



**CONSOLIDATED
FINANCIAL STATEMENTS**

**AS OF DECEMBER 31, 2021 AND 2020
AND FOR THE YEARS ENDED
DECEMBER 31, 2021 AND 2020
AND
INDEPENDENT AUDITOR'S REPORT**

Item 8. Financial Statements

**AVIDBANK HOLDINGS, INC.
INDEX TO AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
FOR THE YEAR ENDED DECEMBER 31, 2021**

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INDEPENDENT AUDITOR'S REPORT

Shareholders and Board of Directors
Avidbank Holdings, Inc. and Subsidiary
San Jose, California

Report on the Audit of the Financial Statements***Opinion***

We have audited the consolidated financial statements of Avidbank Holdings, Inc. and Subsidiary, which comprise the consolidated statements of financial condition as of December 31, 2021 and 2020, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Avidbank Holdings, Inc. and Subsidiary as of December 31, 2021 and 2020, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, Avidbank Holdings, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2021, based on criteria established in the Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 15, 2022 expressed an unmodified opinion.

Basis for Opinion

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

Responsibilities of Management for the Financial Statements

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

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

(Continued)

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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


Crowe LLP

Sacramento, California
March 15, 2022

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

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

	2021	2020
ASSETS		
Cash and due from banks	\$ 29,616	\$ 14,327
Due from Federal Reserve Bank	463,727	215,706
Total cash and cash equivalents	493,343	230,033
Available-for-sale investment securities	380,170	163,631
Loans, less allowance for loan losses of \$13,054 in 2021 and \$12,558 in 2020	1,210,290	980,925
Federal Home Loan Bank stock, at cost	5,133	3,777
Property and equipment, net	4,565	5,565
Cash surrender value of Bank-owned life insurance policies	31,875	11,425
Accrued interest receivable and other assets	37,102	35,270
Total assets	\$ 2,162,478	\$ 1,430,626
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	\$ 993,156	\$ 665,095
Interest bearing	986,254	588,659
Total deposits	1,979,410	1,253,754
Subordinated debt securities, net	21,703	21,565
Accrued interest payable and other liabilities	24,265	27,383
Total liabilities	2,025,378	1,302,702
Commitments and contingent liabilities (Note 10)		
Shareholders' equity:		
Preferred stock - no par value; \$1,000 liquidation preference; 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2021 and 2020	-	-
Common stock - no par value; 10,000,000 shares authorized; 6,256,682 and 6,168,313 shares issued and outstanding at December 31, 2021 and 2020, respectively	72,799	70,720
Retained earnings	68,801	56,537
Accumulated other comprehensive (loss) income, net of taxes	(4,500)	667
Total shareholders' equity	137,100	127,924
Total liabilities and shareholders' equity	\$ 2,162,478	\$ 1,430,626

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

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

	2021	2020
Interest income:		
Interest and fees on loans	\$ 50,823	\$ 49,517
Interest on taxable investment securities	3,606	901
Interest on Federal funds sold	456	482
Total interest income	54,885	50,900
Interest expense:		
Interest on deposits	2,618	4,712
Interest on borrowings	1,238	1,243
Total interest expense	3,856	5,955
Net interest income	51,029	44,945
Provision for loan losses	3,572	1,702
Net interest income after provision for loan losses	47,457	43,243
Non-interest income:		
Service charges, fees and other income	2,366	2,169
Federal Home Loan Bank dividends	272	193
Appreciation in cash surrender value of insurance contracts	451	269
Gain on sale of investment securities	735	–
Other income	1,489	–
Total non-interest income	5,313	2,631
Non-interest expenses:		
Salaries and employee benefits	25,256	23,233
Occupancy and equipment	4,078	4,123
Other	6,282	5,811
Total other expenses	35,616	33,167
Income before provision for income taxes	17,154	12,707
Provision for income taxes	4,890	3,080
Net income	\$ 12,264	\$ 9,627
Basic earnings per common share	\$ 2.08	\$ 1.64
Diluted earnings per common share	\$ 2.02	\$ 1.61

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2021 and 2020
(in thousands)

	2021	2020
Net Income	\$ 12,264	\$ 9,627
Other Comprehensive Income:		
Unrealized gains (losses) on securities:		
Unrealized holdings gains (losses)	(6,771)	776
Reclassification adjustment for (gains) included in net income	(735)	—
Other comprehensive income, before tax	(7,506)	776
Tax effect	2,339	(217)
Other comprehensive income	(5,167)	559
Total Comprehensive Income	\$ 7,097	\$ 10,186

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2021 and 2020
(dollars in thousands)

	Common Stock		Retained	Accumulated	Total
	Shares	Amount	Earnings	Other	Shareholders'
				Comprehensive	Equity
				Income (Loss)	
Balance, January 1, 2020	<u>6,087,160</u>	<u>\$ 69,377</u>	<u>\$ 46,910</u>	<u>\$ 108</u>	<u>\$ 116,395</u>
Net income			9,627		9,627
Other comprehensive income				559	559
Repurchase of common stock	(25,347)	(447)			(447)
Restricted stock issued, net of forfeitures and shares withheld to cover taxes	106,500	(496)			(496)
Stock based compensation		2,286			2,286
Balance, December 31, 2020	<u>6,168,313</u>	<u>\$ 70,720</u>	<u>\$ 56,537</u>	<u>\$ 667</u>	<u>\$ 127,924</u>
Net income			12,264		12,264
Other comprehensive (loss)				(5,167)	(5,167)
Repurchase of common stock					-
Restricted stock issued, net of forfeitures and shares withheld to cover taxes	88,369	(199)			(199)
Stock based compensation		2,278			2,278
Balance, December 31, 2021	<u>6,256,682</u>	<u>\$ 72,799</u>	<u>\$ 68,801</u>	<u>\$ (4,500)</u>	<u>\$ 137,100</u>

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

AVIDBANK HOLDINGS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2021 and 2020
(in thousands)

	2021	2020
Cash flows from operating activities:		
Net income	\$ 12,264	\$ 9,627
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) on sale of investment securities	(735)	–
Provision for loan losses	3,572	1,702
Depreciation, amortization and accretion	1,722	1,558
Amortization of debt issuance costs	138	(5)
Increase (decrease) in deferred loan origination fees, net	1,022	403
Earnings on bank-owned life insurance policies	(451)	(269)
Repayment of operating lease liabilities	3,432	2,695
Share based compensation expense	2,278	2,286
Change in deferred income taxes	1,094	1,070
Loss on disposal of fixed assets	113	1
Net increase in accrued interest receivable and other assets	(4,017)	(1,464)
Net increase in accrued interest payable and other liabilities	(3,120)	(1,877)
Net cash provided by operating activities	<u>17,312</u>	<u>15,727</u>
Cash flows used in investing activities:		
Purchase of available-for-sale investment securities	(275,660)	(128,698)
Proceeds from sales/paydowns/maturities of available-for-sale investment securities	51,361	17,210
(Purchase) of Federal Home Loan Bank stock	(1,356)	(269)
Net increase in loans	(233,959)	(105,517)
Purchase of Bank-owned life insurance	(19,999)	–
Purchase of premises and equipment	(78)	(939)
Disposal of fixed assets	232	3
Net cash used in investing activities	<u>(479,459)</u>	<u>(218,210)</u>
Cash flows from financing activities:		
Net increase in deposits	725,656	280,611
Repurchase of common stock	–	(447)
Restricted stock issued, net	(199)	(496)
Net cash provided by financing activities	<u>725,457</u>	<u>279,668</u>
Increase in cash and cash equivalents	263,310	77,185
Cash and cash equivalents at beginning of period	230,033	152,848
Cash and cash equivalents at end of year	<u>\$ 493,343</u>	<u>\$ 230,033</u>
Supplemental cash flow information:		
Interest paid	\$ 3,705	\$ 6,460
Income taxes paid	\$ 6,640	\$ 3,506
Supplemental noncash disclosures:		
Lease liabilities arising from obtaining right-of-use assets	\$ –	\$ 8,811

