with certain directors, officers, principal shareholders and their related entities. At December 31, 2020 and 2019, there were \$538,000 and \$549,000 in loans outstanding to directors, officers and their related entities. Additionally, the Bank had additional undisbursed commitments to lend \$550,000 and \$375,000 at December 31, 2020 and 2019, to directors, officers and their related entities. Deposits from certain directors, senior officers, principal shareholders and their related entities were \$37,148,000 and \$21,019,000 as of December 31, 2020 and 2019, respectively.

As of December 31, 2020 and 2019, the Bank had an equity investment in a local wealth management firm. One of the partners in the wealth management firm is a member of the Bank's Board of Directors. This investment is included in Other Assets on the Bank's Consolidated Balance Sheets. See Note 7 for discussion about subsequent event related to this equity investment.

NOTE 15 – Derivatives

The Bank utilizes interest rate swap and interest rate cap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the derivative agreements does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap and interest rate cap agreements.

Interest Rate Swaps Designated as Fair Value Hedges – Interest rate swap agreements were commenced in order to economically hedge interest rate risk related to the loan portfolio. For each existing interest rate swap agreement, the Bank will pay a fixed rate and receive a variable rate of one month LIBOR. At December 31, 2020 and 2019, summary information of the interest rate swaps is as follows (*dollars in thousands*):

	2020	2019
Notional amount:	\$ 230,000	\$ 205,000
Weighted average pay rates:	1.613%	1.811%
Weighted average receive rates:	0.149%	1.754%
Weighted average maturity:	5.4 years	5.5 years
Fair value of interest rate swap:	\$ (14,573)	\$ (1,083)

The fair values of the interest rate swaps at December 31, 2020 and 2019 is reflected in other liabilities. As of December 31, 2020 and 2019, the fair value adjustment of the hedged item was \$14,306,000 and \$1,183,000, respectively, reflected in net loans. As of December 31, 2020 and 2019, the amortized cost basis of the closed portfolios used in these hedging relationships was \$401,342,000 and \$367,867,000. As of December 31, 2020 and 2019, the amount that represents the hedged items or the designated last of layer, was \$357,535,000 and \$329,672,000. The hedges were determined to be effective during all the periods presented. The Bank expects the hedges to remain effective during the remaining terms of the swaps.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reflects the fair value hedges included in the Consolidated Statement of Operations as of December 31, 2020 and 2019 (*dollars in thousands*):

Interest rate contracts	Location	2020	2019	2018
Change in fair value on interest rate swaps	Net interest income	\$ (13,490)	\$ 1,792	\$ (600)
Change in fair value of pool of loans – hedged items	Net interest income	\$ 13,123	\$ (1,836)	\$ 609

Interest Rate Swaps Not Designated As Hedges – During 2020, the Bank also entered into interest rate swap agreements that were commenced in order to economically hedge interest rate risk related to the loan portfolio, but they do not qualify as hedges for accounting purposes. Therefore, changes in fair value are reported in current year earnings. For these interest rate swap agreements, the Bank will pay a fixed rate and receive a variable rate of one month LIBOR. At December 31, 2020, summary information of the interest rate swaps is as follows (*dollars in thousands*):

	2020
Notional amount:	\$ 100,000
Weighted average pay rates:	0.661%
Weighted average receive rates:	0.149%
Weighted average maturity:	9.2 years
Fair value of interest rate swaps:	\$ 659

The fair value of the interest rate swaps not designated as hedges at December 31, 2020 is reflected in other liabilities and the corresponding change to income recorded in non-interest income.

Interest Rate Caps Not Designated As Hedges – During 2018 and 2017, the Bank entered into interest rate caps. The interest rate caps were initially designated as a cash flow hedge of certain Federal Home Loan Bank advances and were determined to be fully effective during those years. As such, no amount of ineffectiveness has been included in net income for those periods. Therefore, the fair value of the caps was recorded in other assets with changes in fair value recorded in other comprehensive income (loss).

During 2019, the Bank discontinued the hedging relationship as it paid down the associated FHLB advances. At the time of each of these hedging relationship de-designations, the Bank reclassified the amounts which had previously been recorded in other comprehensive income (loss) to earnings. Subsequent to the de-designation, the changes in value of the caps was recorded in the Bank's Statement of Operations in Noninterest Income.

During 2020, two interest rates caps with a notional amount of \$170,000,000 matured and the Bank purchased one interest rate cap with a notional amount of \$70,000,000.

At December 31, 2020 and 2019, summary information of the interest rate caps is as follows (*dollars in thousands*):

	2020	2019
Notional amount:	\$ 70,000	\$ 170,000
Weighted average original maturity:	4 years	2.8 years
Weighted average remaining maturity:	3.1 years	0.6 years
Index:	One month LIBOR	One month LIBOR
Cap rates:	3.13%	2.000%–3.000%
Fair value of interest rate caps:	\$ 9	\$ 4
Unrealized Loss:	\$ (44)	\$ —

The Bank recognized \$14,000, \$239,000 and \$198,000 of cap premium amortization on these cash flow hedges in the consolidated statements of operations for the year ended December 31, 2020, 2019, and 2018. The Bank recognized a loss on de-designation of these swaps in the amount of \$269,000 in the consolidated statements of operations for the year ended December 31, 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 – Earnings per Common Share (EPS)

The following reconciles the numerator and denominator used in the calculation of both the basic and diluted earnings per common share (*dollars in thousands except for per share amounts*):

	Years Ended December 31,		
	2020	2019	2018
Basic EPS Calculation			
Net income available to common shareholders	\$ 31,627	\$ 25,312	\$ 24,005
Weighted average common stock outstanding	1,442,895	1,436,405	1,426,895
Add: Participating securities	22,567	24,469	28,021
Weighted average shares outstanding for basic EPS	1,465,462	1,460,874	1,454,916
Basic EPS	<u>\$ 21.58</u>	<u>\$ 17.33</u>	<u>\$ 16.50</u>
Diluted EPS Calculation			
Net income available to common shareholders plus assumed conversions	\$ 31,627	\$ 25,312	\$ 24,005
Weighted average shares outstanding for diluted EPS	1,465,462	1,460,874	1,454,916
Diluted EPS	<u>\$ 21.58</u>	<u>\$ 17.33</u>	<u>\$ 16.50</u>

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2485 Natomas Park Drive, Sacramento, CA 95833 | 916.567.2600 | rivercitybank.com



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