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Avidbank Holdings, Inc. (the "Company") was incorporated on December 17, 2007 and subsequently obtained approval from the Board of Governors of the Federal Reserve System to operate as a bank holding company. On April 2, 2008, Avidbank (the "Bank") consummated a merger with the Company effected through the exchange of one share of the Company's stock for each share of the Bank's stock. The reorganization represented an exchange of shares between entities under common control, and, as a result, assets and liabilities of the Bank were recognized at their carrying amounts in the accounts of the Company. Subsequent to the reorganization, the Bank continued its operations as previously conducted, but as a wholly-owned subsidiary of the Company.

The Bank is a California state-chartered institution, headquartered in San Jose, California, and provides financial products and services to customers who are predominately small and middle-market businesses, professionals and individuals residing in Santa Clara, San Mateo and San Francisco Counties.

We have considered all events occurring from December 31, 2021 through March 16, 2022, the date the consolidated financial statements were available for issuance.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, the Bank. All significant intercompany balances and transactions have been eliminated. The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Risks and Uncertainties

In the normal course of business, the Company 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 Company 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 and the valuation of deferred tax assets.

The Company is subject to the regulations of various governmental agencies. These regulations can change from period to period. Such regulations can also restrict the Company's ability to sustain continued growth as a result of capital and other requirements. The Company 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 Company, 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, the effectiveness of vaccination efforts and how quickly and to what extent normal economic and operating conditions can resume. During 2020, short-term payment relief was provided to certain borrowers impacted by the pandemic, however as of December 31, 2021, all such borrowers have resumed making regular payments. No COVID-19 accommodations were made for borrowers in 2021. That said, Management does not yet know the full extent of the impact of the pandemic as circumstances can quickly change and could become more severe. The effects of the COVID-19 pandemic 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 Company's investments, loans, or deferred tax assets.

Use of Estimates

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

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

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and due from banks and Due from Federal Reserve Bank. Generally, Due from Federal Reserve Bank funds are sold for one day periods. On the statement of cash flows, net cash flows are reported for customer loan and deposit transactions.

Investment Securities

Investment securities are classified into the following categories:

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

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. At December 31, 2021 and 2020, all of the Company's securities were classified as available-for-sale and there were no transfers between categories during those years.

Gains and losses on the sale of securities are computed using the specific identification method on the trade date. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums which are accounted for on the level-yield method without anticipation of prepayment except for mortgage backed securities where prepayments are anticipated. In addition, unrealized losses, if any, that are determined by management to be other than temporary are recognized in earnings in accordance with the methodology described below.

An investment security is impaired when its carrying value is greater than its fair value. Impaired investment securities are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate the decline is permanent, but indicates the prospects for a near-term recovery of value are not necessarily favorable, or there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not the Company will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not the Company will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings.

Investment in Federal Home Loan Bank Stock

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans are stated at principal balances outstanding net of deferred loan fees and costs, and an allowance for loan losses. Interest is accrued daily based upon outstanding loan balances. However, when a loan is past due 90 days or in the opinion of management, loans are considered to be impaired and the future collectability of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received on loans on nonaccrual status are applied to reduce principal to the extent necessary to ensure collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectability of principal is not in doubt, are applied first to earned but unpaid interest and then to principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Substantially all loan origination fees, commitment fees, direct loan origination costs and purchase premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (including both principal and interest) in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, the structure and nature of collateral, if any, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and the payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The amount of impairment, if any, on an impaired loan is measured based on the present value of expected future cash flows discounted at the loan's effective rate, except that as a practical expedient, impairment may be measured based upon the loan's observable market price or the fair value of collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

Allowance for Loan Losses

The allowance for loan losses (the "allowance") is a valuation allowance for probable incurred credit losses. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged-off amounts is recorded as a recovery to the allowance.

The overall allowance consists of two primary components: specific reserves related to impaired loans which are individually evaluated for impairment and general reserves for losses related to loans that are collectively evaluated for impairment.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms.

Loans reported as TDRs are considered impaired and measured for impairment as described above. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The determination of the general reserve for loans that are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of all historical losses based on a five-year lookback period by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses in the portfolio taken as a whole.

The Company determines a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial, construction, residential real estate, commercial real estate and consumer loans. The allowance for loan losses attributable to each portfolio segment, which includes both loans individually evaluated for impairment and loans that are collectively evaluated for impairment, are combined to determine the Company's overall allowance, which is included on the consolidated balance sheet.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

The Company assigns a risk rating to all loans, and periodically performs detailed reviews of all such loans exhibiting variances in expected payment and/or financial performance to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into six major categories, defined as follows:

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

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

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

Substandard-Impaired – A substandard loan is impaired when, based on current information and known or anticipated events, it is probable that the lender will be unable to collect all amounts due according to the terms of the original loan agreement. These loans are typically on nonaccrual and have many of the same weaknesses as substandard non-impaired loans.

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 liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss – Loans classified as loss are considered uncollectible and charged off immediately.

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

Commercial – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators which are closely correlated to the credit quality of these loans. Asset based commercial loans are advances generally made against receivables to companies generating consistent sales without yet having reached consistent profitability. These companies are subjected to an audit of their receivables and ineligible accounts are excluded from the borrowing base. The Company controls the entire receivables cash flow of the company and advances are made on a portion of eligible receivable balances. Receivables are monitored daily and borrowing capacity is calculated based upon contractual formulas. As a result of these controls, asset based lending loans typically possess less risk than unsecured commercial loans. Cash flow term loans are made to companies based upon their cash flow for limited time periods. The companies may have yet to achieve an established trend of profitability and therefore these loans possess more risk than loans to companies that have demonstrated more consistent profitability.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

Residential real estate (including home equity lines of credit) – Residential real estate loans are loans made with a residence serving as collateral. These are not typical mortgage loans and may have a variety of reasons for the borrowing including providing funding to a business or paying for large personal expenditures. These loans generally possess a lower inherent risk of loss than commercial real estate and construction loans and are often situations where the borrower is the occupant of the residence. The degree of risk in home equity loans depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

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

Consumer – Consumer loans are primarily loans to individuals that may be unsecured or secured by collateral other than real estate. The unsecured loans are generally revolving personal lines of credit to established clients. The Company also offers demand deposit lines of credit to certain checking account clients. The high quality of the clients who are offered these products has historically caused this loan product to have less risk of loss than commercial loan products.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the Federal Reserve Bank, the FDIC and the California Department of Financial Protection and Innovation, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations. The allowance for loan losses at December 31, 2021 and 2020 reflects management's estimate of probable incurred credit losses in the Company's loan portfolio.

Reserve for Undisbursed Loan Commitments

The Company maintains a separate reserve for losses related to undisbursed loan commitments. Management estimates the amount of probable losses by applying the loss factors used in the allowance for loan loss methodology to an estimate of the expected usage of undisbursed lines of credit. This reserve was \$392,000 at December 31, 2021 and \$370,000 at December 31, 2020, and is included in accrued interest payable and other liabilities on the consolidated balance sheet.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation is determined using the straight line method over the estimated useful lives of the related assets. The useful lives of furniture, fixtures and equipment are estimated to be five to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain current employees and former 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The determination of the amount of deferred income tax assets, which are more likely than not to be realized, is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The recognition of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

The Company considers all tax positions recognized in its financial statements for the likelihood of realization. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than fifty percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above, if any, is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest expense and penalties associated with unrecognized tax benefits, if any, are included in the provision for income taxes in the statement of operations. The Company did not have any uncertain income tax positions and has not accrued for any interest or penalties as of December 31, 2021 and 2020.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards 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 Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company's accounting policy is to recognize forfeitures as they occur.

The Company reports the cash flows resulting from the tax benefits arising from tax deductions in excess of the compensation cost recognized for options (excess tax benefits) as a cash flow from financing in the statement of cash flows. There were no excess tax benefits for the years ended December 31, 2021 or 2020.

Earnings Per Common Share

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which share in the earnings of the Company. The treasury stock method is applied to determine the dilutive effect of stock options in computing diluted EPS. Earnings and dividends per share are restated for all stock splits and stock dividends through date of issuance of the financial statements.

Comprehensive Income

Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income. The components of accumulated other comprehensive income are presented in the statement of changes in shareholders' equity.

Loss Contingencies

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of New Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments." This ASU significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In issuing the standard, the FASB is responding to criticism that today's guidance delays recognition of credit losses. The standard will replace today's "incurred loss" approach with an "expected loss" model. The new model, referred to as the current expected credit loss ("CECL") model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for sale ("AFS") debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities.

As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU No. 2016-13 is effective for interim and annual reporting periods beginning after January 1, 2023 for the Company; early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach). The Company has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, and engaging with a specialized software provider and professionals to plan implementation and testing. A CECL calculation has been developed and the Company will run it in parallel with the incurred loss model in 2022 in preparation for implementation on January 1, 2023.

During March and April of 2020, various regulatory agencies, including the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, ("the agencies") issued regulatory guidance encouraging financial institutions to work with customers affected by the COVID-19 pandemic and providing additional information regarding loan modifications. The guidance clarifies the interaction between the interagency statement issued on March 22, 2020 and the temporary relief provided by Section 4013 of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act signed into law on March 27, 2020. Section 4013 allows financial institutions to suspend the requirements to classify certain loan modifications as troubled debt restructurings (TDRs). The revised statement also provides supervisory interpretations on past due and nonaccrual regulatory reporting of loan modification programs and regulatory capital. The Section 4013 TDR relief rules were applied by the Company to loan modifications made related to the COVID-19 pandemic as eligible and appropriate. In December new legislation became effective extending the TDR relief under Section 4013 of the CARES Act to January 1, 2022 or the date that is 60 days after the date on which the COVID-19 emergency terminates. Future TDRs are indeterminable and will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES

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

	2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Agencies	\$ 1,285	\$ 6	\$ –	\$ 1,291
Residential Mortgage-Backed Securities	385,465	50	(6,636)	378,879
Total debt securities	\$ 386,750	\$ 56	\$ (6,636)	\$ 380,170
	2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
U.S. Agencies	\$ 1,646	\$ 43	\$ –	\$ 1,689
Residential Mortgage-Backed Securities	161,059	1,162	(279)	161,942
Total debt securities	\$ 162,705	\$ 1,205	\$ (279)	\$ 163,631

Net unrealized loss on available-for-sale investment securities totaling \$4.5 million were recorded as accumulated other comprehensive income, net of tax of \$2.1 million, within shareholders' equity at December 31, 2021 and net unrealized gain on available-for-sale investment securities totaling \$667,000 were recorded as accumulated other comprehensive income, net of tax benefits of \$259,000, within shareholders' equity at December 31, 2020.

There were five sales and no calls of available-for-sale investment securities during 2021 and no sales or calls during 2020. The proceeds from sales of securities and the associated gains are listed below:

	2021	2020
Proceeds	\$ 25,442	\$ –
Gross gains	735	–
Gross losses	–	–

The tax provision related to these net realized gains was \$209,000 for the year ended 2021. There was no tax impact in 2020.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

Investment securities with unrealized losses at December 31, 2021 and December 31, 2020 are summarized and classified according to the duration of the loss period as follows: (in thousands)

	2021					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Agencies	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
Residential Mortgage-Backed Securities	266,846	(2,693)	110,127	(3,943)	376,973	(6,636)
Total debt securities	<u>\$ 266,846</u>	<u>\$ (2,693)</u>	<u>\$ 110,127</u>	<u>\$ (3,943)</u>	<u>\$ 376,973</u>	<u>\$ (6,636)</u>
	2020					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Agencies	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –
Residential Mortgage-Backed Securities	128,413	(279)	–	–	128,413	(279)
Total debt securities	<u>\$ 128,413</u>	<u>\$ (279)</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 128,413</u>	<u>\$ (279)</u>

At December 31, 2021, the Company held five U.S. government-sponsored residential mortgage-backed securities which were in a loss position for greater than 12 months. Management believes the unrealized losses on the Company's investments in residential mortgage-backed securities were caused by interest rate changes. The contractual cash flows of those investments are guaranteed or supported by an agency or sponsored entity of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell, and it is more likely than not that it will not be required to sell those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2021.

2. AVAILABLE-FOR-SALE INVESTMENT SECURITIES (Continued)

The amortized cost and estimated fair value of available-for-sale investment securities at December 31, 2021 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. (in thousands)

	2021	
	Amortized Cost	Fair Value
Within one year	\$ —	\$ —
One to five years	—	—
Five to ten years	1,285	1,291
Beyond ten years	—	—
	<u>1,285</u>	<u>1,291</u>
Investment securities not due at a single maturity date: residential mortgage-backed securities	<u>385,465</u>	<u>378,879</u>
	<u>\$ 386,750</u>	<u>\$ 380,170</u>

No investment securities were pledged to the Federal Reserve for discount window borrowing or to the Federal Home Loan Bank at December 31, 2021 or December 31, 2020. No investment securities were pledged to secure public deposits at December 31, 2021 or December 31, 2020.

3. LOANS

Outstanding loans are summarized below: (in thousands)

	December 31	
	2021	2020
Commercial	\$ 518,737	\$ 407,740
Construction	191,778	185,945
Residential real estate	14,410	15,556
Commercial real estate	497,931	383,131
Consumer	2,331	1,932
Total outstanding loans	1,225,187	994,304
Deferred loan origination fees, net	(1,843)	(821)
Allowance for loan losses	(13,054)	(12,558)
Total loans net of allowance for loan losses	\$ 1,210,290	\$ 980,925

Salaries and employee benefits totaling \$2,468,000 and \$2,276,000 have been deferred as loan origination costs for the years ended December 31, 2021 and 2020, respectively.

From time to time, the Bank pledges loans as collateral under a short-term borrowing arrangement through the Discount Window of the Federal Reserve Bank. The Bank has pledged a total of \$142 million of loans for borrowing capacity of \$114 million at December 31, 2021. The Bank had no borrowings outstanding as of December 31, 2021 (Note 9). The Bank has entered into a blanket lien agreement providing for the pledging of Call Report loan categories for borrowing capacity with the Federal Home Loan Bank. The Bank has pledged a total of \$836 million of loans for borrowing capacity of \$373 million at December 31, 2021 (Note 9).

4. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses during the years ended December 31, 2021 and 2020 were as follows: (in thousands)

	2021	2020
Balance, beginning of year	\$ 12,558	\$ 11,267
Provision for loan losses	3,572	1,702
Losses charged to allowance	(3,076)	(411)
Recoveries	—	—
Balance, end of year	\$ 13,054	\$ 12,558

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Allocation of the Allowance for Loan Losses by Portfolio Segment and Impairment Methodology as of and for the years ended December 31, 2021 and 2020: (in thousands)

	<u>Commercial</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Total</u>
Allowance for loan losses:						
Balance, at January 1, 2020	\$ 5,555	\$ 2,163	\$ 69	\$ 3,469	\$ 11	\$ 11,267
Provision for loan losses	592	481	44	582	3	1,702
Loans charged-off	(411)	—	—	—	—	(411)
Recoveries	—	—	—	—	—	—
Balance, at December 31, 2020	\$ 5,736	\$ 2,644	\$ 113	\$ 4,051	\$ 14	\$ 12,558
Provision for loan losses	3,607	(405)	(48)	422	(4)	3,572
Loans charged-off	(3,076)	—	—	—	—	(3,076)
Recoveries	—	—	—	—	—	—
Balance, at December 31, 2021	\$ 6,267	\$ 2,239	\$ 65	\$ 4,473	\$ 10	\$ 13,054

4. ALLOWANCE FOR LOAN LOSSES (Continued)

December 31, 2021	<u>Commercial</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Total</u>
<u>Allowance for loan losses:</u>						
Ending balance	\$ <u>6,267</u>	\$ <u>2,239</u>	\$ <u>65</u>	\$ <u>4,473</u>	\$ <u>10</u>	\$ <u>13,054</u>
Ending balance: individually evaluated for impairment	\$ <u>—</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>—</u>
Ending balance: collectively evaluated for impairment	\$ <u>6,267</u>	\$ <u>2,239</u>	\$ <u>65</u>	\$ <u>4,473</u>	\$ <u>10</u>	\$ <u>13,054</u>
<u>Loans:</u>						
Ending balance	\$ <u>518,737</u>	\$ <u>191,778</u>	\$ <u>14,410</u>	\$ <u>497,931</u>	\$ <u>2,331</u>	\$ <u>1,225,187</u>
Ending balance: individually evaluated for impairment	\$ <u>448</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>2,796</u>	\$ <u>—</u>	\$ <u>3,244</u>
Ending balance: collectively evaluated for impairment	\$ <u>518,289</u>	\$ <u>191,778</u>	\$ <u>14,410</u>	\$ <u>495,135</u>	\$ <u>2,331</u>	\$ <u>1,221,943</u>

4. ALLOWANCE FOR LOAN LOSSES (Continued)

December 31, 2020	<u>Commercial</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Total</u>
<u>Allowance for loan losses:</u>						
Ending balance	\$ 5,736	\$ 2,644	\$ 113	\$ 4,051	\$ 14	\$ 12,558
Ending balance: individually evaluated for impairment						
	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ending balance: collectively evaluated for impairment						
	\$ 5,736	\$ 2,644	\$ 113	\$ 4,051	\$ 14	\$ 12,558
<u>Loans:</u>						
Ending balance	\$ 407,740	\$ 185,945	\$ 15,556	\$ 383,131	\$ 1,932	\$ 994,304
Ending balance: individually evaluated for impairment						
	\$ 618	\$ —	\$ —	\$ 2,929	\$ —	\$ 3,547
Ending balance: collectively evaluated for impairment						
	\$ 407,122	\$ 185,945	\$ 15,556	\$ 380,202	\$ 1,932	\$ 990,757

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Profile by Internally Assigned Grade as of December 31, 2021 (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Grade:						
Pass	\$ 507,339	\$ 191,778	\$ 14,410	\$ 495,135	\$ 2,331	\$ 1,210,993
Special Mention	5,950	–	–	–	–	5,950
Substandard-Non- Impaired	5,000	–	–	–	–	5,000
Substandard- Impaired	448	–	–	2,796	–	3,244
Total	\$ 518,737	\$ 191,778	\$ 14,410	\$ 497,931	\$ 2,331	\$ 1,225,187

Credit Risk Profile by Internally Assigned Grade as of December 31, 2020 (in thousands)

	Commercial	Construction	Residential Real Estate	Commercial Real Estate	Consumer	Total
Grade:						
Pass	\$ 393,380	\$ 172,417	\$ 15,556	\$ 376,803	\$ 1,932	\$ 960,088
Special Mention	10,259	13,528	–	2,039	–	25,826
Substandard-Non- Impaired	3,483	–	–	1,360	–	4,843
Substandard- Impaired	618	–	–	2,929	–	3,547
Total	\$ 407,740	\$ 185,945	\$ 15,556	\$ 383,131	\$ 1,932	\$ 994,304

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Past Due and Nonaccrual Loan Detail as of December 31, 2021
(in thousands)

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	\$ —	\$ —	\$ 448	\$ 448	\$ 518,289	\$ 518,737
Construction	—	—	—	—	191,778	191,778
Residential Real Estate	—	—	—	—	14,410	14,410
Commercial Real Estate	—	—	2,796	2,796	495,135	497,931
Consumer	—	—	—	—	2,331	2,331
Total	\$ —	\$ —	\$ 3,244	\$ 3,244	\$ 1,221,943	\$ 1,225,187

Past Due and Nonaccrual Loan Detail as of December 31, 2020
(in thousands)

	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	\$ —	\$ —	\$ 618	\$ 618	\$ 407,122	\$ 407,740
Construction	—	—	—	—	185,945	185,945
Residential Real Estate	—	—	—	—	15,556	15,556
Commercial Real Estate	—	—	2,929	2,929	380,202	383,131
Consumer	—	—	—	—	1,932	1,932
Total	\$ —	\$ —	\$ 3,547	\$ 3,547	\$ 990,757	\$ 994,304

4. ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loan Detail for the year ended December 31, 2021 (in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	\$ 1,059	\$ 448	\$ -	\$ 2,190	\$ -	\$ -
Construction	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial Real Estate	3,000	2,796	-	1,951	-	-
Consumer	-	-	-	-	-	-
Total	\$ 4,059	\$ 3,244	\$ -	\$ 4,141	\$ -	\$ -

Impaired Loan Detail for the year ended December 31, 2020 (in thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
Commercial	\$ 1,195	\$ 618	\$ -	\$ 1,601	\$ 12	\$ -
Construction	-	-	-	-	-	-
Residential Real Estate	-	-	-	-	-	-
Commercial Real Estate	3,029	2,929	-	2,999	-	-
Consumer	-	-	-	-	-	-
Total	\$ 4,224	\$ 3,547	\$ -	\$ 4,600	\$ 12	\$ -

There were no impaired loans with an allowance recorded as of and for the years ended December 31, 2021 and 2020.

The recorded investment in loans includes accrued interest receivable and loan origination fees, net. For purposes of this disclosure, the unpaid principal balance is not reduced for any related loan loss allowance.

As of December 31, 2021, the Company had a recorded investment in troubled debt restructurings of \$3,244,000. The Company determined no specific reserve was required for these loans. As of December 31, 2020, the Company had a recorded investment in troubled debt restructuring of \$3,547,000 with no required specific reserve for these loans. The Company has not committed to lend any additional amounts on loans identified as troubled debt restructurings.

Section 4013 of the CARES Act provided optional, temporary relief from evaluating loans that may have been considered troubled debt restructurings. As of December 31, 2020, all Section 4013 loan modifications granted to borrowers had expired resulting in no outstanding COVID-19 related modifications. No loan modifications were granted in 2021.

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following: (in thousands)

	December 31,	
	2021	2020
Leasehold improvements	\$ 5,270	\$ 6,167
Furniture and equipment	1,757	2,307
Computer equipment	1,622	3,255
Gross property and equipment	8,649	11,728
Less accumulated depreciation and amortization	4,084	6,163
Property and equipment, net	\$ 4,565	\$ 5,565

Depreciation included in occupancy and equipment expense totaled \$965,000 and \$916,000 for the years ended December 31, 2021 and 2020, respectively. A number of fully depreciated assets were removed from the balance sheet in 2021, resulting in reduced gross amounts for both the asset and the associated accumulated depreciation totals.

6. LEASES

Lease Arrangements

The Company enters into leases in the normal course of business primarily for headquarters, back-office operations locations and business development offices. The Company's leases have remaining terms ranging from three to eight and a half years, some of which include termination or renewal options to extend the lease for up to 5 years.

The Company leases its administrative offices in San Jose under a noncancellable operating lease. The lease expires in 2027 and has one five-year renewal option. The Company also leases office space for loan production offices in Redwood City and San Francisco, California. At the end of September 2021, the Company closed its Palo Alto branch office and the space has been subleased. The Redwood City loan production office lease expires in 2025 and has one three-year renewal option. The San Francisco loan production office lease expires in 2030.

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

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the Federal Home Loan Bank (FHLB) of San Francisco, adjusted for the lease term and other factors.

6. LEASES (Continued)

Right-of-use assets and lease liabilities by lease type, and the associated balance sheet classifications, are as follows (in thousands):

Balance Sheet Classification	December 31,	
	2021	2020
Right-of-use assets:		
Operating leases - Accrued interest receivable and other assets	\$ 14,702	\$ 17,888
Total right-of-use assets	\$ 14,702	\$ 17,888
Lease liabilities:		
Operating leases - Accrued interest payable and other liabilities	\$ 15,832	\$ 19,075
Total lease liabilities	\$ 15,832	\$ 19,075

Lease Expense

Total lease cost was comprised solely of operating lease expense of \$2,796,000 and \$2,217,000 for the years ended December 31, 2021 and 2020, respectively.

Lease Obligations

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

<u>December 31,</u>	<u>Leases</u>
2022	\$ 2,879
2023	2,964
2024	3,053
2025	2,620
2026	2,594
Thereafter	4,156
Total undiscounted lease payments	18,266
Less imputed interest	2,434
Net lease liabilities	\$ 15,832

Supplemental Lease Information

	December 31,	
	2021	2020
Operating lease weighted average remaining lease term (years)	6.37	7.31
Operating lease weighted average discount rate	2.53	2.50

7. INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following: (in thousands).

	December 31,	
	2021	2020
NOW accounts	\$ 50,674	\$ 25,391
Savings	8,758	10,596
Money market	836,960	408,442
Time, \$250,000 or more	79,475	125,669
Other time	10,387	18,561
Total interest-bearing deposits	\$ 986,254	\$ 588,659

Scheduled maturities of time deposits for the next five years were as follows: (in thousands)

Year Ending December 31,		
2022	\$	65,835
2023		5,222
2024		5,269
2025		3,990
2026 and after		9,546
Total time deposits	\$	<u>89,862</u>

Interest expense recognized on interest-bearing deposits for the years ended December 31, 2021 and 2020 consisted of the following: (in thousands)

	<u>2021</u>	<u>2020</u>
NOW accounts	\$ 66	\$ 55
Savings	18	23
Money market	1,650	1,845
Time, \$250,000 or more	712	2,338
Other time	<u>172</u>	<u>451</u>
Total interest on deposits	<u>\$ 2,618</u>	<u>\$ 4,712</u>

At December 31, 2021 the Company had one deposit relationship that exceeded 5% of total deposits. At \$107.2 million, it represented 5.4% of total deposits. At December 31, 2020 the Company had no deposit relationships that exceeded 5% of total deposits.

8. INCOME TAXES

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

2021	Federal	State	Total
Current	\$ 3,928	\$ 2,056	\$ 5,984
Deferred	(842)	(252)	(1,094)
Provision for income taxes	<u>\$ 3,086</u>	<u>\$ 1,804</u>	<u>\$ 4,890</u>
2020	Federal	State	Total
Current	\$ 2,470	\$ 1,680	\$ 4,150
Deferred	(555)	(515)	(1,070)
Provision for income taxes	<u>\$ 1,915</u>	<u>\$ 1,165</u>	<u>\$ 3,080</u>

Deferred tax assets (liabilities) at December 31, 2021 and 2020 consisted of the following: (in thousands)

	2021	2020
Deferred tax assets:		
Allowance for loan losses	\$ 3,951	\$ 3,799
State tax	388	327
Fixed assets	352	–
Lease liabilities	4,742	5,665
Accrued expenses	1,698	1,468
Other	365	258
Share-based compensation	1,283	1,044
Unrealized loss on available for sale investment securities	2,081	–
Total deferred tax assets	<u>\$ 14,860</u>	<u>\$ 12,561</u>
Deferred tax liabilities:		
Other	\$ (157)	\$ (81)
Fixed assets	–	(69)
Right of use asset	(4,531)	(5,502)
Loan origination costs	(1,008)	(920)
Unrealized gain on available for sale investment securities	–	(259)
Total deferred tax liabilities	<u>(5,696)</u>	<u>(6,831)</u>
Net deferred tax asset	<u>\$ 9,164</u>	<u>\$ 5,730</u>

8. INCOME TAXES (Continued)

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate to income before income taxes. The effects of these differences are as follows (dollars in thousands):

	Years Ended December 31,			
	2021		2020	
	Amount	Rate %	Amount	Rate %
Federal income tax expense, at statutory rate	\$ 3,602	21.0%	\$ 2,668	21.0%
State franchise tax expense, net of Federal tax expense	1,425	8.3%	920	7.2%
Share-based compensation	22	0.1%	(40)	(0.3)%
Tax-exempt income from life insurance policies	(94)	(0.5)%	(56)	(0.4)%
Meals and entertainment	6	0.0%	8	0.1%
Low income housing credit	(96)	(0.6)%	(96)	(0.8)%
Other	25	0.2%	(324)	(2.5)%
Total income tax expense	\$ 4,890	28.5%	\$ 3,080	24.2%

The total amount of unrecognized tax benefits, related to potentially uncertain tax positions, including interest and penalties, at December 31, 2021 or 2020, was not considered significant for disclosure purposes. The amount of tax benefits that would impact the effective rate, if recognized, is not expected to be material. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next twelve months.

Status of Open Tax Years

The Company is subject to U.S. Federal income tax as well as various other state income tax. Federal income tax returns for 2018 through 2020 and state income tax returns generally for 2017 through 2020 are currently open for Federal or state income tax examinations.

9. SUBORDINATED DEBT AND OTHER BORROWING ARRANGEMENTS

On December 20, 2019, the Company issued \$22,000,000 in ten-year, fixed-to-floating rate subordinated notes to certain qualified institutional buyers and institutional accredited investors. The subordinated notes have a maturity date of December 30, 2029 and bear interest at the rate of 5.0% per annum, payable semiannually, for the first five years of the term, and then quarterly at a variable rate based on the then current 3-month Secured Overnight Financing Rate plus 359.5 basis points. The notes are redeemable after five years subject to certain conditions. The indebtedness evidenced by the subordinated notes, including principal and interest, is unsecured and subordinate and junior to general and secured creditors and depositors. On the balance sheet the subordinated notes are carried net of debt issuance costs of \$512,000 less accumulated depreciation of \$215,000 as of December 31, 2021.

The Company had unsecured Federal Funds lines of credit totaling \$55,000,000 with its correspondent banks at December 31, 2021 and \$55,000,000 at December 31, 2020. There were no borrowings outstanding under these agreements at December 31, 2021 and 2020.

The Company has a short-term borrowing arrangement with the Federal Reserve Bank through the Discount Window. The Company currently has a blanket lien on certain loans to secure borrowings. The borrowing capacity under the agreement varies depending on the amount of loans pledged. There were no borrowings outstanding under the agreement at December 31, 2021 or 2020.

As a member of the Federal Home Loan Bank (FHLB) of San Francisco, the Bank is eligible to use the FHLB's facilities for short and long term borrowing. Borrowing capacity requires stock ownership in the FHLB and is based on pledged assets or a blanket lien against certain Call Report loan categories. There were no borrowings outstanding from the FHLB at December 31, 2021 and 2020. The borrowing capacity at December 31, 2021 was \$373,000,000 under a blanket lien based on Call Report loan categories.

10. COMMITMENTS AND CONTINGENCIES

Federal Reserve Requirements

The Federal Reserve Board reduced reserve requirement ratios to zero percent effective March 26, 2020, in response to the COVID-19 pandemic. This action eliminated reserve requirements for all depository institutions. Prior to that date banks were required to maintain reserves with the Federal Reserve Bank equal to a percentage of their reservable deposits. The amount of such reserve balances required at December 31, 2021 and 2020 was \$0.

Financial Instruments With Off-Balance-Sheet Risk

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance sheet credit risk at year-end were as follows (in thousands):

	December 31,			
	2021		2020	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	\$ 67,302	\$ 449,016	\$ 53,810	\$ 343,794
Standby letters of credit	1,971	5,645	1,739	6,281

Commitments to extend credit consist primarily of unfunded single-family residential and commercial real estate construction loans and commercial revolving lines of credit. Construction loans are established under standard underwriting guidelines and policies and are secured by deeds of trust, with disbursements made over the course of construction. Commercial revolving lines of credit have a high degree of industry diversification. Commitments to make loans are generally made for periods of 10 years or less. The fixed rate loan commitments have interest rates ranging from 2.45% to 5.50% and maturities ranging from 1 year to 10 years.

Standby letters of credit are generally secured and are issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to customers. The fair value of the liability related to these standby letters of credit, which represents the fees received for issuing the guarantees, was not significant at December 31, 2021 and 2020. The Company recognizes these fees as revenue over the term of the commitment or when the commitment is used.

Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial and consumer loans primarily to customers in the California counties of San Mateo, San Francisco and Santa Clara. Although the Company has a diversified loan portfolio, a substantial portion of its portfolio is secured by commercial and residential real estate. Management believes the loans within this concentration have no more than the normal risk of collectability. However, a substantial decline in real estate values in the Company's primary market area could have an adverse impact on the collectability of these loans. Personal and business income represent the primary sources of repayment for a majority of these loans and management believes the risks presented by the concentration are further mitigated by diversification of property types within the Company's real estate portfolio and by conservative underwriting.

At December 31, 2021, in management's judgment, a concentration of loans existed in construction and commercial real estate related loans. At that date, approximately 56% of the Company's loans were construction and real estate related, representing 16% and 40% of total outstanding loans, respectively.

At December 31, 2020, in management's judgment, a concentration of loans existed in construction and real estate related loans. At that date, approximately 57% of the Company's loans were construction and real estate related, representing 19% and 38% of total outstanding loans, respectively.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

11. SHAREHOLDERS' EQUITY

Dividends

The Company's ability to pay cash dividends is dependent on dividends paid to it by the Bank, if any, and limited by California law. Under California law, the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available, subject to certain restrictions. California General Corporation Law prohibits the Company from paying dividends on its common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of the Company's assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred liabilities) and the current assets of the Company would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities.

Dividends paid from the Bank to the Company are restricted under certain Federal laws and regulations governing banks. In addition, the California Financial Code restricts the total dividend payment of any bank in any one year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period, without the prior approval of the California Department of Financial Protection and Innovation. At December 31, 2021, \$37,121,000 was free of such restrictions.

Earnings Per Common Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations for the years ended December 31, 2021 and 2020 is shown below:

(\$ in thousands, except the per share amounts)

	<u>Net Income</u>	<u>Net Income Available to Common Shareholders</u>	<u>Weighted Average Number of Shares Outstanding</u>	<u>Per Share Amount</u>
<u>December 31, 2021</u>				
Basic earnings per common share	\$ 12,264	\$ 12,264	5,890,216	\$ 2.08
Effect of dilutive options			172,266	—
Diluted earnings per common share	<u>\$ 12,264</u>	<u>\$ 12,264</u>	<u>6,062,482</u>	<u>\$ 2.02</u>
<u>December 31, 2020</u>				
Basic earnings per common share	\$ 9,627	\$ 9,627	5,859,547	\$ 1.64
Effect of dilutive options			108,233	—
Diluted earnings per common share	<u>\$ 9,627</u>	<u>\$ 9,627</u>	<u>5,967,780</u>	<u>\$ 1.61</u>

There were no options excluded from the calculation of diluted earnings per share in 2021 and 2020.

11. SHAREHOLDERS' EQUITY (Continued)

Stock Repurchase Program

The Company announced a stock repurchase program on November 25, 2020, effective immediately, authorizing the repurchase of up to 5% or 307,780 shares of the Company's outstanding common stock. The program has no expiration date. Under the stock repurchase program, the Company may, from time to time, repurchase shares of its outstanding common stock in the open market, in privately-negotiated transactions, or otherwise, subject to applicable laws and regulations. The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements, availability of funds, and other relevant considerations, as determined by the Company. The Company may, at its discretion, begin, suspend or terminate repurchases at any time prior to the program's expiration, without any prior notice. There is no obligation on the part of the Company to repurchase any shares of its common stock. For the year ended December 31, 2021, no shares were repurchased. For the year ended December 31, 2020, 25,347 shares were repurchased at a cost of \$447,375.

Regulatory Capital

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer was phased in from 0.0% for 2015 to 2.50% by 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2021, the Company and the Bank meet all capital adequacy requirements to which they are 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 year-end 2021 and 2020, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

11. SHAREHOLDERS' EQUITY (Continued)

Regulatory Capital (Continued)

As of December 31, 2021, the most recent notification from the FDIC 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 Bank's category. To be categorized as well-capitalized, under the regulatory framework for prompt corrective actions, the Company and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below:

Actual and required capital amounts (in thousands) and ratios, exclusive of the capital conservation buffer are presented below at December 31, 2021 and 2020:

	2021		2020	
	Amount	Ratio	Amount	Ratio
<u>Leverage Ratio</u>				
Avidbank Holdings, Inc.	\$ 141,600	6.89%	\$ 127,258	8.67%
Minimum regulatory requirement	\$ 82,182	4.00%	\$ 58,704	4.00%
Avidbank	\$ 155,681	7.59%	\$ 141,478	9.66%
Minimum requirement for "Well-Capitalized" institution	\$ 102,565	5.00%	\$ 73,239	5.00%
Minimum regulatory requirement	\$ 82,052	4.00%	\$ 58,591	4.00%
<u>Common Equity Tier I</u>				
Avidbank Holdings, Inc.	141,600	8.90%	127,258	10.35%
Minimum regulatory requirement	\$ 71,582	4.50%	\$ 55,351	4.50%
Avidbank	\$ 155,681	9.80%	\$ 141,478	11.53%
Minimum requirement for "Well-Capitalized" institution	\$ 103,209	6.50%	\$ 79,771	6.50%
Minimum regulatory requirement	\$ 71,452	4.50%	\$ 55,226	4.50%
<u>Tier 1 Risk-Based Capital Ratio</u>				
Avidbank Holdings, Inc.	\$ 141,600	8.90%	\$ 127,258	10.35%
Minimum regulatory requirement	\$ 95,442	6.00%	\$ 73,802	6.00%
Avidbank	\$ 155,681	9.80%	\$ 141,478	11.53%
Minimum requirement for "Well-Capitalized" institution	\$ 127,027	8.00%	\$ 98,180	8.00%
Minimum regulatory requirement	\$ 95,270	6.00%	\$ 73,635	6.00%
<u>Total Risk-Based Capital Ratio</u>				
Avidbank Holdings, Inc.	176,749	11.11%	161,751	13.15%
Minimum regulatory requirement	\$ 127,257	8.00%	\$ 98,403	8.00%
Avidbank	\$ 169,127	10.65%	\$ 154,406	12.58%
Minimum requirement for "Well-Capitalized" institution	\$ 158,783	10.00%	\$ 122,725	10.00%
Minimum regulatory requirement	\$ 127,027	8.00%	\$ 98,180	8.00%

12. SHARE-BASED PAYMENT

Equity Incentive Awards

Under the 2013 Equity Incentive Plan, the Company is able to provide stock-based awards to employees, directors, and contractors. Awards under the 2013 Equity Incentive Plan may be in the form of, but not limited to, the following: stock options, restricted stock or units, performance based shares or units, and other stock-based awards as determined by the Board of Directors. The 2013 Equity Incentive Plan specifies that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid for in full at the time the option is exercised. All options expire on a date determined by the Board of Directors, but not later than five years from the date of grant. Upon grant, options vest ratably over a four-year period. As of December 31, 2021, all stock option awards have been fully vested and exercised or expired. There are no plans to award additional stock option awards.

As of December 31, 2021, there were 89,162 remaining shares available to be granted as options or restricted stock among other forms of equity compensation under the 2013 Equity Incentive Plan.

Restricted Common Stock Awards

The 2013 Equity Incentive Plan provides for the issuance of restricted stock to directors and officers. Restricted common stock grants typically vest over a three-year period. Restricted common stock (all of which are shares of our common stock) is subject to forfeiture if employment terminates prior to vesting. The cost of these awards is recognized over the vesting period of the awards based on the fair value of our common stock on the date of the grant.

The following table summarizes restricted stock activity for the year ended December 31, 2021:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at January 1, 2021	313,420	\$ 22.35
Granted	127,415	19.83
Vested	(63,645)	23.00
Forfeited	(29,380)	22.27
Non-vested shares at December 31, 2021	<u>347,810</u>	<u>\$ 21.32</u>

During the year ended December 31, 2021, 127,415 shares of restricted common stock were granted from the 2013 Equity Incentive Plan. Offsetting the 127,415 grants were 9,666 shares withheld to cover taxes, in addition to 29,380 shares forfeited due to terminations that resulted in net restricted stock issued of 88,369 shares. The restricted common stock had a weighted average fair value of \$19.83 per share on the date of grant. Most restricted shares granted have a three-year cliff vesting period, with shares vesting on the three year anniversary date.

9,000 shares were awarded to non-employee directors in 2021 with a one-year vesting period.

As of December 31, 2021, there were 347,810 shares of restricted stock that were nonvested and expected to vest. Share-based compensation cost charged against income for restricted stock awards was \$2,277,369 and \$2,286,003 for the years ended December 31, 2021, and 2020, respectively.

As of December 31, 2021, there was \$3,047,518 of total unrecognized compensation cost related to nonvested restricted common stock. Restricted stock compensation expense is recognized on a straight-line basis over the vesting period. This cost is expected to be recognized over a weighted average remaining period of 1.91 years and will be adjusted for subsequent changes in estimated forfeitures.

13. EMPLOYEE 401(k) PROFIT SHARING PLAN

The Company has a 401(k) profit sharing plan. All employees 21 years of age or older become eligible to participate in the plan on the first day of the month following employment with the Bank. Eligible employees may elect to make tax deferred contributions of their salary up to the maximum amount allowed by law. The Bank may make additional contributions to the plan at the discretion of the Board of Directors. Bank contributions vest at a rate of 25% annually for all employees. Bank contributions for the years ended December 31, 2021, and 2020 totaled \$450,000 and \$413,000, respectively.

14. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including directors and officers. The following is a summary of the aggregate activity involving related party borrowers during 2021: (in thousands)

Balance, January 1, 2021	\$	–
Additions		–
Amounts repaid		–
Balance, December 31, 2021	\$	–
Undisbursed commitments to related parties, December 31, 2021	\$	<u>2,505</u>

In 2021 the Company increased its investment in bank owned life insurance (BOLI) by \$20 million through purchases of additional policies from insurance carriers for which we have existing relationships. As the broker-administrator of the policies we used the firm Bank Compliance Consulting (BCC), which employs the son of the Company's largest shareholder. BCC receives its compensation from the insurance carriers and does not receive any payments from the Company

15. OTHER EXPENSES

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

	<u>2021</u>	<u>2020</u>
Data processing	\$ 1,647	\$ 1,587
FDIC and DFPI assessments	1,226	1,088
Professional fees	756	541
Director's fees and expenses	724	702
Correspondent bank charges	531	462
Advertising and marketing	326	335
Travel and meals	167	154
Legal fees	141	219
Insurance and bonding	139	114
Credit reports and appraisals	79	56
Other	546	553
Total other expenses	<u>\$ 6,282</u>	<u>\$ 5,811</u>

16. FAIR VALUE

In accordance with accounting guidance, the Company groups its financial assets and financial liabilities measured at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair values of its financial instruments at December 31, 2021 and 2020:

Cash and Cash Equivalents, Federal Funds Sold and Interest Bearing Deposits in other banks

The carrying amount of these instruments approximate the fair value and are classified as Level 1 in the fair value hierarchy.

Investment Securities

For investment securities, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

Loans

The fair value of variable rate loans that reprice frequently and with no significant change in credit risk is based on the carrying value and results in a classification of Level 3 within the fair value hierarchy. Fair value for other loans are estimated using discounted cash flow analysis using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification in the fair value hierarchy. For collateral dependent real estate loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are 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. The estimated fair values of financial instruments disclosed above as of December 31, 2021 and 2020 follow the guidance in ASU 2016-01 which prescribes an "exit price" approach in estimating and disclosing fair value of financial instruments incorporating discounts for credit, liquidity, and marketability factors.

Deposits

The fair value of demand deposits (e.g. interest and non-interest bearing, savings and certain types of money market accounts) are, by definition, equal to the amount payable in demand at the reporting date (i.e. carrying value) resulting in a Level 1 classification in the fair value hierarchy. The carrying amounts of variable rate, fixed-term money market accounts and certificate of deposits approximates their fair value at the reporting date in a Level 2 classification in the fair value hierarchy. Fair values for fixed rate certificate of deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

16. FAIR VALUE (Continued)

Subordinated Debt/Other Borrowings

Other Borrowings: The carrying amount of other borrowings generally mature within thirty days and therefore approximate their fair values resulting in a Level 1 classification.

Subordinated Debt: The carrying amount of the Company's Subordinated Debentures are estimated using discounted cash flow analysis based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

The carrying amounts and estimated fair values of financial instruments, at December 31, 2021 and December 31, 2020 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2021 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and due from banks	\$ 29,616	\$ 29,616	\$ –	\$ –	\$ 29,616
Due from Federal Reserve Bank	463,727	463,727	–	–	463,727
Available-for-sale investment securities	380,170	–	380,170	–	380,170
Loans	1,210,290	–	–	1,207,540	1,207,540
Accrued interest receivable	3,518	–	641	2,877	3,518
Financial liabilities:					
Deposits	1,979,410	1,889,547	144,358	–	2,033,905
Subordinated debt	21,703	–	–	21,661	21,661

	Carrying Amount	Fair Value Measurements at December 31, 2020 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and due from banks	\$ 14,327	\$ 14,327	\$ –	\$ –	\$ 14,327
Due from Federal Reserve Bank	215,706	215,706	–	–	215,706
Available-for-sale investment securities	163,631	–	163,631	–	163,631
Loans	980,925	–	–	996,530	996,530
Accrued interest receivable	2,907	–	321	2,586	2,907
Financial liabilities:					
Deposits	1,253,754	1,109,524	144,358	–	1,253,882
Subordinated debt	21,565	–	–	21,513	21,513

16. FAIR VALUE (Continued)

Assets Recorded at Fair Value

The following tables present information about the company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2021 and December 31, 2020:

Recurring Basis

The Company is required or permitted to record the following assets at fair value on a recurring basis as follows: (in thousands)

Description	2021			
	Fair Value	Level 1	Level 2	Level 3
U.S. Treasuries and Agencies	\$ 1,291	\$ –	\$ 1,291	\$ –
U.S. Govt-Sponsored Residential Mortgage-Backed Securities	378,879	–	378,879	–
Available-for-sale securities	<u>\$ 380,170</u>	<u>\$ –</u>	<u>\$ 380,170</u>	<u>\$ –</u>

Description	2020			
	Fair Value	Level 1	Level 2	Level 3
U.S. Treasuries and Agencies	\$ 1,689	\$ –	\$ 1,689	\$ –
U.S. Govt-Sponsored Residential Mortgage-Backed Securities	161,942	–	161,942	–
Corporate Debt Securities	–	–	–	–
Available-for-sale securities	<u>\$ 163,631</u>	<u>\$ –</u>	<u>\$ 163,631</u>	<u>\$ –</u>

Fair values for available-for-sale investment securities are based on quoted market prices for similar securities (Level 2). During the years ended December 31, 2021 and December 31, 2020, there were no significant transfers in or out of Levels 1, 2 or 3.

Non-recurring Basis

The Company may be required, from time to time, to measure certain other financial assets at fair value on a non-recurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets

There were no assets measured at fair value on a non-recurring basis for the years ended December 31, 2021 and 2020.

At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive specific allocations of the allowance for credit losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are 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. The fair value of impaired loans is based on the fair value of the collateral. Impaired loans were determined to be collateral dependent and categorized as Level 3 due to ongoing real estate market conditions resulting in inactive market data, which in turn required the use of unobservable inputs and assumptions in fair value measurements. Impaired loans evaluated under the discounted cash flow method are excluded from the table above. The discounted cash flow method as prescribed by topic 310 is not a fair value measurement since the discount rate utilized is the loan's effective interest rate which is not a market rate. There were no changes in valuation techniques used during the year ended December 31, 2021.

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 Company. Once received, the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value is compared with independent data sources such as recent market data or industry-wide statistics.

16. FAIR VALUE (Continued)

Assets Recorded at Fair Value (cont.)

Non-recurring Basis (cont.)

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$3,244,000 with no valuation allowance at December 31, 2021.

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$3,547,000 with no valuation allowance at December 31, 2020.

During the years ended December 31, 2021 and 2020, there were no provisions for credit losses recorded related to loans carried at fair value. During 2021 and 2020 there were zero and \$411,000 in charge-offs related to loans carried at fair value, respectively.

17. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company invests in qualified affordable housing projects. At December 31, 2021 and 2020, the balance of the investment for qualified affordable housing projects was \$4,609,000. These balances are reflected in the accrued interest receivable and other assets line on the consolidated balance sheets. Total unfunded commitments related to the investments in qualified affordable housing projects totaled \$139,000 at December 31, 2021 and 2020. The Company expects to fulfill these commitments no later than 2024.

During the year ended December 31, 2021 and 2020, the Company recognized amortization expense of \$422,000 and \$423,000, respectively, which was included within income tax expense on the consolidated statements of income.

Additionally, during the years ended December 31, 2021 and 2020, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of \$96,000 in each year. During the years ended December 31, 2021 and 2020, the Company incurred no impairment losses.

OFFICERS and DIRECTORS

EXECUTIVE OFFICERS

Mark D. Mordell

Chairman and Chief Executive Officer

Gina Thoma-Peterson

Executive Vice President and Chief Operating Officer

Patrick Oakes

Executive Vice President and Chief Financial Officer

Dori Hamilton

Executive Vice President and Chief Banking Officer

Geoffrey Butner

Executive Vice President and Chief Credit Officer

DIRECTORS

Mark D. Mordell, Chairman

Bryan C. Polster, Lead Independent Director

Kristofer W. Biorn, Corporate Secretary

Diane J. Flynn

Lisa B. Hendrickson

Roxy H. Rapp

Michael F. Rosinus

Robert H. Scott

Marc Verissimo

Avidbank Holdings, Inc., headquartered in San Jose, California, offers innovative financial solutions and services. We specialize in commercial & industrial lending, venture lending, structured finance, asset-based lending, sponsor finance, real estate construction and commercial real estate lending. Avidbank provides a different approach to banking. We do what we say.

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